# Risk Management 101
## "Where Are the Alligators?"

## Applied Risk Management
### Tools, Techniques, and Case Studies

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**PARMA Conference & Expo**

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# Session Purposes

- Introduce attendees to risk management

- Demonstrate the value of risk management

- Provide simple and practical recommendations for implementing risk management practices
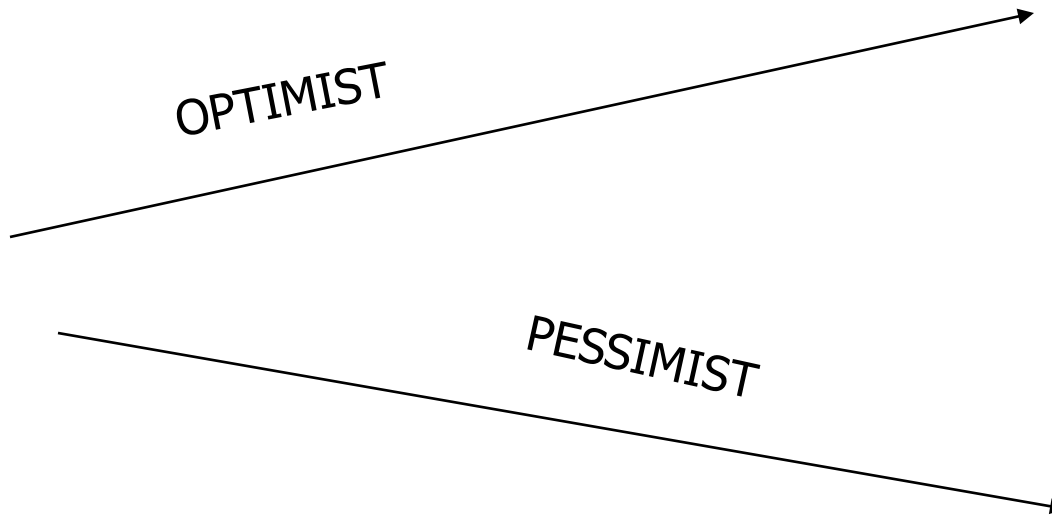
# *Outline*

