The danger of buying insurance without risk management advice

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Risk management is perceived by most people as simply buying insurance. As a result, many companies take out insurance assuming they will be protected from the risks that they face, which is a rapidly eroding model that doesn't take stock of risks that are in fact only partially or completely uninsurable.

Michael Ferendinos, Enterprise Risk Business Unit Head at Aon South Africa

"Mature companies understand that while insurance is an important aspect of risk management, it is by no means the only tool at their disposal to address their risk profile in totality. They understand that other risk treatment options may be less costly in specific situations, and in some cases, certain risks are in fact partially or completely uninsurable," explains Michael Ferendinos, Enterprise Risk Business Unit Head at Aon South Africa.

"As a guiding principle, pure risks are insurable whilst speculative risks are uninsurable. A pure risk generally refers to a threat that results in sudden and unforeseen loss such as a safety incident, fires, natural disasters and property damage. Companies normally don't have the financial capacity to field this type of risk on their own and from a strategic point of view it absolutely makes sense to transfer the risk to an insurer," he adds.

"A speculative risk, on the other hand, is strategic in nature and entails voluntary risk-taking in order to generate superior returns. Examples could include the company entering into a new market, introducing a new product, engaging in new competition or even increasing their risk of reputational damage. Companies normally have a moderate tolerance for these risks due to the perceived business benefits," says Michael.

Aon's risk maturity Index developed in partnership with The Wharton Business School and the University of Pennsylvania highlights the fact that companies with greater levels of risk maturity tend to have better stock price performance and less share price volatility as they improve in risk maturity.

Mature companies don't solely rely on insurance to manage their risks, and additionally employ the following four risk treatment options:
• **Risk Avoidance:** The risk is avoided by changing approach in some way to bypass the risk. A manufacturer for example can avoid the risk of product failure by refusing to introduce new products. The aim of this risk response strategy is to eliminate the uncertainty associated with the risk.
• **Risk Reduction:** If a risk cannot be avoided, perhaps it can be reduced. This refers to traditional risk mitigation or reduction of either the likelihood of the risk occurring or the impact that it will have. A manufacturer for example can reduce the risk of product failure through careful product planning and market testing. The aim of this risk response strategy is to modify the exposure or size of the risk to acceptable levels.
•**Risk Acceptance:** A firm will, and probably must, take on certain risks as part of doing business. The risk may be accepted perhaps because there is a low impact or likelihood. The firm that markets a new product assumes the risk of product failure - after first reducing that risk through market testing. The aim of this risk response strategy is to take the risk and hope to get lucky.
• **Risk Transfer:** Certain risks can be insured against whereby some or all of the risk is transferred to a third party. An insurer agrees, for a premium, to assume financial responsibility for losses that may result from a specific risk. The aim of this risk response strategy is to allocate ownership to the third party best able to manage the risk effectively.

Corporate risks are becoming far more complex and interconnected than ever before. Fully insurable risks are not only becoming less of a priority but are also becoming more expensive to mitigate. The latest Aon Global Risk Management Survey – which surveyed 1843 CEOs, CFOs and Risk Managers around the world from companies of all sizes – states that there won't be a single fully insurable risk in its list of top ten global business risks by 2020. The top priority business risks in 2020 will rather be comprised of partially insurable and uninsurable risks.

Insurers also incentivise companies to have effective risk management programmes by making them eligible for lower insurance premium or deductible structures. Having an effective risk management programme in place shows an insurer that your company is committed to loss reduction or prevention, making it a better risk to insure.

The insurance brokerage model is also evolving, with brokers now offering a broader range of risk management services beyond insurance advice. Forward-looking brokers have become trusted advisors to their clients by not just selling them policies but supplementing the process by helping them manage their full exposure. Companies tend to be far more loyal to their brokers due to the added benefits that risk-based intervention brings about and are less swayed by minor insurance premium savings.

“Companies will be well-served to engage with the risk consulting team at their brokerage at the inception of insurance and risk management discussions in order to secure an all-encompassing risk solution that addresses the full spectrum of its insurable, partially insurable and uninsurable risks,” says Michael.

This is where the value of dealing with an expert broker by your side comes to the fore. “A brokerage that understands the industry and business landscape as well as the trends and emerging technologies that might disrupt the business going forward, is paramount to compiling a well-rounded risk management strategy and insurance solution. Of paramount importance is the realisation that insurance in and of itself is not the cure-all for all risks, and that buying insurance without risk advice and mitigation strategies is the riskiest approach of all,” concludes Michael.