

## Topic 6— “Risk Management Techniques: Loss Financing”

### Risk Management Alternatives

- Avoidance, loss control, loss reduction, separate exposure units, duplicate exposure units.

### Financing Options

- Sources of funds to pay for losses
  - External or Internal
- Risk Transfers of Finance Type
  - Still have asset (still exposed to loss)
  - Transferring financial responsibility for the loss
    - Insurance—(Big)
      - Not responsible for asset or activity (owner/firm is)
      - Insurance will step in and pay financial loss
      - Problem → if insurance doesn't pay—you will
    - Non-Insurance Risk Transfer
      - Hold Harmless Agreement
        - Engaged contractor—financially responsible for any losses contractor will accept the loss risk for you/firm. But contractor will not assume responsibility/liability for your negligence.
      - Hold Harmless / Waivers / Releases
        - “Assumption of Risk”
          - Skydiving, bungee jumping
    - Lease
      - Tenant financially responsible for all losses that occur to property that is in his/her *Care / Custody / Control* → The 3 C's (CCC)

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### 1. Retention-- “Retain Exposure”

- a. Firm / individual assumes responsibility for loss
- b. **EXAMPLES:**
  - i. Not buy insurance
  - ii. Under insure
  - iii. Insurance policy with deductible
- c. Deductible= **Active Retention**
  - i. Actively and deliberately chose to retain at least part of loss—General liability of property and auto.

### 2. Passive Retention

- a. May not be aware of deductible
- b. Failed to properly identify the loss or
- c. Flat out underestimated

### 3. Funded Retention

- a. Putting funds away every period—monthly / yearly / quarterly

- i. Money in reserve for losses
    - ii. Very intentional—budget & plan
  - 4. **Unfunded Retention** → Choice
    - a. Putting no money aside—pay out of pocket
      - i. May have to borrow money if you don't have it
    - b. If there is a loss, there is *low severity*—low cost
    - c. Low frequency
    - d. P★□= 1,200,000      Put aside 100,000 / month  
Losses that are predictable
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#### **Self Insurance= Active / Funded Retention**

- Program for firms with many losses and potentially large losses
    - 0 *Large deductible/ self insurance retention funding most losses*
  - Very well planned strategy
    - 0 Large group needed
    - 0 Health Insurance—need 50% of employee participation
    - 0 ER Benefit plan—dental, visual, prescriptions
    - 0 Workers comp—largest number of employees
      - Wages and medical benefits
  - **Ideal Characteristics for Self Insurance:**
    - 0 Large Number of participants
    - 0 Fairly predictable losses
    - 0 Long pay out period
  - **Advantages of Self Insurance**
    - 0 No premiums; No Losses → you keep the money
    - 0 No Risk Charge / or outsider administration costs
      - Commission and state fee → 10%-30%
    - 0 Personalized product
  - **Disadvantages of Self Insurance**
    - 0 Catastrophic loss—could ruin company
    - 0 Commercial product → you know what premium will be
      - With a good year—rates may get better
  - **"Stop Loss Policy"—Policy of Last Resort**
    - 0 Will stop company from losing everything
  - Employer has to submit plans for audit
  - Employer needs to prove its providing what it promised
  - Company not paying premiums → maybe use \$\$ elsewhere
  - Self Insure—still retaining benefit of successful loss control and loss reduction techniques
    - 0 Incentives—smoking cessation, gym
    - 0 Cash bonus to opt out—but employee must have coverage
    - 0 Take spouses coverage
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### Firm is Self-Insured

- No risk charge—no administrative cost to insurance company
  - Firm increase administration cost when it self insures
  - Employees:
    - 0 Data/ records
    - 0 Settle claims
    - 0 Return to work
    - 0 Wellness program
  - Buy "Administration Services Only" (ASO Contract)
    - 0 3<sup>rd</sup> party administrator = TPA
    - 0 Reputable - backing you up
    - 0 Face/Name - not necessarily employers
    - 0 Fee \$
    - 0 Tax Perspective
      - Cost of premiums is tax deductible
      - Self Insure—Pay Taxes
    - 0 Tax code is biased against firms that self insure
      - Cost Benefit Analysis
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### Captive Insurance Company

- Wholly owned subsidiary of company that is NOT an insurance company.
- **Primary Purpose:** Insure risk of parent company
  - 0 Parent= 1 company or many together
    - *Single Parent*—1 firm funds everything
    - *Association Parent*—Group funds
- **Advantages:**
  - 0 Helps pricing in a hard market
  - 0 Offshore captive—Bermuda, Cayman Islands, Canada
    - Reason: **Tax Benefits**
    - Very Stable governments
  - 0 Parent Company essentially paying premiums to Captive Insurance companies
    - Self Funded Retention / Reserve
  - 0 Risks of Parent are the only Risk covered by captive
- **Big Problem:**
  - 0 Cant conduct business on shore