



INSURANCE AND RISK CONTROL MANAGEMENT

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Historically insurance premiums have been dictated by market forces, based for the most part on perceptions of risk rather than any realistic data.

However, such data is often readily available. For example, by utilising risk assessment data that may be collected to satisfy regulators, it is possible to identify, for a major asset, the actual risks faced.

IMPLEMENTATION

A Risk Profile can be constructed that provides a record of the detrimental events associated with the asset, along with their probable frequency and consequences.

Estimates of consequences may include asset damage, business interruption costs and costs associated with environmental clean up or compensation. The Risk Profile can then be used to calculate the long-term average annual loss, or “expected loss”.

By transferring the risk fully to an underwriter, an asset owner smoothes their cash flow. Also, since he will naturally be adverse to major losses, and in order to allow for uncertainties in the Risk Profile, the owner should be prepared to pay the underwriter significantly more than the “expected loss”. The premium income received by the underwriter is therefore more than the average annual payout and so, in the long term, he makes a profit. His risk aversion should also be lower than that of the asset owner since he can re-insure and pool risks across his client base.

IMPLEMENTATION

Therefore, it should be possible to find a solution that is satisfactory for both parties - in most cases there will be a premium low enough to represent a rational purchase decision for the asset owner and yet high enough to allow the underwriter to make a fair profit in the long term.

At RMRI, we use the Data and Decision Management Tool (DDMT) together with an add-on Decision Support Tool (DST) to allow both the insured and the insurer to optimise their strategy. The approach can be used either by asset owners or underwriters individually or by the two working in collaboration.

