Think Differently about Risk

Captive Insurance Times talks to Marty Scherzer of AIG about risk profiles and why alternative risk transfer vehicles are sometimes the answer to traditional insurance needs

What sort of risk profile does a modern company have and how has this changed during your time in the industry?

Typically, the risk profile of a company looks very different today than it did in the past. Global expansion has resulted in companies needing to address risks across wider geographic areas, each with its own regulatory requirements. Companies operating in emerging economies face even greater uncertainty since these countries do not always have well established or documented insurance regulation and are increasingly issuing new regulations and oversight requirements. Today’s companies must invest substantial time and resources navigating the challenges of conducting business throughout the world while trying to operate as efficiently as possible in an environment of increased regulation and regulatory scrutiny.

Companies are very mindful that plaintiffs’ awards are considerably larger today than even just a decade ago, and accordingly, companies look to purchase larger limits. Risks are more interdependent than in the past as companies are learning from dealing with an interconnected global supply chain. The Thailand floods were an all too painful example of this phenomenon. With social media, information—both good and bad—moves faster and is in a much more unstructured way than ever before, thereby creating risks that did not exist just a few years ago.

As companies seek to expand and develop new businesses, new risks will continue to evolve. If you asked someone what a cyber threat was in 1980, they would have struggled to comprehend what you meant. Today, most firms are acutely aware of cyber risk, whether it is from a cyber-attack or a careless mistake that leads to the release of personally identifiable information. Similarly, the growth of the internet and smartphones, fracking, supply chain exposures and other innovations, will result in more risks that must be addressed.

Where do you expect growth to come from in the future?

As companies expand geographically and develop new businesses, the type and number of risks to which they are exposed will increase thereby creating an increased demand for insurance. Similarly, as emerging economies grow, the assets of both the businesses and the individuals within those countries will grow, which will create increased demand for insurance protection for these assets.

I believe the most exciting opportunities for growth will result from asking our clients to ‘think differently about insurance’. We are an industry that’s been around a very long time. As early as 3000 BC, Chinese traders exposed to losing cargo when a boat capsized agreed to share the risk by redistributing their individual cargo across the group’s many vessels. These traders faced a problem, had resources, and devised a strategy to utilise those resources to address the problem.

While it is great that our industry is well known, this deeply ingrained tradition of defining insurance solely as a means to share risk often limits our thinking about how insurance can address a wide variety of challenging issues. This limitation is particularly relevant when risk transfer is not the motivation for the insurance purchase; for example, when the sole need for insurance is to provide evidence of insurance to meet a regulatory requirement. I believe there is a tremendous opportunity to be gained by broadening how our clients define us—from ‘traditional insurance provider’ to ‘problem solver with a wide array of resources to address risk’.

Thinking differently about insurance poses a particularly strong growth opportunity for captives as well as rent-a-captives. With the client retaining a significant portion of a risk, these types of programmes generally have more flexibility than traditional risk transfer programmes, particularly in terms of the types of exposures that can be addressed and the structure of the programme.

How do you broaden the way clients think about insurance to include being a resource for addressing problems, obstacles and risks inherent in their business?

Accomplishing this repositioning is no easy task. We need to change the way we market to include a much larger educational component. All of the parties involved in the insurance transaction—the insurer, the broker and the client—need to invest the time to learn how insurance can provide broader solutions than just transferring risk.

Jenna Jones Reports
Jenna Jones is a reporter for Captive Insurance Times which originally published this article.
The first step is convincing clients and brokers that investing time with us can produce results. To accomplish this task, we use case studies to demonstrate the multitude of issues that can be solved with non-traditional insurance programmes. These scenarios help us explain the range of exposures our programmes can address and the variety of insurance structures that we can design and implement.

In the second step, we ask that the client teach us about their business. Through a series of in-depth questions, we seek to gain a deeper understanding of our client’s business objectives, obstacles, problems and opportunities.

