

Snapshot of Risk Managers Poised for Change

Faced with the lingering effects of a global financial crisis, dramatically downsized staffs and reduced budgets, corporate risk and finance managers depend heavily on insurance brokers and consultants, according to a Towers Watson pulse survey of nearly 250 U.S. risk and finance executives.

Despite this reliance on brokers and consultants, our survey findings suggest that many risk managers expect little more than efficient transfer of risk to insurance companies and show limited interest in more sophisticated risk management solutions. Other key findings include:

- Retained claims are the single greatest concern for risk managers. As companies retain more and more of their risk exposures, managers look to their risk management consultants and insurance brokers for help.
- Most risk managers tolerate or are resigned to contingent commissions paid by insurers to insurance brokers. Opposition to the sometimes controversial commissions comes mostly from larger companies.
- Slightly more than half of respondents have implemented enterprise risk management (ERM). However, despite its demonstrated ability to reduce the cost of risk, ERM is still not getting management support.

“For all the advanced services that some brokers provide, risk managers still value their placement ability the most,” noted Steve Levene, head of corporate risk management and insurance brokerage at Towers Watson. “It raises the question of whether risk managers are concentrating adequate consulting firepower on potentially costly or high-risk areas, such as retained claims.”

Serious thinking and analysis, as far as most risk managers are concerned, remains the province of actuaries. As for new technology, predictive claim analytics has a way to go before risk managers are ready to trade in their adjusters and third-party administrators (TPAs).

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All told, 244 risk managers were surveyed. About 45% of respondents were from companies with revenues between \$1 billion and \$4.9 billion. The rest were split evenly between smaller and larger companies. Manufacturing was the largest industry category (19%), followed by health care (16%) and utilities (8%).

The overall picture that developed from the new survey is of an industry poised for change...as soon as economic conditions return to normal.

A Closer Look at the Findings

So what keeps risk managers up at night? By far, retained claims are the greatest concern for 64% of the respondents, and are ranked second by an additional 23%.

After claims, premium costs ranked first for 24% and second for 49% of the respondents. Frictional collateral and capital costs were the principal concerns of only 10% of respondents.

Fees for providers such as brokers, actuaries and TPAs were of primary concern to just 1%, yet surprisingly, some 48% of risk managers ranked fees a greater concern than premiums and cost of capital.

Interactions With Brokers

Opinions varied widely on the value of brokers. For example, three-quarters of respondents said they meet with their brokers quarterly or more often. According to 54% of the respondents, the principal topics of conversation with brokers are insurance market conditions and their impact on the upcoming renewals. Only 20% of those surveyed said their brokers actually discussed risk management issues in the context of their company's overall performance, and 9% said their brokers brought up their company's claim experience.

When asked what aspect of a broker's service they valued the most, 52% of risk managers said placement capability and market leverage were key attributes. Only 25% said a broker's knowledge of a client's industry was of primary importance (Figure 1).

The survey revealed that company risk managers rely more often on brokers (55% at least annually) than actuaries (44% annually) for retention and limit reviews. While most would agree that actuaries are the recognized experts on claim experience, risk managers are nevertheless going to brokers for retention and limit reviews.

"What the finding suggests is that risk managers are actually looking for benchmarking rather than analysis," said Levene. "They are asking brokers to tell them what limits their peers are carrying rather than conducting a hard analysis of their own experience and risk appetite."

Contingent Commissions

Only five years after several attorneys general extracted settlements and levied large fines against brokers who accepted contingent commissions from insurers, half of the risk managers surveyed said that contingent commissions were not of particular concern to them.

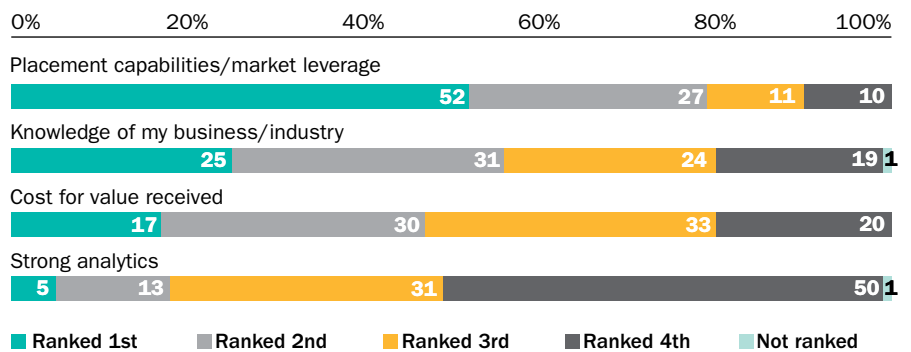
Some 39% said the idea of brokers receiving contingent commissions was acceptable as long as the broker disclosed the compensation in a timely manner. Another 11% said that contingent commissions were not a problem as long as current laws are followed and detailed records are kept for regulatory review.

