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# RISK MANAGEMENT VS. MANAGING RISKS

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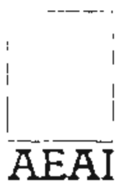


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Risk Management is Managing Risk

You have just heard an excellent presentation by Wolfgang as to how the risk management process should work and the proper theories behind it. Virtually all of the points Wolfgang raised apply not only to property risks but to liability risks as well. Thus, in order to avoid the ultimate risk in any presentation like this of the second speaker being totally redundant to the first speaker, it is my intent to give you some practical risk management tips, from a Risk Manager's perspective rather than an insurance company's perspective, and where possible apply them more towards liability risks than property. However, as I just mentioned virtually everything Wolfgang said about property can in some way be applied to liability. Likewise, many if not all of the things I will be talking to you about regarding liability can be applied back to property.

The first practical thing I am going to do is provide you with two examples of actual risk management philosophy or policy statements. Many people refer to them but very few people ever show you one. I borrowed these from Volume I of the Essentials of Risk Management, which I taught for several years, and I figured we might as well start with what academia in risk management believes to be an example of very good practical risk management policy statements.

The slide is from General Mills, after the presentation you can get a copy of this along with a copy of another more detailed policy statement which is used by a chemical company.

Another practical and hot tip I strongly recommend you do which may seem obvious but so few of us do it, is to make the risk management policy statement page 1 of your risk management manual. If you don't have a manual you ought to develop one right away. It should outline your program and generally explain your coverages. It should explain to your operating people in a succinct manner what they are covered for, what they should do at the time of an emergency, outline their emergency response plan and/or crisis management plans, explain what they should do if there is an explosion or fire, or what they should do if there is evidence of product tampering, what they should do for virtually any situation that risk management should get involved. Senior management should sign off on the manual so that when you distribute it to plant managers and other operations people, the people that make the money in your company, that it carries a little weight.

While a property person like Wolfgang is probably correct that the greatest risks for non-U.S. corporations are property risks, I believe that Europe is well on its way towards becoming like the U.S. in that products liability will become most corporations ultimate risk. There only way you, as a risk manager, are going

to get a handle on products liability is to Know Your Products. That may sound very simple again, but you would be surprised at how many people out there don't know the products their company makes and how those products can fail or how they can lead to damages eventually being awarded against their company. But to know your products well, and thus know your ultimate risks, you need cooperation.

The very first thing you have to understand as a risk manager is that no risk manager is smart enough to know even 10% of what goes on throughout his company from a risk perspective (which isn't really surprising since we all know that the average CEO knows only about 5% of what's going on within his company.) Thus, to know what's going on you have to have good interaction with your operations people. Operations people include not only manufacturing people but also sales and marketing. Or, if you're in an industry such as pharmaceuticals, you also need to have a very close rapport with research. One way to build this rapport is through establishment of committees that have various names from group products safety committees to product liability committees, etc., but all with the general purpose of focusing on product liability risks. These committees need to meet regularly and they must have representation from various disciplines. However, before I go into the real makeup of one of these committees and how they should function, I want to focus on one

of the basic needs in any corporation or any type of organization at all, the need for incentives to motivate those people whose cooperation you most need.

Let's face it, as a risk manager you are probably in a staff function at corporate headquarters reporting to either the Treasurer or the Legal Department and are seen by most operations people as corporate overhead. You are an expense not a profit center. Quite frankly, most of the people out there don't know exactly what you do and don't care. You have to make them care. How do you do that. You have to incentivize them where they all understand. That is, in their wallets.

