Elements of Risk Management
Learning Objectives

Section I

1. Discuss the definitions of risk and risk management.
2. Discuss the terminology used by risk managers.
3. Identify the five steps of the risk management process.
4. Describe the components of the total cost of risk and how it is used by risk managers.

Section II – Step 1: Risk Identification

1. Explain why risk identification is the most important step of the risk management process.
2. Identify and discuss the six general classes of risk.
3. Explain the purpose, method, strengths and weaknesses of the ten risk identification methods.
4. Identify and describe each of the four logical classifications of exposures.
5. Explain the general rules applicable to risk identification methods.

Section II – Step 2: Risk Analysis

1. Describe how collection and analysis of loss data aids an organization with decision making.
2. Discuss the ways in which the quality of data is evaluated.
3. Distinguish between qualitative analysis and quantitative analysis and understand the purpose of each.
4. Discuss when to use benchmarking in risk management.

Section II – Step 3: Risk Control

1. Discuss the definition of risk control and its role in the risk management process.
2. Discuss the five primary types of risk control techniques.
3. Discuss the definition of claims management and the primary types of claims management plans.
4. Discuss the definition and characteristics of a crisis.
5. Discuss the definition and principles of crisis management.

Elements of Risk Management
Learning Objectives continued

Section II – Step 4: Risk Financing

1. Discuss retention and transfer and the methods of transfer.
2. Identify the various transfer options.
3. Discuss the definition, advantages and disadvantages of a guaranteed cost plan.
4. Discuss the definition, advantages, and disadvantages of a dividend plan.
5. Discuss the definition, advantages and disadvantages of a deductible plan.
6. Discuss the definition, advantages and disadvantages of a self-insured plan.
7. Discuss the definitions of a pooling arrangement and a captive.

Section II – Step 5: Risk Administration

1. Understand the responsibilities, demands and skill sets and required of an effective risk manager.
2. Identify members of the internal and external risk management team.
3. Explain when a risk manager might find it necessary to get assistance from outside service providers.
4. Discuss the various methods used in the agent/broker/producer selection process.
5. Discuss the purpose and various uses for a Risk Management Information System (RMIS).

Section 1

Overview of the Risk Management Process

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Learning Objective #1: Discuss the definitions of risk and risk management.

I. RISK

A. Definition – uncertainty that may be either positive or negative arising out of a given set of circumstances

B. Types of risk

1. Pure – chance of loss or no loss

2. Speculative – chance of loss or gain; often referred to as a "business risk"

II. RISK MANAGEMENT

A. Definition – the process of managing uncertainty of exposures that affect an organization's assets and financial statements using five steps: identification, analysis, control, financing, and administration

B. Focus of the process is two-fold:

1. Protects the assets of the organization

2. Protects the financial statements of the organization; thereby, protecting its solvency and viability (its bottom line)

C. Benefits of an effective risk management program

1. Identifies exposures and risks associated with the exposures

2. Provides resources to determine the organization's willingness to accept or tolerate risk (referred to as risk appetite)

3. Reduces and mitigates losses and associated costs

4. Spreads the total cost of risk (TCOR) effectively

5. Integrates risk control and safety

6. Improves the organization's ability to budget and plan

7. Assists management with adding value to the organization and achieving the organization's goals

Learning Objective #2:	Discuss the terminology used by risk managers.

III. RISK MANAGEMENT TERMINOLOGY

A. Exposure – a situation, practice, or condition that may lead to an adverse financial consequence; an activity or asset, e.g., a building

B. Hazard – a condition that may give rise to a loss from a given peril; physical, moral, or morale characteristics that make the likelihood of a loss from a given peril greater, e.g., a frayed electrical cord within the building, steps in the building

C. Peril – the cause of a loss, e.g., water on the steps, fire, wind, hail

D. Incident – an event that disrupts normal activities and may become a loss, e.g., fall on steps with no injury

E. Accident – an unplanned event definite as to time and place that results in injury or damage to a person or property, e.g., fall on steps breaking a hip