Eighteen percent said they did not like the idea as allowed under current laws, but believed that an appropriate system could be developed. Only 29% of the risk managers surveyed said contingent commissions should not be allowed under any circumstances.

The survey demonstrated a strong correlation between company size and tolerance for contingent commissions. Smaller companies tended to be more accepting, while larger companies were less so. Several reasons are offered for the wide difference in opinion.

"Smaller clients typically deal with smaller brokers," said James Swanke, managing consultant at Towers Watson. "Their focus is the premium they're going to be paying, not the size of the broker's commission. Some risk managers at smaller companies also believe — not always with justification — that contingent commissions can result in lower premiums for them."

Figure 1. Most Important Aspects of Your Broker's Service



Larger companies, for the most part, were more likely to oppose contingent commissions. "We find that, in general, risk professionals at larger companies tend to question the degree of transparency and may sometimes question the quality of the carriers their brokers are steering them to," said Swanke.

Mr. Swanke added that larger companies are also more likely to have compliance guidelines that influence the thinking about contingent commissions. Risk managers may have to answer to shareholders, regulators, attorneys general, rating agencies and even their own boards.

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Interactions With Actuaries

As companies retain more and more of their total risk portfolio, the vast majority (more than 70%) of risk managers meet with their actuary at least yearly, and 48% at least twice a year.

The conversations risk managers have with their actuaries seem to be more substantive than the talks they have with their brokers. According to the survey, 37% of meetings are devoted to a practical discussion of actuarial findings in the context of overall company performance. In 34% of cases, the conversation centers on a technical analysis of claim experience and trends.

When asked to gauge what aspects of their actuaries' service were most important to them, 47% of respondents said technical capability and resources. But while technical capability is a given, more than half said that the ability to communicate findings in plain language rated first or second in importance. Knowledge of the company's industry was ranked most important by only 19% (Figure 2).

According to the survey, 44% of risk managers ask their actuaries to review their retention, limit and financing costs annually. Despite actuaries' superior technical ability to review retention and claim experience, 21% of respondents said they prefer to have their brokers benchmark their programs against peers.

The Value of Analytics

While industry experts increasingly stress the importance of analytics, just 5% of risk managers consider analytical ability a critical broker service. The vast majority (76%) said they are satisfied, and only 4% reported that they were dissatisfied with their broker's current analytical capability. One-fifth of the respondents indicated they were neither satisfied nor dissatisfied.

Once again, respondents seemed to expect more from their actuaries. When asked to gauge the value of the analytics supplied by their actuaries, 88% of the respondents were satisfied; 1% were dissatisfied, and 11% were neither satisfied nor dissatisfied.

The differences in satisfaction with analytics may reflect what risk managers see as differing value propositions. For many of them, brokers place business while actuaries analyze and quantify risk.

Enterprise Risk Management (ERM)

A discipline widely accepted and even embraced by insurance carriers, ERM is lagging in the general business community. Slightly more than half (55%) of our respondents said their companies have an ERM program in place — up from 37% in 2005 and just 11% in 2000 (Figure 3).

According to the survey results, 71% of risk managers said their companies had identified, assessed and prioritized key risks and assigned risk owners. Forty-six percent said their boards of directors receive regular reports on ERM activities and findings. Some 36% said they use ERM to quantify their key risks and use those metrics in making business decisions, while 17% said that risk metrics are integrated into their budgeting and planning process.