One of the very first things any risk manager needs to do is make sure he has complete understanding of the budget and allocation process in his corporation and then structure the risk management and insurance budgets such that operations people are incentivized to turn theoretical risk management and risk control plans into practical reality. You want to be sure to structure the charging out of the claims and insurance costs to reward those people who are following good risk management procedures, that is, they are making a good product; or are having their auto fleet drive safely; or are having their workforce work safely or whatever. You want to incentivize these people by charging them less against their budget, which should then put more money in

their own pocket. Similarly, you want to hammer those people who refuse to follow good risk management procedures. You want to make sure that you have worked out with your chief financial officer some sort of process wherein the bad actors out there, the people who will not operate their plant safely or who do not follow good quality assurance procedures are charged more for their insurance coverage, or are directly charged back quickly for their claims costs so that they are incentivized to change their habits and institute good risk management controls.

Thus, before actually getting to the operations people, we really need to get the cooperation of another staff function just down the hall from you, and that is the notorious accountants. You have to convince the controller and his merry band of accountants that you understand their budget game. Regardless of whether your background is that of an engineer, a lawyer or whatever, it is important that you learn how to play the accounting game which will become your tool to get to the more important game of risk management. The idea is to learn the accountant's buzz words and their processes and to know that if you can use their terms they will think you are one of them; and, that you have their same priorities in mind and then they will leave you alone so that you can start doing-risk management. By taking the time to learn a

little bit about what the budgetary process is truly all about in your company and what is important to your CFO and to the Controller, you can structure your presentations in such a way that at least you sound like you know what you are talking about (especially in front of the outside auditors which will then make the controller and CFO very happy) and you can then escape from the accountants and get down to your business; but, with their support! Since they now think you are one of them and understand their priorities, you can more easily use that budget and allocation procedure to hammer the bad operations people out there and reward the good ones so that you can get <u>your</u> priorities in place.

Now we are ready to deal with operations. At this point I am going to disagree just a little with what Wolfgang had to say in the earlier presentation. Wolfgang said, and I quote, "A frequent mistake in risk management is to weigh risk control measures against short term savings and risk control costs." Theoretically, that is true; however, let's face it, very few corporations can see past the end of their "quarterly" nose. We in the U.S. are always being criticized that European and Japanese corporations have long term goals more in mind and don't think with a quarter to quarter mentality as much as U.S. corporations do. Well, I have worked for multinational

companies based both in Europe and in the United States, and quite frankly when you brush away the nationalistic facade that we all like to talk about, all capitalists are created equal. Deep down inside we all think alike. We all know that each quarter is important but we also all know that the long term is important and somehow we try to do both and probably don't do either one as well as we can. But, as long as people are paid every two weeks which is a pretty short-term period, people are going to keep thinking very short term; and as long as they get bonuses based on one year's performance, the quarterly and one year results are going to be important and to some be thought of as long term.

However, I have an idea as to how risk managers can institute some of what Wolfgang is saying. But we need help, in particular from the insurers. I say to the insurers - put your money where your mouth is. Too long, whether it be on the property or liability side, I have had plant managers or operations people or research people of one form or another say to me, "Well, I'll put that loss control measure in but will I get a premium reduction?" And I always have to say, "Well, now you have to understand we are part of this big worldwide program and that overall somehow I am able to reduce the overall costs <u>in the long run</u> if we do put a sprinkler system in here or a new quality control technique in there, new product literature out here or a driver's training

program in there. But candidly folks, plant managers don't think like that. They think about their current budget. Ah, back to the budget. Now wouldn't it be nice if I could figure out some way with my insurer to give this plant manager some sort of credit. I say work with your insurer on a higher level and say, "Look, I know you can't give me a dollar for dollar premium reduction for every loss control technique implemented because the process doesn't really work that way; but, is there something more we can do?" Let me give you an example.

One insurer that I am dealing with is willing to pay the costs for me to hire a consultant to help me in developing a crisis management plan for product tampering risks which is a very significant risk for the pharmaceutical industry. The insurer will pay the costs of this consultant and also those of a public relations consultant in an amount up to 10% of the costs of my annual premium. Thus, if I had a $200,000 premium my insurer will pay up to $20,000 towards a consultant to come in and lessen my risk. Needless to say this has been very well received in my company.

