Concerns and Resolutions for Property Risk Management in 2009

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"Would you tell me, please, which way I ought to go from here?" asked Alice.
"That depends a good deal on where you want to get to," said the Cat.
"I don't much care where--" said Alice.
"Then it doesn't matter which way you go," said the Cat.

-From *Alice's Adventures in Wonderland* by Lewis Carroll

"One of these days is none of these days".
-H. G. Bohn

"There is only one thing about which I am certain, and this is that there is very little about which one can be certain."
-W. Somerset Maugham

It is a New Year and none of us know how the days ahead in Year 2009 will affect us. While we seek good fortunes as individuals as risk managers we need to focus continually on possible events that may be adverse to ourselves, co-workers, public and our organizations. What will you do today and in the days ahead to ensure that your property risk management program including the appropriate use of insurance is proper for your organization today and in the days ahead?

Many events lie ahead of us, some expected while others not. Recent history suggests that 2009 will be a challenge to the risk management community.

- A month ago economists confirmed the US has been in recession since December 2007 and that no end date can be accurately projected; we will know it is over when it's over.
- Unemployment continues to rise and may not decrease or even level off until 2010.
- Credit has somewhat returned but the financial services industry is extremely cautious in granting it.
- India suffered greatly a month ago as it was ravaged by terrorist acts that threaten both its overall economic well being and its "back room" industry for many US based organizations.
- War continues in Iraq and Afghanistan and ocean going pirates seem to rule the seas off the coast of Somalia.
- Catastrophic storms will again be a concern to many US citizens and organization as parts of the US brace for the 2009 hurricane season while other US areas prepare for tornados and other equally devastating natural acts.

The one constant for many risk managers in 2009 will be the continuation to limit their focus for property risk management (and unfortunately likely for all facets of their risk management practices) on the continued view of their schedule of insurance as a risk management planning tool; a static list of insurance policies that is based on prior expectations of risk of direct damage and time element loss. Is this planning device adequate? No and especially not in times of great economic and global uncertainty.

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What can we learn from Alice's adventures in Wonderland? She needs more than a road map. She needs a plan; she needs a destination-she needs an objective. How many risk management professionals challenge themselves to know what may have changed or may change within their organization in the days, weeks and months ahead? As the Cat says to Alice, without a destination she can take any path from here and arrive somewhere. The unfortunate reality of following any path as a risk manager is the destination or objective may not be appropriate when viewed later, especially after an adverse loss event.

Procrastination undermines an individual's ability to seek timely satisfaction of critical tasks and objectives and thus becomes an operational risk to the risk management process itself. Mr. Bohn says succinctly putting off today for tomorrow will probably mean that nothing will be done and no directional changes will occur; status quo is a danger to all risk management professionals.

To paraphrase Mr. Maugham we must remind ourselves that uncertainty is certain; things happen-some good, some adverse but things do happen. A recent television advertisement by Nationwide Insurance says it all: "Life comes at you pretty fast". Seize the moment today, not tomorrow, to understand your organization's exposures as may exist today and how they may change by tomorrow; do not rely on exposures identified last year and simply rollover your risk management practices from 2008 into that for New Year 2009.

Many risk management professionals rely solely on their current schedule of insurance, recent statement of values and business income worksheet as risk management planning tools for property exposures and use of insurance for possible direct damage and time element loss. When one continually focuses on a policy renewal date it is possible that ongoing risk assessment will not be done, especially when needed in times of uncertainty as we expect change in 2009 and for the foreseeable future. How can risk prevention, risk reduction and risk transfer be effective if the underlying risk assumptions are not frequently reviewed, understood and tested? It can not unless one wants to rely on luck alone, an inadequate and uncertain tool in the risk management professional's toolbox.

Risk management resolutions for 2009

Nearly all US industry is and will continue to be effected by the current recession. This recession will create potential risks that may be new to many risk management professionals. A key resolution for 2009 (actually an activity that should never stop) is to determine what changes have occurred and may occur later in the New Year that may create new and larger risks of loss to your organization. This global view should not be just on direct damage and time element issues but across the whole spectrum of an organization especially if an organization is implementing an enterprise risk philosophy: risk is risk and risk of loss can occur from many sources not just "insurable" risks.

Risk management encompasses many activities and is a job for more than one person. A risk manager will manage risk only by leading, directing, soliciting and involving others first and in doing so will manage all risk activities. This is especially true for large organizations with many locations and multiple operations. Unemployment is the highest in many years. Certain parts of the US have higher employment than others. Thousands of jobs have been terminated. It is possible that some jobs lost were held by individuals that served the risk manager as his or her ad hoc eyes and ears within the organization. Have these critical internal resources been lost? What happened to the keepers of an organization's institutional history that may have more in-depth organizational and operational knowledge than the risk manager? Are you as risk manager visible enough to others in the organization to receive proactive notice of organizational and operational changes that may affect the property risk management program? Is your past network still intact? Do others in the organization know that you are the go to person for risk and insurance issues? If not, what can you do to increase and sustain this needed visibility?

