

## **WOULD YOU LIKE TO REDUCE YOUR COST OF RISK?**

If your company is better at managing its insurable risk than your peer group, the chances are that you are paying too much for your insurance. Insurance premia is normally a significant element of a company's cost of risk.

The traditional insurance market has not been good at fully recognising and rewarding well risk managed insureds. "The losses of the few are paid by the many," is a fundamental principle of insurance. This works well if your company is one of the "few". However, if your company is on top of its risk management, with little or no insured losses, the likelihood is that you are not getting full credit for your good claims experience.

In these circumstances you are, in essence, subsidising your lesser risk managed competitors' insurance costs.

### **What Is The Solution?**

Quite simply, well risk-managed companies need to strike a careful balance between retaining insurable risk and buying insurance in the traditional market.

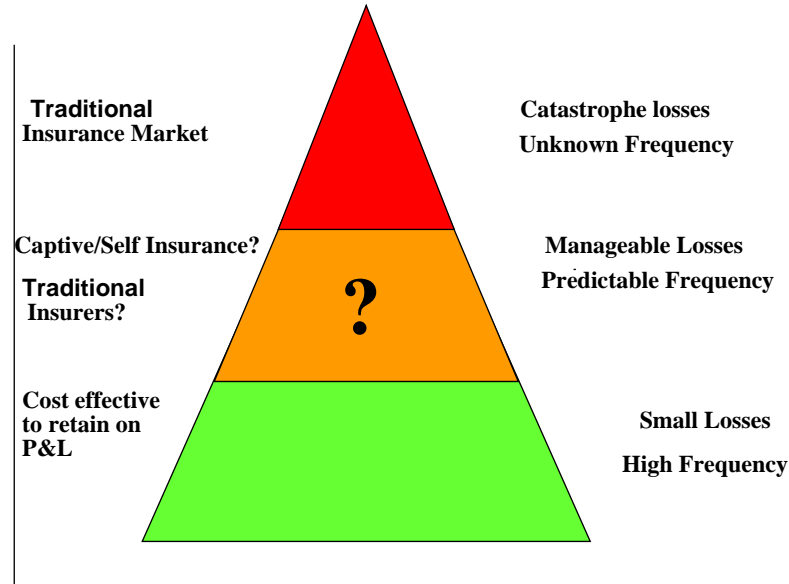
In my opinion, every company should aim to maximise their economical retention of insurable risk. Buying insurance in the traditional market, in isolation, may not be the most cost-effective way of reducing your company's overall cost of risk.

You may be asking yourself how can my company determine its most appropriate level of economical insurable risk retention?

The following diagram illustrates how insurable risk can be segmented:

- low severity, high frequency losses should never be insured. Such losses should stay on your company's P&L account;
  
- for well risk-managed companies, 'manageable' losses, of predictable frequency, should be retained. However, in some circumstance, such as when traditional insurance is very cheap, it may not be economical to retain this type of risk; and
  
- catastrophic losses of unknown frequency should be insured in the traditional insurance or reinsurance market.

### What Risk Profile Best Fits Risk Retention?



Your company should focus its insurable risk retention attention within the middle segment of ‘manageable’ losses, with predictable frequency. It is here that you will most likely achieve the ‘biggest bang for your risk retention buck’!

### How Does A Company Determine Its Level of Insurable Risk Retention?

The actual level of insurable risk retention will depend on your company’s individual circumstance, including:

- the financial strength of your balance sheet;
- ongoing trading and financial conditions;
- your appetite for risk; and
- the ‘premium discount’ offered by your insurers, for the additional risk retention.

### Retained Risk: Self-Insurance versus A Captive Insurance Company.

A captive is a form of self-insurance.

However, the following are the principal reasons why placing self-insurance through a captive, rather than merely retaining large deductibles in the business (self-insurance) is more beneficial to a company:

- 1) Risk Management
- 2) Market Capacity
- 3) Financial Value
- 4) Managing Down Group Deductibles

1) Risk Management

Formalised self-insurance through a captive enables comprehensive maintenance and analysis of claims information. Leading from this is the ability to improve further your company's risk management efforts. Also, proper analysis of claims information enables the parent to negotiate the proper price and attachment point of external insurance. These benefits are achieved more easily through the formality and the discipline which the existence of the captive imposes, compared with attempting to maintain such records within the parent.

2) Market Capacity

The accumulation within a captive of underwriting profits and investment income, together with some flexibility in reserving, will enable a captive to offer the parent an increasing level of capacity. This underlying assumption is on the basis that the captive business is profitable. The captive will also assist the parent (in a way which parental deductibles cannot do) by acting as a co-insurer and by providing access to the reinsurance market. A captive can underwrite risks, which the traditional market does not, thus providing a form of discipline on the parent. A captive's very existence will also contribute to pressurising the external insurance market to offer the most competitive premiums.

3) Financial Value

The following tables provides an idea of the possible benefits to the parent of a captive, using some reasonable assumptions, based on a 5 year period:

	GBP
Premiums that would have been paid to Market Insurers	(10,000,000)
Claims that would have been paid by the Market Insurers	1,000,0000
Net Profit/ (Cost) to the parent:	(9,000,000)

Underwriting profit from the captive	9,000,000
Plus Investment Income earned by the captive	1,500,000
Less Operating Expenses of the captive	(250,000)
<b>Net Profit to captive:</b>	<b>10,250,000</b>

4) Managing Down Group Deductibles

A captive will be able to provide insurance cover to your company, at a lower level than would be possible, without such a vehicle.

**How Can HSBC Help You with This Process?**

HSBC Insurance Management (“HIM”) has been helping clients successfully retain insurable risk for more than 20 years.

HIM is the marketing name under which the HSBC Group provides third party administration services for insurance/reinsurance companies and risk retention groups. HIM has offices in Bermuda, Cayman, Guernsey, London and Malta; as well as New York, South Carolina and Vermont, in the United States.

HIM is one of the world's largest independent insurance managers, with approximately 200 client relationships, across a wide spectrum of businesses, including banks and financial institutions.

Being part of one of the world's most financially secure Groups, HIM is unique amongst insurance managers.

HIM can help you determine the most appropriate level of insurable risk retention for your company, by undertaking an analysis and assessment of your company's:

- risk profile;
- loss experience;
- premium spend; and
- financial strength.

The outcome of this process will indicate whether or not your company has the most appropriate balance between insurable risk retention and traditional insurance.

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You can find out more about how HSBC can help you reduce your cost of risk by either contacting Peter on: +44 (0) 207 992 1173 or visiting [www.insurancemanagement.hsbc.com](http://www.insurancemanagement.hsbc.com)