- Risk Management and Its Value

- Evolution of Risk Management

- The Risk Management Process

- Risk Management Communication

- Making risk management work for you, your organization, or your clients

# This is Your Future
## Hopes, Dreams, Fears, Budget, Goals, etc.
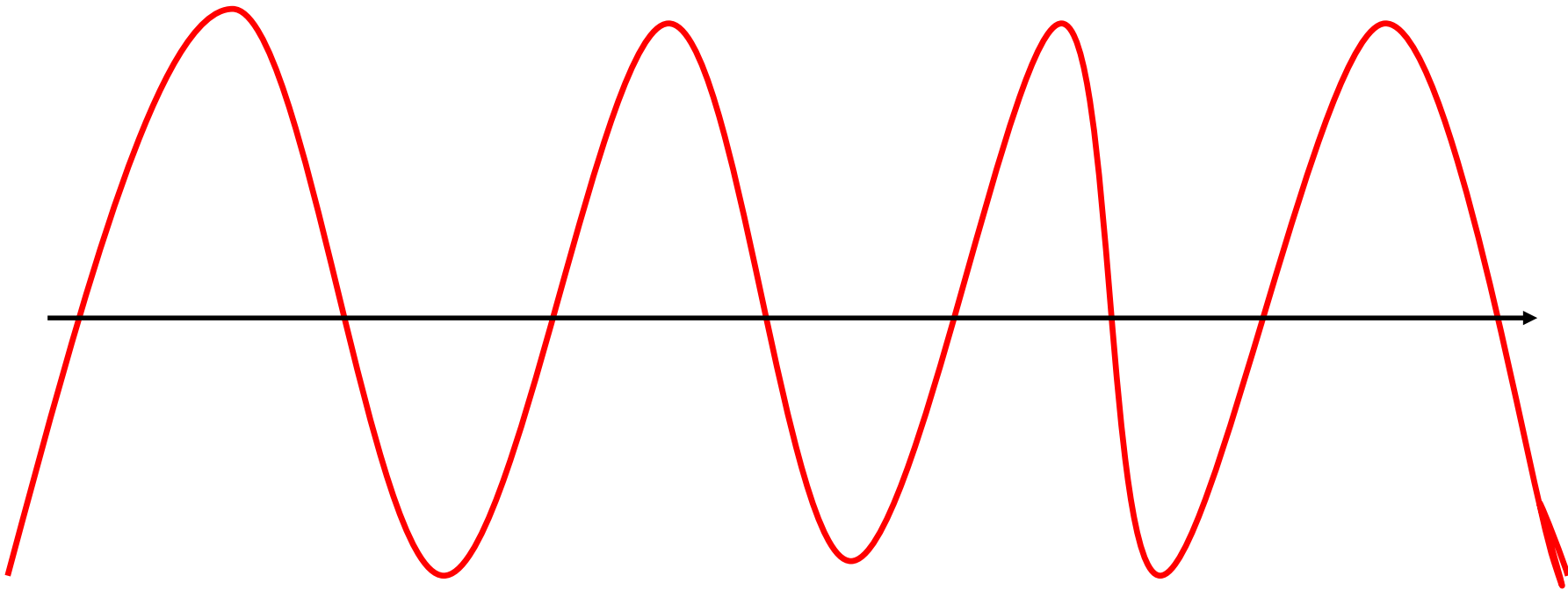
Your Future/Life
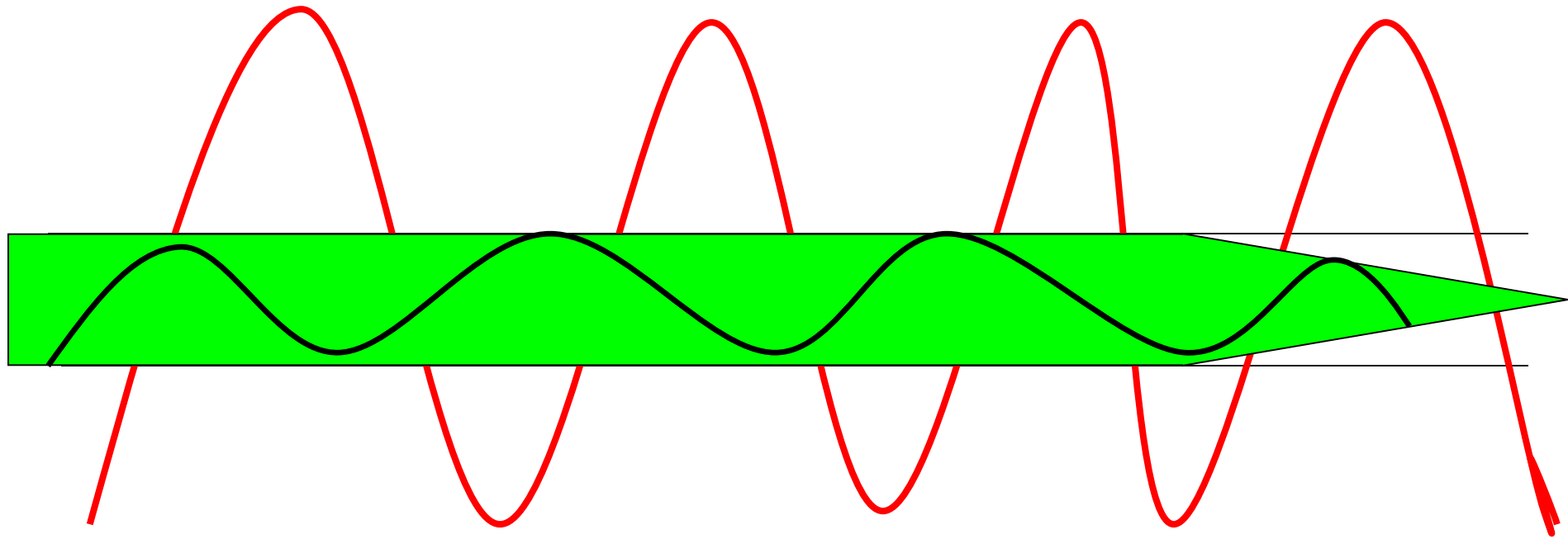
Or, if you're an:

OPTIMIST

PESSIMIST
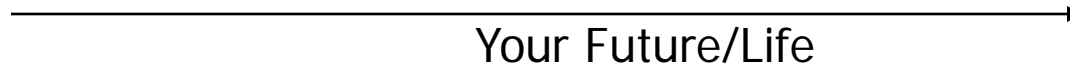
# This Is Risk – Variance

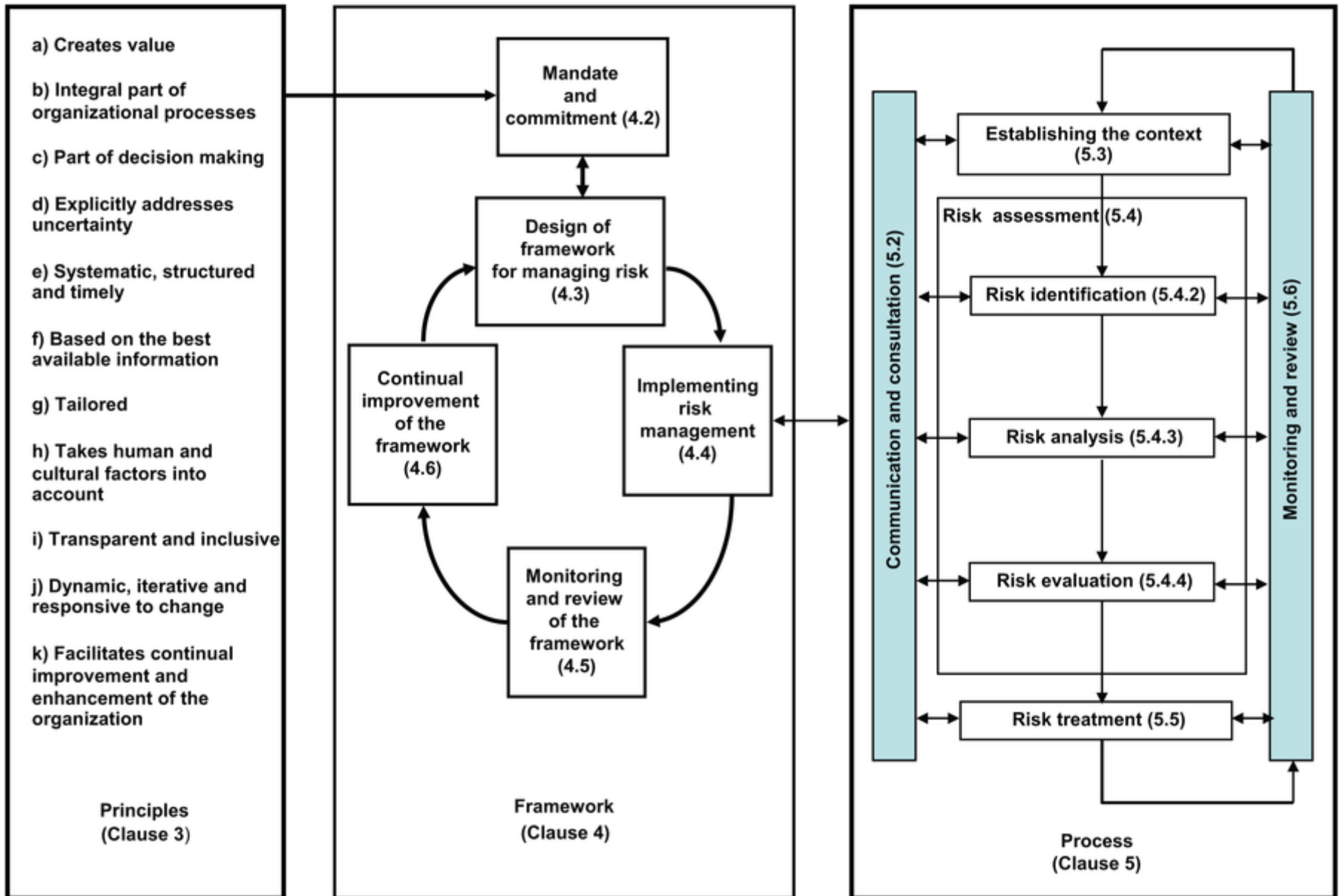## *Potential* Actual Goal, Budget, etc. *Results*