While we all know that consultants only tell you what you already know, they are helpful in crystallizing and focusing corporate attention on a problem and getting senior management to react. However the down side is that everybody is always complaining

about how much they cost. Thus, wouldn't it be nice to get a free one now and then, who's advice you could use or because they are free not use, but which help you then to focus on the problems and work through those "what if" scenarios that you would like to do but, because of the enormous staff that you probably have, you can't find anyone to do it.

Another practical example of how you can work with your insurers to lessen your risks and generate the cooperation and communication you need with your operations people in order to know your risk and do the true "risk management decision making process" that Wolfgang spoke about; (that is identifying and analyzing the risk; selecting and implementing the correct risk management techniques; and then monitoring your results and, if necessary modifying your techniques), is to set up training seminars for your operations people. For example, at another employer I had all of my plant managers and vice presidents of manufacturing flown in for three or four day seminars in Boston held by Arkwright Mutual, which of course Wolfgang has some affinity towards. This is not a commercial for Arkwright because virtually all major insurers can offer similar types of programs. The benefit is that it gets all of your people together thinking risk management for a few days. It gets them knowing your insurer so that when the insurer shows up at the plant whether to do a property inspection or to do a quality assurance review, they are

welcome, because they have been the host of these fella's for three or four days in Boston or wherever, fed them a couple of lobster dinners, have presented a few good seminars, and showed them their research laboratories etc. Your people have been educated that your insurer and <u>you</u> are basically their ally instead of just some sort of corporate auditor or young punk engineer from the insurance company.

What you need to do as a risk manager is to sit down at renewal time with your insurer and ask what would make your company a better risk for the insurer to insure; what would reduce your premium rate if done. Ask them whether a well trained workforce in risk management techniques would reduce the risks. I am sure they are going to say it would and then say to them, wouldn't it be in our mutual interests to have a training seminar. And, thus since it would be in our mutual interests, why don't you pay for it. Perhaps they won't pay for it all, but they may give you a premium reduction or credit that could be applied only if you do put on a seminar in the coming year. In other words, a seminar such as the one I mentioned might cost $30,000 for 30 men to be in a city for a few days. Perhaps the insurer will waive the normal costs or will give you a credit on your premium if you in fact are willing to foot the bill for the seminar. No seminar, no premium reduction. But what this does is enable you to build

a rapport with your people because you are with them for a few days, and they will start listening to you when you call because they now know you better. You're not just someone from the ivory tower of corporate telling them what to do. You are someone who has interacted with them and been in a training session with them and worked with your hands with them and also went out to dinner and had beers with them, and heard about their problems in Boise, Idaho which to them are quite different than what you in your corporate suite in Manhattan or Paris perceive.

And, perhaps as good quid pro quo to the insurer for their willingness to do these things, you explain that a seminar builds a better overall rapport between the insured and the insurer which then should lead to longer term relationships which insures love because it provides them a longer period of time in which to recover their money from a loss should one occur. And, if the reinsurance market ever gets its act together again perhaps you can even enter into multi-year contracts. Also, it gets your management to start thinking long term, which is one of the risk management priorities you want out of it.

Another way to learn your risk, which I mentioned earlier, is to establish product safety or product liability committees within your company. These should be formal in structure in the sense that they must meet at least quarterly and involve high level people. Basically, they should involve somebody from research,

manufacturing, marketing, sales, and ideally from legal and/or risk management. These committees should review any <u>new</u> products to make sure for instance that the marketing and sales people are not making assertions about a product that research never intended or tested for; and, also these committees should periodically review all products even the most mundane of your old products. You would be surprised how often through the years a product is being touted to do something by the salesforce which 20 years earlier, when it was originally developed it was never designed to do. And, often times the literature hasn't caught up to it, or perhaps research never did any testing to ensure that this product can do what the sales and marketing people say it can do. You would also be surprised how often manufacturing people are influenced by the sales people to alter the specs slightly to meet certain sales demands, but that the research people are never told about it and thus are not given the opportunity to try to stop such changes in the specs even if they are ever so slight because it might actually affect the integrity of the product. These round table discussions by a committee that is forced to meet regularly are very helpful in preventing problems. Also, they (and their minutes) are very helpful at a time of litigation in showing that you are a conscientious company that has made all the good and reasonable decisions at the right time. The committee will enable you on an ongoing basis to do the risk management decision making process of identifying risks, of analyzing risks, of then selecting the