F. Occurrence – an accident with the limitation of time removed (an "accident" that is extended over a period of time rather than a single observable happening)

G. Loss – a reduction in the value of assets

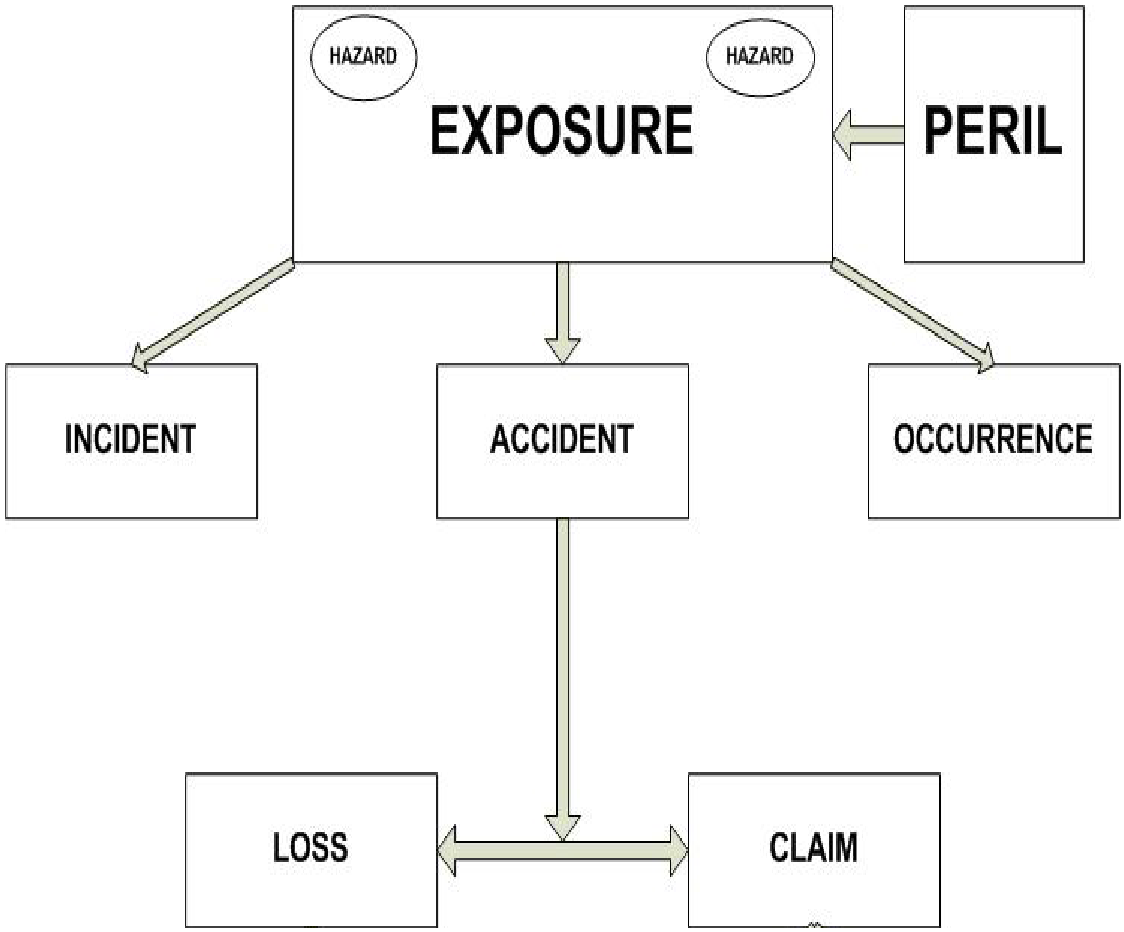
H. Claim – a demand for payment or an obligation to pay as a result of a loss or occurrence

I. Frequency – the **number** of losses occurring in a given time period

J. Severity – the **dollar amount** of a given loss or the aggregate dollar amount of all losses for a given period

K. Expected losses – projection of the frequency or severity of losses based on loss history, probability distributions, and statistics; the expected loss projection is commonly called a "loss pic" or "loss pick"