"Life is what happens when you're busy making other plans"  - John Lennon

# This Is Risk Management



**Maintaining Actual Results Within a
<u>Tolerable Level of Uncertainty</u>**

# This Is ISO 3001 Risk Management

**a) Creates value**

**b) Integral part of organizational processes**

**c) Part of decision making**

**d) Explicitly addresses uncertainty**

**e) Systematic, structured and timely**

**f) Based on the best available information**

**g) Tailored**

**h) Takes human and cultural factors into account**

**i) Transparent and inclusive**

**j) Dynamic, iterative and responsive to change**

**k) Facilitates continual improvement and enhancement of the organization**

**Principles (Clause 3)**

**Mandate and commitment (4.2)**

**Design of framework for managing risk (4.3)**

**Continual improvement of the framework (4.6)**

**Implementing risk management (4.4)**

**Monitoring and review of the framework (4.5)**

**Framework (Clause 4)**

**Communication and consultation (5.2)**

**Monitoring and review (5.6)**

**Establishing the context (5.3)**

**Risk assessment (5.4)**

**Risk identification (5.4.2)**

**Risk analysis (5.4.3)**

**Risk evaluation (5.4.4)**

**Risk treatment (5.5)**

**Process (Clause 5)**

# ISO RM Principles

a) **Creates value**

b) **Integral** part of organizational processes

c) Explicitly **addresses uncertainty**

d) Systematic, structured and timely

e) Based on the best available information

f) Tailored

g) Takes **human and cultural factors** into account

h) Transparent and **inclusive**

i) Dynamic, iterative, and responsive to change

j) Facilitates **continual improvement** and enhancement of the organization

# ISO RM Framework
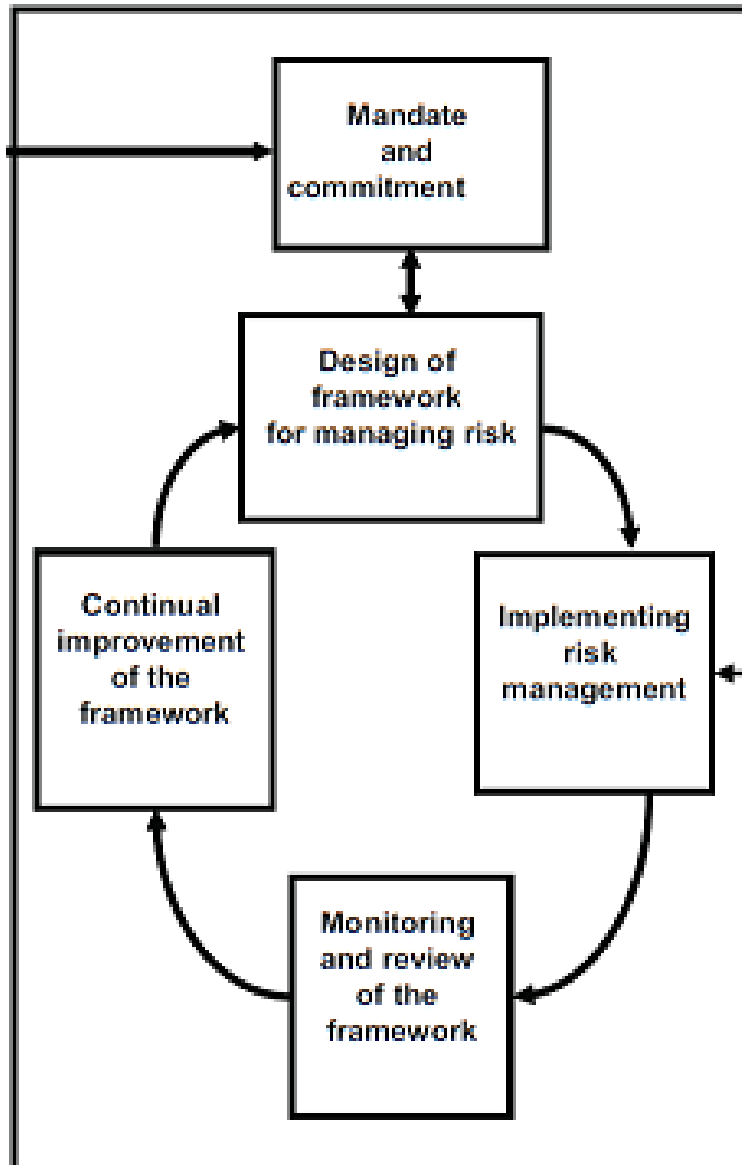


**Mandate & Commitment**

- Design
- Implement
- Monitor
- Improve

# Don't Start Without Commitment!

## The Hierarchy of Commitment

**Level of Commitment**

| Level | Statement |
|-------|-----------|
| **Commitment** | I Will Do It! I Will Lead Others To Do It… |
| **Compliance** | I Have To Do It! I Can Do It When I am Told To… |
| **Complain** | Why Should I Do It? If Nobody Say So… |
| **Non – Committal/Condemn** | I Will Not Do It! I Will Influence Others… |

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*If You're Boss Doesn't Care About it – Will You?*

# Gaining Commitment to Risk Management

**Demonstrate the value** of risk management to the various groups within your organization

# Risk Management & Its Value

**All organizations *exist* to manage risks**

- Business risks -  sales, expenses