best alternative technique to handle the risk, and then monitoring your results and modifying anything you need to modify thereafter. This risk management process decision should not be limited to just products liability or property risks which we talked about earlier, but also for general liability, auto liability and for workers compensation. Because once you know the risks you can get into risk and loss control but you must foresee the risks. Let me give you a workers compensation or safety example.

At a previous employer my parent corporation was a European corporation with very high technology and considered one of the foremost leaders in the world in making fiberglass. They wanted to come into the U.S. market and they designed a plant similar to the plants they had in Europe. It was state of the art, and they built it in Texas. At the end of the assembly line large 50 pound spools of fiberglass thread would come off the assembly line. These would then be stacked. Well one of the risks that the engineers didn't identify when designing the plant was that even though this same plant design had been very successful in Europe, it was designed for the average 150 pound European male. While it can be hard work, if properly trained, a European male of 150 pounds can lift a 50 pound spool of fiberglass thread relatively safely over a long period of time. However, it turns out that in Texas the workforce that was being hired to do this

rather menial task at the end of the assembly line was mostly women or people of Mexican decent who were of slight build, or interestingly enough slightly built Cambodians and Vietnamese who settled in large numbers in the town after the Vietnam War. Well no longer are you dealing with 150 pound males of European extraction who are generally bigger, you are now dealing with people of Mexican and southeast Asian heritage and women for whom a 50 pound weight is extremely heavy. Guess what, we started to have an enormous amount of back injuries and in the United States these can average as much as $50,000 a back. In addition claims increased because these were new employees who were not well trained. But even if they were well trained, this was perhaps too heavy a task for them. Well, guess what, this really effected the profitability of this fiberglass plant because it now had extremely high medical costs. Now eventually we did through robotics engineer out the problem (i.e. analyze, select, and implement) by putting small overhead cranes in for the people to use, but not until we expended extreme amounts of money in medical bills. Interesting and as somewhat of a humorous side note, the best laid risk control plans can still often go astray. Initially, when the overhead cranes were put in they were manually controlled by the worker who would walk along with and somewhat under them. It was almost humorous since the workers were now walking around without hard hats or steel toed shoes carrying these weights overhead and walking virtually under them. I constantly foresaw a more serious accident occurring of the

50 pound weight landing on their feet or their head and crippling or killing them and having the cause be attributed to my requiring the loss control technique of cranes. However, to the best of my knowledge that has not yet occurred, but it just goes to show you what can go wrong even when you are trying to institute good risk control measures.

Back to products liability. Now that you have your product liability committee and you've had your seminars with your operations people etc. and you are building a rapport with your controllers department (who is constantly alerting you of any extra expenses that are occurring out there), you need to go to your operating people again and ask them how you can help them. At first they will look at you askance and think, well, there's no way you can help me. But I think there is. I think what you need to do is to appeal to their good common sense and say, look, if money was no object what would you like to have done at your plant. Then you explain to them that perhaps you could be their ombudsman or advocate at Corporate to get certain things into their budget that they know deep down inside of them they need but they would never ask their superior for because they know he is constantly telling them to cut expenses. But if they could put the word in your ear, and you could be their advocate, then you could be the bad guy who is supposedly spending all the money but yet knowing deep down inside that you are doing the right thing and the plant manager knows you are doing the right thing

and thus something for the long term gets done. This is how you make an ally out of them. In other words ask them for a wish list of what they would like to have if they weren't afraid to ask for it.

