BETTER ... OR JUST DIFFERENT

by Bertus Kik

The presumption is that we are discussing the comparison between North America and Europe. Today my task will be to give you my views as far as Europe is concerned and at the end my conclusions will follow.

For a better understanding I will divide my presentation into three periods of time:

1. Before the year 1940

2. 1945 - 1970

3. 1971 - up to the present

I think I don't have to define what Risk Management is but during my speech I shall have to refer to the five interdependent functions of Risk Management: Risk Management Policy, Risk Analysis, Treatment, Financing, Administration (coordination, communication, education).

<u>1. The Situation before 1940</u>

The word Risk Management as such did not exist, but risk prevention and control were practised on a large scale whilst Risk Financing and Administration existed in exceptional cases, mostly in large industrial companies.

By turning over the leaves of some Dutch insurance reference books, I read, amongst other things, the following two stories.

The first one concerns the establishment of the Philips electric lamp factory. It says: "In 1892 the production started. In April of that year the first order was booked from-- wonderful to say --the Gouda candle factory for the delivery of 50 electric lamps in order to minimize the danger of fire in their light inflammable work shops." Is this not a good example of loss prevention?

Or another case dated from 1927 when the towage job of the Singapore dock from England to the Far East and built by order of the Royal Navy was commissioned to the Dutch company L. Smit & Co's international sea towage service and not to a British company.

The colossus had a height of 21 meters above sea level which means a height of a seven-storied building.

Questions were raised in parliament by angry M.P.'s, but the government answered short and to the point: "Nobody, not even Lloyds', is prepared to insure this risky job unless it is commissioned to Smit & Co. the smartest sea towage navigators in the world."

After a voyage of 117 days, the dock arrived safely and undamaged in Singapore. Is this not a good example of risk analysis and risk treatment both on the side of underwriters and the insureds?

During the period under review, risk management, with some exceptions, consisted only of risk prevention and loss control whereby brokers and insurers played their role.

Insuring with a deductible or risk financing through self insurance was not exceptional. On a very small scale captives also existed (insuring the companies' properties in a limited way) as well as the so-called in-house brokers.

2. The period 1945 - 1970

The situation in the field of risks as outlined did not alter so much because during the first 10-15 years, building up and restoration of the properties badly damaged and or destroyed in WWII were the order of the day. The magic word was production, and again and again production and, of course, the food supply was priority number one. At that time the fire premium rates per unit, sometimes 5 to 10 different rates for one and the same complex, were streamlined to one flat rate per unit and later on even one per country.

The big companies offered their fire risks "en bloc" in the market, whereby favourable premiums could be obtained and the favourable damage trend with most of them gave no cause to modify their policy. The difference between the premiums paid and the claims left the insurers with a margin, and the big insurance buyers, in fact, had their true "catastrophy" cover at a modest premium.

In the second half of the sixties and the early seventies, new production processes, new products, new building materials and the like, modern systems of goods handling, storage and distribution, new means of transportion were introduced. To mention a few such as oils and chemicals --plastics (PVC), computerised storage in silos, very large warehouses and coldstores and not to mention the use of additives in food and cattlefood, new medicines, the building of large oiltankers for the transportation of mineral oils, etc. New factories were built and the old ones extended.

The introduction of all these new applications in industry led to substantially higher claims, in most cases lodged by those who had apparently not paid sufficient attention to or had not invested enough money in risk prevention and loss limitation.

The consequences were that fire premiums were drastically raised, in particular in Continental Europe. The rise in basic premiums in many cases caused insurance to change from a negligible item to a cost factor which had to be taken into account very seriously. In some countries the rise in fire insurance premiums led to a doubling and in certain cases to a trebling, and even more, of premiums in a period of no more than 4 to 5 years, whilst in the same period the asset value rose only by about 70%. Despite the fact that large amounts were invested in fire prevention, the insurers in various countries, including some big ones, were not able because of tariff agreements to deviate from the local market premiums.

At that time, the second half of the sixties, insurance managers of the big miltinationals in the U.K. and in various Continental European countries had also formed small informal groups to discuss and to exchange views and information on their mutual interests.

In the meantime the Risk Management concept was blown over from North America via the U.K. to Continental Europe and so I am now arriving at

3. The period 1971 - up to the present

At first most of our colleagues, including myself, were not so enthusiastic, saying that what we hear about Risk Management we have been doing ourselves for many years already, thus it is nothing new under the sun.

However, gradually they came to the conclusion that Risk Management in the broadest sense would serve the goals of their companies in the best possible way.

The informal groups extended, and more than one group in the same country were formed of which Airmic has nowadays most members.

Before reviewing further developments in relation to Risk Management, it seems desirable to examine what happened in 1973 and later.

Consequences of Oil Crisis

The high insurance premiums as outlined above and the oil crisis in 1973, as a consequence of which the value of buildings-plants and, to a much larger extent, that of raw materials and stocks of finished products increased to an unprecedented height, induced insurance managers, in particular those of multinationals and national big companies with more than one production unit spread over the country to seek other ways of financing the risks in the best interests of their companies. Or, in other words, captive insurance.