- **Operational risks** – production, logistics
- **Regulatory** - government requirements
- Product safety
- Service E&O

**"The primary purpose of government is to protect its citizens" – from what?**

*Harm to persons or property*

# Management is Risk Management

Can use tools in any number of applications

**"Risk Management should be called GOOD Management"**

*Do it every day without thinking about it*

Hiring Someone

Dealing with an angry customer

Buying a car

Crossing the street!



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# Risk Management Goals



- *Tolerable uncertainty*
- **Legal & regulatory compliance**
- Business Continuity
- **Earnings Stability**
- Profitability & growth
- **Social responsibility**
- Survival
- **Economy of operations**

# Who is the Risk Manager?

Most organizations can't afford a full time
Risk Manager

If organizations are fundamentally in the
business of risk management, but not large
enough to have a Risk Manager, *who is the
Risk Manager in fact, if not in name?*

# *You Are!*

Officers, Directors, and managers,
*whether they like it or not,* are the Chief Risk Managers for their organizations

When something goes wrong they are held accountable

**If the risk hits the fan,**

**will <u>you</u> be covered with it?**

**If yes, congratulations, *it's your risk*.**

# RM101 - Key Concept
## Treat It Low

Always **treat risk at the lowest possible level**, *where the decisions are made that can prevent or cause a loss.*

**Risk Management means getting people to recognize and take ownership of the risks they face in performing their daily tasks.**

**Goal is to <u>make *everyone* a risk manager</u>, accountable for managing their own risks, but *still need coordinator* of info and responsibility**

PARKING AT OWNER'S RISK

PARMA recently changed its name from the Public Risk **Managers** Association to the Public Risk **Management** Association

parma
public agency risk management association

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# *Risk Management & Its Value*

## Is risk really that big an issue?

- Studies suggest that **5% to 20% of the typical budget is consumed by the cost of risk.**

  - What are you paying for Work Comp?

  - For admin costs related to preventing and processing claims?

- Research shows there are **as much as $10-25 in indirect losses that occur for every $1 of direct losses.**

  - How much are you paying in overtime while others are out?

  - Are you capturing your "soft" costs of risk?