RISK MANAGEMENT TERMINOLOGY

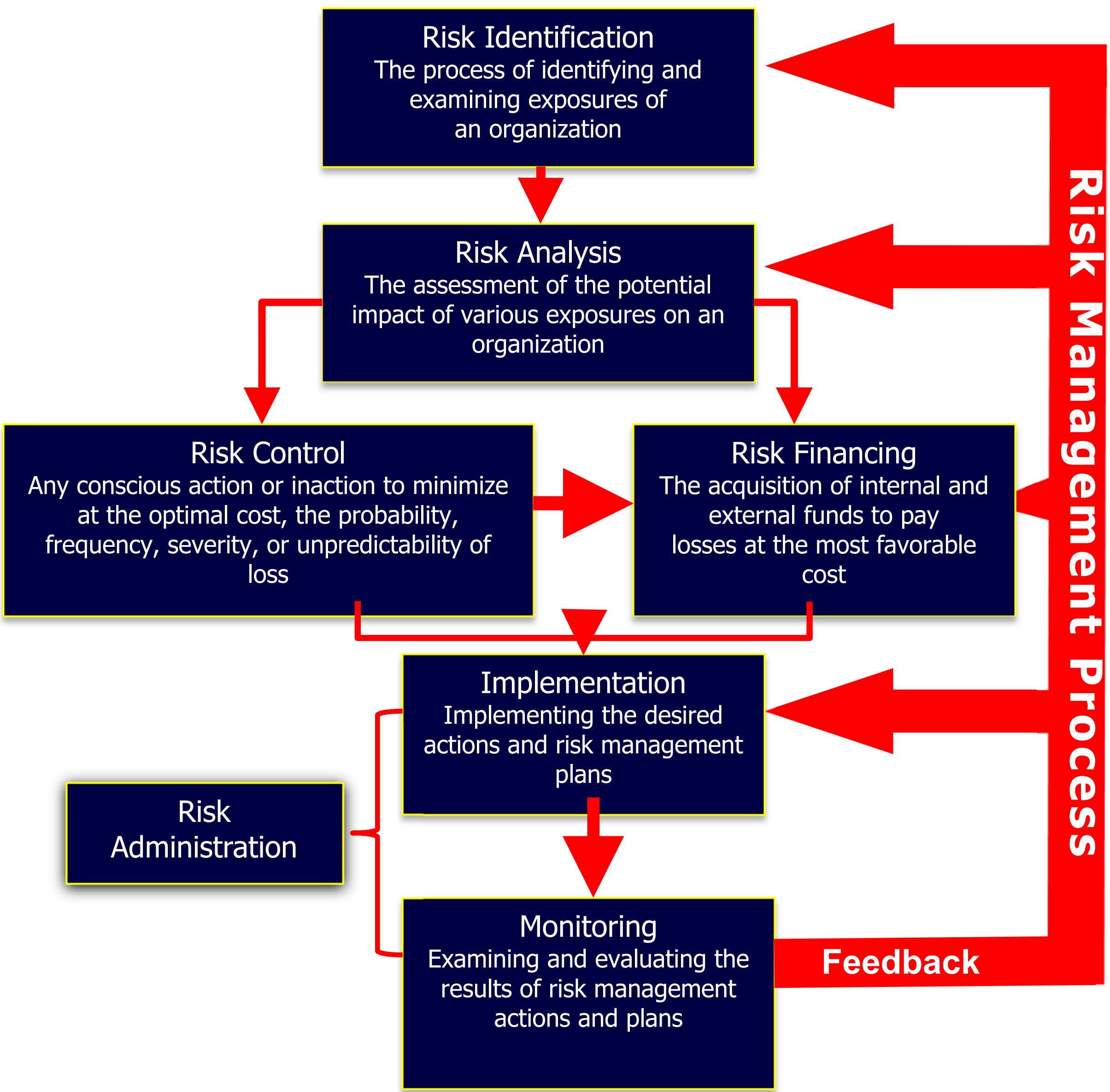


Learning Objective #3:	Identify the five steps of the risk management process.