Events external to the organization may affect fixed assets and the potential to generate gross income. Let's consider some events and how the risk management professional may need to respond.
<u>The organization expects a reduction in sales which causes it to reduce inventories and consolidate facilities.</u>

- Coverage limits for scheduled and unscheduled locations may be inadequate as values are shifted from inactive locations to active ones. Location coverage may be subject to margin clause which provides a certain percentage greater than reported value (such as 120%) but may not sufficient if the consolidation at any one location is greater than the margin allowed.

- Certain goods may be liquididated reducing insurable values. Inventory values may need to be recalculated (actual cash instead of replacement cost) that may result in decreased values.

- Goods in transit may increase for any one vehicle as inventory is consolidated from one location to another.

- Consolidation of facilities may cause organizations to maintain vacant locations until lease termination or sale of property. A vacant and/or unoccupied location may invoke coverage restrictions for loss by vandalism and burst pipes. Uninsured loss is not an effective use of self-insurance. Exposure and policy language must be examined.

- Co-insurance requirements must be reviewed to ensure that consolidated locations still maintain the proper relationship of value at risk to limit insured.

- The probable maximum loss (PML) of a given location may increase from additional insured direct damage and time element values. This change may require the insurer to reduce its net line and rely on facultative reinsurance thereby increasing premium beyond that simply tied to increase in exposure (total insurable value: TIV).

- Physical damage exposure for road going vehicles (private passenger and trucks) will need to be reviewed. Large fleets are often self-insured for physical damage (fire, theft, windstorm) since the thought is with many exposure units and spread of risk there is a limited catastrophe exposure from one single event. Staff reductions may result in consolidated inventories of vehicles. The risk manager will need to consider any change in exposure that may led to possible aggregation of values at risk and seek new risk treatment.

<u>Expected reduction in sales and operating income-considerations for business income and extra expense</u>

- Manufacturing redundancy may be reduced creating potential for bottlenecks and longer downtimes from major loss events such as fire, windstorm and interruption of power.

- Reductions in redundant operations may increase the possibility of a longer period of interruption when operations can not be easily shifted from damaged location to undamaged location. The risk manager will need to evaluate the length of time to be insured, i.e. increase to 180 days from 90 days. This same scenario may require the need for increased extra expense coverage when the organization needs to operate as quickly and seamlessly post-loss event as it had pre-loss event.

- Reductions in workforce may require changes in amount of ordinary payroll, whether to insure the exposure and duration of coverage if insured.

- Workforce reductions may affect the effectiveness of existing disaster and business resumption plans. Remaining staff may not be well versed in post loss event recovery responsibilities and procedures. As a result the organization may be more vulnerable to lengthy interruption of loss event than existed when fully staffed.

<u>The organization makes changes in trading partners as some go out of business; some have reduced operational capacity while others no longer satisfy credit standards.</u>

- If the number of suppliers has been reduced thus limiting redundancy in incoming supplies or outgoing sales then the risk manager will need to reconsider the need for contingent time element whether business income or extra expense.

- Change in world exposures (India) may require an organization to “in-source” activities that previously had been “out-sourced” thus creating new direct damage and time element exposures.

- Continued acts of piracy may lead to reduced efficiency in outgoing and incoming shipments which may in turn result in increased values being shipped and delays in obtaining replacement materials for damaged or destroyed personal property. This second scenario will need to be reviewed for both business income and extra expense exposure and coverage.

Postponed capital expenditures

- Senior management concerns for reduced income may result in postponement of certain planned capital expenditures. Loss control recommendations (such as upgraded sprinkler systems, booster pumps, etc.) may be held back by senior management until after the economic slowdown as these expense are not seen as critical to expanding sales or improving profitability.

Conclusion
The risk management professional will need to take stock of risk and exposure issues within his or her organization as the organization addresses the new and increased pressures of the New Year. Times of difficulty are times that can create great success and visibility for oneself seen as solving problems through planning and execution. One need not be an Alice or a procrastinator. Some New Year resolutions are offered to risk managers as a starting off point for planning property risk management practices for 2009 beyond simply use of a schedule of insurance.

Resolution 1: Test your internal networks and usual contacts used to learn about the organization. Internal co-worker resources for a risk manager include and are not limited to functions such as security, facilities, finance, HR, procurement, operations, sales and senior management. Identify other individuals in each department in case your #1 contact leaves. Create the means to have frequent contact with these individuals and instill in all to reach out to you with any risk question or notice of an upcoming change in operations.

Resolution 2: Use the New Year to relearn the operations, activities and exposures of the organization. Do not forget past history but focus on the challenges the organizations expects to have in the months ahead.

Resolution 3: Restructure the property risk management program based on information gathered during Resolution 2. Rank proposed changes on need and cost. Implement those changes that will have the greatest economic value to the organization. Counsel senior management on proposed changes, especially those that result in significant increased insurance expense.

Resolution 4: Communicate property risk management issues (for that matter *all* risk management issues) to appropriate management. Include thoughts on possible solutions as well. Discuss the need for ongoing loss control initiatives especially those that will require a capital expenditure. Provide management with a cost/benefit analysis of why the expense should be incurred now instead of later.

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