The other thing you need in order to analyze your risks well is you need good data. And good data means knowing about your losses, having good loss figures so that you can focus on trends which may help you to spot truly big risks coming down the road. Unfortunately, it has been my experience that it is very difficult to get good products liability loss data in particular from insurance company loss runs. It's sad but safe to say that I have never gotten a totally correct loss run from a major insurance company in America. Thus, I recommend if possible you make an effort, perhaps with your insurer, to develop a good in-house risk management information system. This may involve using the insurers software since some insurers allow you to link up and go on-line with them directly. Or, get somebody on your staff, or yourself, well trained in how to develop your own loss runs so that you have good data. Only with good data can you know where your efforts should be focused. In addition, only with good accurate data can you strongly negotiate your insurance renewals properly. Without good data the insurer is always going to be conservative in his underwriting and you are going to be paying more at renewal. Speaking of renewals, let's talk financing.

Wolfgang earlier alluded to the fact that you need as a corporation to establish your ultimate risk tolerance. I couldn't agree more. As a risk manager you need to get to the CFO and CEO along with whoever else those two might think necessary and find out exactly how much your company can afford to lose in a year without truly adversely affecting the ability of your company to meet its goals. This amount may vary significantly by company and by whether or not your corporation is public or private. If your corporation is public, you need to get a handle on what is considered "material" by your outside auditors so that if you had a loss you'd know when a footnote would be required in your financial statement. As we all know, most CFO's don't like footnotes.

Once you have established your risk tolerance level, then in a multi-national corporation I think you need to make the next giant philosophical leap and say that if we can afford, for instance, a $10 million loss or self-insured retention or deductible in the U.S., we can afford one in Europe. By that I mean, it seems to be the tendency to buy the lower deductible local insurance in many countries, and have fairly high deductibles in the U.S. because the insurance is "cheaper in Europe and other places" than it is in the U.S. While this is generally true, it still is costing you something, and if you are a multi-national, what difference does it make if you have your

loss in the U.S. or you have it in France. Ten million dollars is ten million dollars wherever the loss may occur. Now right up front I want to say that there are exceptions to every rule in every corporation and you must be flexible to take advantage of extreme market situations. But however, in general, I think a problem companies have is that they don't establish a worldwide risk management program. Everyone treats the U.S. differently, (albeit it arguably should be different because it does have different types of laws, etc.); but still financial decisions are financial decisions and especially if you have a consolidated financial statement what the hell difference does is make where you have the loss. But, so that one can take care of the exceptions but still have uniformity somewhat in philosophy I would recommend that you have as one option up your sleeve a captive insurance company. Now, captives are not for everyone, I realize that. However, by having a captive or some sort of financial vehicle to fund up to the risk tolerance level I spoke of earlier, you have the flexibility to tailor a program to your needs. Remember also that even after a captive is in place you don't have to use it the same way every year.

Personally, I have found that a captive has enabled me to have the peace of mind of knowing that my company is in regulatory compliance in every country worldwide for things such as clinical trials which are extremely important for pharmaceuticals. Regardless of whether you use a captive or not, you as a

risk manager in a worldwide program in liability need to convince the local operating people in the various countries that the corporate philosophy of risk tolerance is a worldwide philosophy. And, thus they need to be made part of that program. This may involve having the same high levels of deductibles apply worldwide which might seem extraordinarily high in certain countries; but, if the losses can be funded by your corporation in some sort of way through for instance "artificial" premiums being charged to local subsidiaries and retained in a corporate fund, then there should <u>in the long run</u> be a significant saving for the overall corporation.

There I am, sneaking in the term "in the long run" again. I do believe you can begin to get your long-term risk management philosophy and goals in place by looking for allies in operations and giving them little incentives that help them look better in their short-term budgets while helping you reach your long-term goals. As the title of the presentation says, risk management <u>is</u> managing risks, but it also surely is managing people, managing budgets, managing attitudes, managing your philosophy and managing to reach your long-term goals.