IV. RISK MANAGEMENT PROCESS

Steps of the Risk Management Process

A. Risk Identification
B. Risk Analysis
C. Risk Control
D. Risk Financing
E. Risk Administration



The Risk Management Process Overview

Risk Identification

Logical Classifications

- Property
- Human Resources
- Liability
- Net Income

Identification Methods

- Checklist and Survey
- Flowchart
- Insurance policy review
- Physical inspections
- Compliance review
- Procedures and policies review
- Contract review
- Experts
- Financial statement analysis
- Loss data analysis

Risk Analysis

Qualitative Analysis

- Risk assessment
- Financial assessment
- Loss data assessment

Quantitative Analysis

- Loss projections or forecasts
- Cash discounting and NPV calculations
- Cost-benefit analyses
- Cost of risk calculations and analyses

Risk Control

Pre-Loss

- Avoidance
- Prevention
- Reduction
- Segregation/separation/duplication
- Transfer

Post Loss

- Claims management
- Litigation management
- Disaster recovery

Risk Financing

Retention

- Active
- Passive

Transfer

- Non-insurance
- Insurance

Risk Administration

- Implementation
- Monitoring

Learning Objective #4: Describe the components of the total cost of risk and how it is used by risk managers.

V. TOTAL COST OF RISK

Total cost of risk (TCOR) – defined as the sum of all costs and expenses associated with the risk management function of an organization. It is the cost of managing risk!

A. Components of TCOR

TCOR = insurance costs + retained losses + risk management departmental costs + outside services fees + indirect costs

1. Insurance costs – premiums and all included expenses

2. Retained losses and allocated loss adjustment expenses – claims under the deductible and predictable losses that the organization can plan and pay for with internal funds

3. Risk management departmental costs – salaries, training and travel expenses, risk management information system, management overhead, etc.

4. Outside service fees – risk management consultants, third party administrators, loss control, legal, actuarial, fee-for-service insurance agent/brokers, etc.