The studies, which were made mostly by financial experts of the companies involved, contained more or less the following main conclusions.

"The geographical and industry spread of the assets and the total insured value thereof make the company's insurance business very profitable.

"The efforts for risk prevention tend to diminish the size and number of claims without full corresponding improvement in premiums paid.

"Customary prepayment of premiums leads to heavy cash outflows at the start of the insurance year, only compensated by refunds of claims later on. The cash flows could be largely retained within the company."

In the period from the early seventies up to the present quite a lot of captives have been created.

Liability Insurances

A lot has happened in the liability insurance field during the last ten years.

It started with the product liability claims boom in the U.S.A. during the affluent years up to the late seventies.

Then the environmental-soil-water and air pollution-asbestos claims and the catastrophies, amongst other things, in Mexico and India gave rise to heavy claims on direct- and re-insurers.

At present premiums for liability insurances have been increased considerably and cancellation of covers by re-insurers has also taken place.

The risk-insurance managers are now also faced with the problem: how solvent is (are) my insurer(s) and re-insurers? Sometimes he even does not know who the latter are.

Risk managers also have to cope with their liabilities coupled with new hazardous waste regulations, including transportation and storage. No doubt our American colleagues can give us more information on this very important point albeit also in Europe a very hot issue.

To make the legal liability story complete, the attention of our American colleagues is drawn to the fact that workmen's compensation in Europe is generally not insured in the private market (exceptions are Belgium and Finland).

Finally I should like to mention the new challenges in the near future, e.g., bio-technologies, new information techniques, robots, etc.

Risk Financing

I am now returning to the captives and risk financing which means, apart from costs versus benefits connected with risk prevention, loss control, etc., either insurance or retention or a combination of both.

The creation of captives through circumstances as I have told you already was and still is in almost all cases only based on property insurance including transportation and in exceptional cases for liabilities and only for smaller amounts. In any case, no long tail business.

The excess amounts were and are still placed on the market directly, in some cases through pools.

Risk-insurance managers are now confronted with less capacity available in the market and the need for coverage of high unpredictable amounts for events which may never occur in a lifetime, but, as you know, which could happen tomorrow.

Therefore hugh premium amounts will have to be paid for the establishment of reserves for this class of business, and the treatment of estimates will produce problems both for insurers and buyers.

The creation of captives during the last ten years whereby large amounts have flown from the direct market to the re-insurance market, followed by the high interest rates and the fierce competition within the insurance industry has changed a hard market into a soft one.

This is not the place to go further into this complicated matter, but I only wish to observe that both insurance suppliers and buyers have a common interest in a stable premium rate adjusted to the risk involved. A dialogue between them would in my opinion be desirable.

Risk Management in Europe

In Europe the Risk Management development has now reached different levels in different countries. In almost all west European countries the Risk Management concept coming from the U.S.A. is now being accepted as far as the larger companies are concerned, but in their own languages, suiting habits, culture and management style.

As regards the position of the risk manager in Europe and the risk management techniques adopted, I may refer to tomorrow's session on survey results relating to a recent AEAI member survey on risk management and a similar one done in the U.S.A.

Education

In the beginning it was the language problem which kept most of the risk-insurance managers away from the seminars and meetings which were held in English and where the English expressions were used. More and more regional seminars are now being held in the local language organised by local organisations--insurance companies, brokers and Risk Management consultancies. Also the Commission on Insurance within the International Chamber of Commerce in Paris is playing an important role. In this commission, delegates from insurance companies, brokers and from industry and trade are represented.

Unfortunately, the interest for meetings and seminars on the part of smaller- and medium-sized companies is practically nil.

However, in several countries there are signs that the situation will improve throuth the creation of new Risk Management organisations in which smaller- and medium-sized companies are represented.

Societies of Risk-Insurance Managers

Airmic, although a body dedicated to the promotion of its members as professionals, commenced the programme of education which included risk management in its concept.

In other countries similar societies of insurance or risk managers were created, although not all the biggest organisations in Europe were represented in these societies. But not withstanding that, other groupings such as the informal group 71 in the U.K. and A.O.G. representing big buyers in the Netherlands came together with the risk management societies in Belgium, France, Germany and Italy in supporting the creation of AEAI in Europe.

In due course, risk and insurance managers were invited to be represented on national and international Chambers of Commerce and to provide a voice at discussion bodies such as those advising the Common Market authorities on future insurance directives for Europe.

This at least demonstrates an increasing acceptance of the part that risk management can play in industrial councils, although it must be admitted that to the outside world the emphasis is still on insurance rather than controlling or managing risks. Whilst it may not be possible to say that the actual operation of risk management is better or worse in Europe or North America, it must be admitted that ideas have advanced further in general terms in North America than in Europe.

In any case, risk management will never progress to a desirable extent until it is recognised by Chairmen, Presidents and Board Directors that the preservation of their assets and their continuing operation is a major part of their responsibility.

My conclusion is that on both sides of the Atlantic there has been progress in there are of risk management but on neither side has it developed to the extent that is desirable, and in these circumstances we are close together, but if we accept that there is indeed a greater advance in North America, then to that extent there is a gap.

* * *