The last step, structuring a solution to bring some certainty around the client’s issues, is probably the easiest. We’ve been in this business for more than 50 years and have the expertise, resources and global footprint needed to craft a solution. Our experience shows that the better job we do in understanding the client’s issues, the more successful we will be in designing and implementing a solution that benefits the client.

How can a company’s risk manager determine if the company is exposed to risks that might be addressed with an alternative risk transfer programme?

If we are successful at broadening the way clients think about insurance, then the risk manager’s role also broadens to being a problem solver, with a wide array of resources at his or her disposal to address risks. To succeed in this broader role, the risk manager must be an integral part of the business’ strategy so that he/she has an in-depth knowledge of the company’s objectives, constraints and obstacles. This knowledge will better enable the risk manager to identify issues that might be addressed with an alternative risk transfer programme and have a more meaningful discussion with providers when working towards a solution.

Companies should empower their risk managers to research alternative risk transfer solutions when the traditional insurance or financial markets do not adequately respond to the company’s needs. As these solutions often involve a capital commitment over a period of time, risk managers need to work closely with their finance departments to define the ultimate objectives.

Risk managers should understand the broadening capabilities of insurance to address unusual or non-traditional risks. Once armed with a solid understanding of the types of alternative risk transfer programmes available, as well as what the insurer will need in terms of loss data and timeframe to structure a programme, risk managers will be well equipped to help their companies address lots of different and complex risk issues. It also helps to work with a knowledgeable broker who can navigate the different alternative risk transfer providers and offer criteria to evaluate those providers. There are many insurers who dabble in this space, but there is a real benefit to working with an experienced provider who has seen the issues, understands the pitfalls and knows how to address them.

What criteria should be used to evaluate an alternative risk transfer provider?

It is important that providers have:

- Global capabilities, including superior servicing and claims handling, as well as the ability to issue locally admitted policies as part of a global master programme and in-depth, local knowledge of regulatory requirements
- Flexibility in the type of exposure, class of risk, and contract best suited to the requirements of the deal (eg, insurance, reinsurance, loans, captive management, or other financial products)
- Ability to offer a broad range of products
- Access to significant risk-bearing and financing capacity in support of structured or alternative risk transactions
- Broad expertise, including the ability to analyse complex and unique risk, and a proven track record of actually implementing creative solutions
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- Multi-disciplinary team, ie, underwriters, actuaries, lawyers, tax experts, accountants, credit officers, regulatory and operational specialists—it takes a village
- Ability to retain significant risk.

How can alternative risk transfer vehicles such as captives help with meeting traditional insurance needs?

Captives are not always used as a solution for when the traditional insurance market cannot respond. Many of our clients are using captives or other risk retention vehicles as part of a well designed, formal, risk retention programme to help them better manage the risks they choose to retain.

When a significant amount of reinsurance is purchased, a captive can create greater transparency for clients through a more direct line of sight to who its reinsurers are. In addition, insurers will look favourably on a well-designed risk retention vehicle such as a captive with the necessary discipline to capture data, perform actuarial reviews and clearly demonstrate how a risk has performed.

What must a company have in place before it should begin considering whether a captive insurance programme is viable?

Firstly, the company must be willing to retain and fund a significant amount of the risk over a long time horizon. Also, the company should be looking to establish a more formalised approach to its risk management programme. It needs financial resources commensurate to the level of risk it is seeking to retain. The company should fully understand the nature of its risks and have effective loss control in place. Lastly, the company should be able to clearly articulate its objectives to its insurer and broker so they can be effective partners in crafting a solution.

If you noticed, I haven’t said that the company must have an existing captive in place. Rent-a-captives and protected cell captives enable companies to pay a fee to ‘rent’ a portion of a captive’s capital, surplus, licences and administrative services to provide insurance or reinsurance. Rent-a-captives offer companies many benefits of a captive, including features that allow the insured to retain a certain proportion of the risks and better manage the associated costs, without the full operating costs of a standalone captive.

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