5. Indirect costs – may be difficult to quantify. Examples include:

   a. Disruption in production or sales

   b. Management time spent on loss-related activities

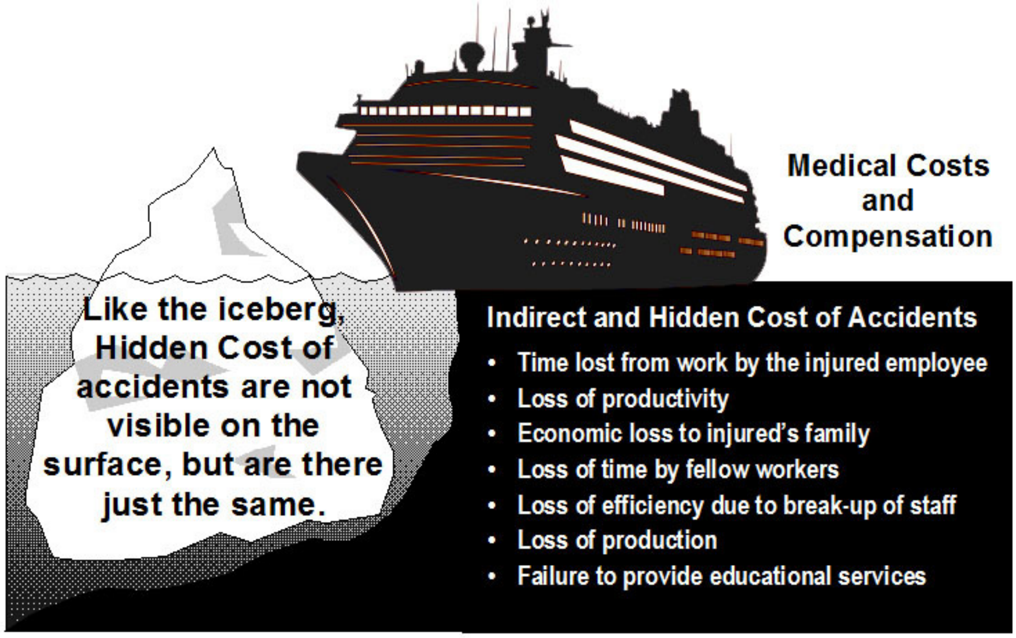
   c. Overtime costs

   d. Hiring and training replacement

   e. Opportunity costs

   f. Loss of goodwill

   g. Social costs due to public image, reputation, etc.



B. Benefits of tracking the TCOR

1. Assist with making effective risk management decisions

2. Measure progress towards risk management objectives (reducing costs)

3. Focus and promote safety and loss control

4. Assist with accurate pricing of products and services

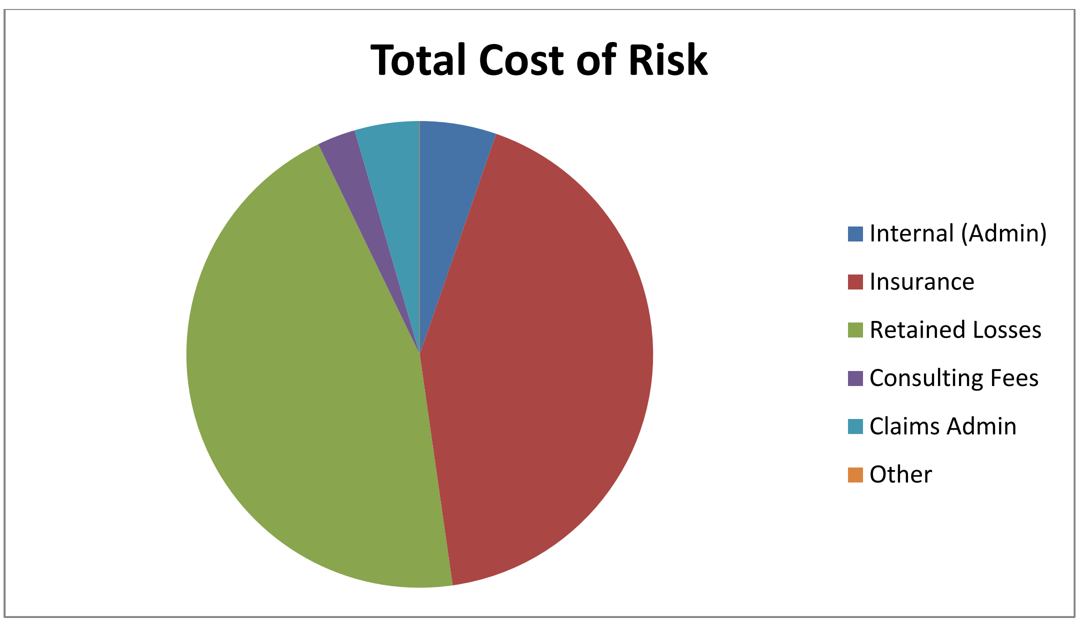
5. Assist with effective management of financial budgets

C. TCOR can be minimized by identifying those factors from each component that can be more effectively controlled

D. Benchmarking – comparing the TCOR within internal departments or divisions and externally to similar organizations to measure and monitor improvement

E. TCOR allocation – must be determined if expenses associated with the organization's risk management program are "charged back" to various divisions or departments to promote accountability

XYZ Corporation's Total Cost of Risk	
Risk Management – Internal (Administration)	**$100,000**
Insurance Costs (net of placement, other fees)	**$800,000**
Retained Losses and Allocated Loss Adjustment Expense (ALAE)	**$850,000**
Outside Services:	
Consulting, Brokerage Services	**$50,000**
Claims Administration	**$85,000**
Other Risk Control	**$25,000**
Total	**$1,910,000**



REVIEW OF LEARNING OBJECTIVES

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