Figure 2. Most Important Aspects of Your Actuary's Service

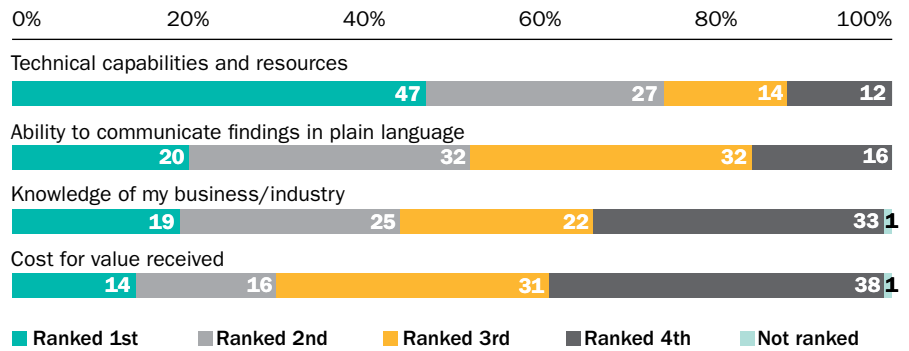


Figure 3. An ERM Process Is in Place

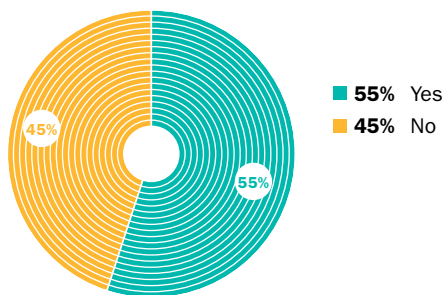
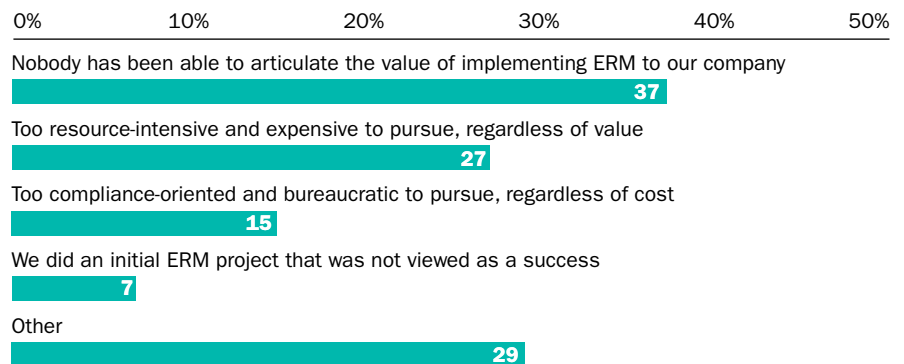


Figure 4. Reasons an ERM Process Is Not in Place



For the 45% of respondent companies without an ERM program in place, risk managers offered a wide range of reasons (Figure 4).

- More than a third (37%) said they have not been able to articulate the value of implementing ERM to company management.
- 27% said ERM was too resource-intensive and expensive to pursue, regardless of value.
- For 15%, ERM is too compliance-oriented and bureaucratic.
- 7% said they had developed an initial ERM project that was not viewed as a success.

For many of the respondents, even those that have implemented programs, the results indicate only a partial understanding of ERM. Even among those companies with existing programs, only a third said they used ERM as part of their decision-making process.

Barry Franklin, Towers Watson managing consultant, added that ERM is a hard sell in the current financial environment. “It is a discretionary undertaking, and the perception is that it is expensive to implement.”

Adoption of Predictive Models

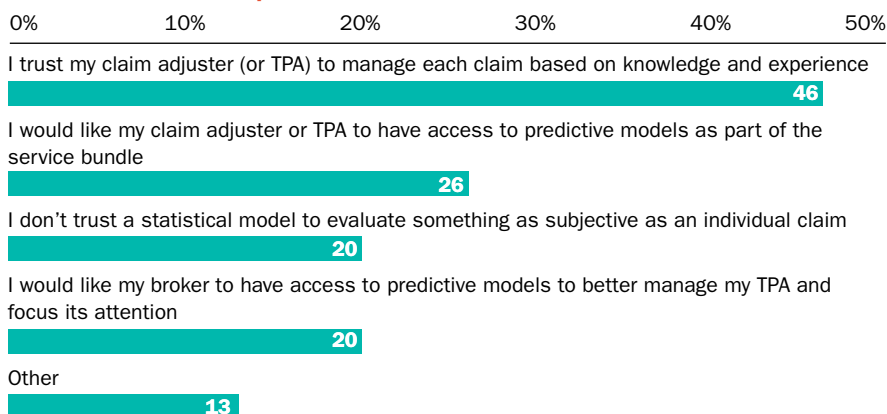
For most risk managers, managing individual claims is seen as a subjective and experience-based discipline. However, some companies are beginning to show an interest in augmenting their capabilities with emerging tools based on predictive models.

When asked to describe their view of predictive models used to identify individual problem claims, 46% said they trusted their claim adjusters to manage each claim based on knowledge and experience. A further 20% reported that they didn’t trust statistical models to evaluate something as subjective as an individual claim.

However, slightly over a quarter (26%) of respondents said they saw value in predictive models and would like their claim adjusters to have access to them. Interestingly, 20% said they would like their brokers to use predictive models to manage their TPAs (*Figure 5*).

Slow adoption of predictive analytics can be attributed to several causes. Predictive claim modeling is still relatively new and unknown to many risk managers. And while never designed for the purpose, the technology is seen by some risk managers as removing a crucial element of human judgment and experience.

Figure 5. View of Predictive Models Designed to Help Identify Individual “Problem” Claims for Specific Attention



“Companies are shifting from monitoring aggregate claim statistics to leveraging knowledge in order to optimize individual claim outcomes,” said Franklin. “The conventional approach of measuring aggregate performance against accepted benchmarks often perpetuates mediocrity, whereas a knowledge-based strategy can improve both claim outcomes and operation efficiency by better focusing company resources.”

To view the complete Towers Watson RIMS Pulse Survey findings, visit www.towerswatson.com.

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