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# Indirect versus Direct Costs
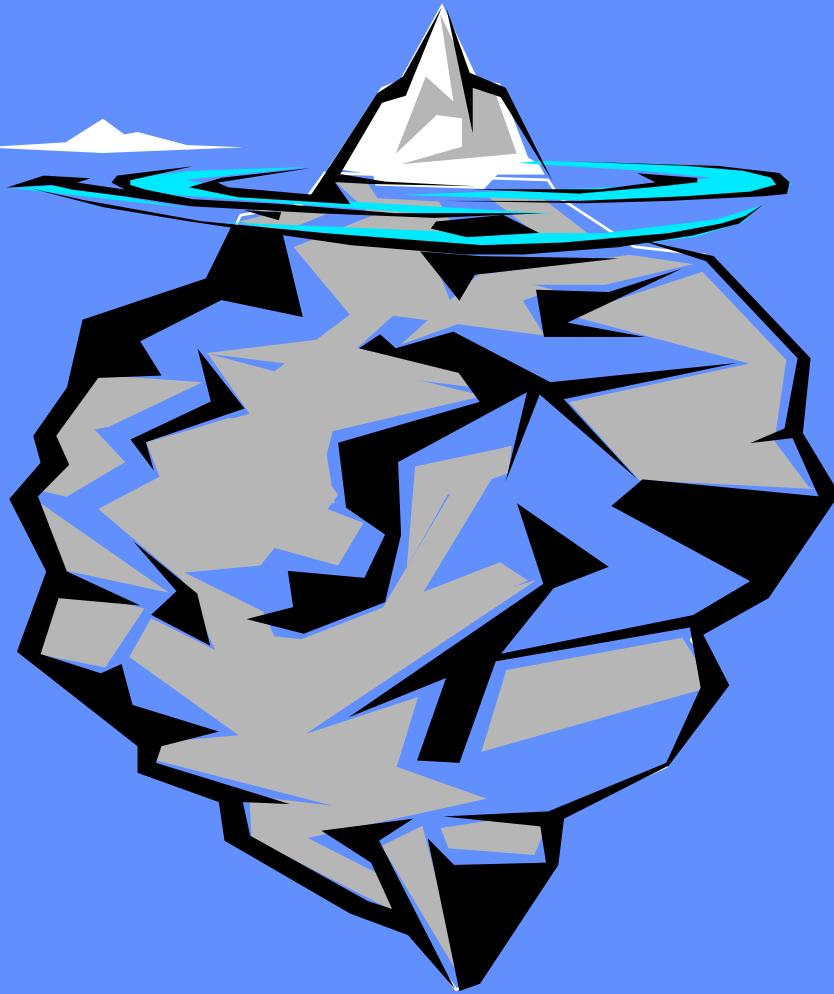
Direct Costs
Compensation
Wages
Medical

Indirect Costs
Investigation by supervision

Internal claim management

Cost of breaking in new Worker

Loss of a particular skill set or knowledge base

Lower Productivity

Lower morale amongst others

# RM101 Key Concept
## *Cost of Risk*

# Retained Losses + Transfer Costs + Admin Costs + Loss Control

Expressed as $ per $100 payroll, values at risk, employees, % of revenue, work hours, population, miles driven, etc.

### Transfer Cost Examples:

- Workers' Comp Insurance - $ per $100 payroll

- Property Insurance - $ per $100 of Values at Risk

- Transit Liability Insurance - $ per Revenue Mile

*+ admin, deductible, loss control and indirect costs!*

# Risk Management Value at Different Levels of Organization
## *Talk their language!*

Improved **Strategic** Management (CEO)

- Better choices of what is to be accomplished
- **Greater ability to achieve** *realistic* **goals**


Improved **Financial** Management (CFO)

- Better financial control
- Lower cost of risk - premiums and losses
- **Better allocation of scarce resources**
- Better informed decision making

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# Risk Management Value at *Different Levels of Organization*

## Improved **Operational** Management (COO)

- Better delivery of services
- **Less time spent dealing with loss consequences**
- **More systematic approach to addressing competing demands**
- Improved health & safety and condition of property & equipment
- Improved **control of risks of contracted work**

# Risk Management & Its Value

Bottom Line Reason to Implement Risk
Management:

**TO SAVE MONEY!**

Need to be able to frame it that way, even if
imprecise, to "sell it".  Don't make it the only
reason or oversell.  Prefer to say:

*A Primary Goal of Risk Management is*

**budget stability through control of the
cost of risk.**

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# *Evolution of Risk Management*
## *A Bit of History*

- Archeologists have found dice made from deer feet and evidence of <u>games of chance dating back to the dawn of man.</u>

- The games were later referred to as **"hazard",** from *al zahr*, the Arabic word for **dice**.

- However, it was not until 1654 that the odds associated with rolling dice were known, with the *invention of probability*.

- **Without probability there is no "risk management,** so we've only been at this 360 years!

# History of Risk Management
## Resource
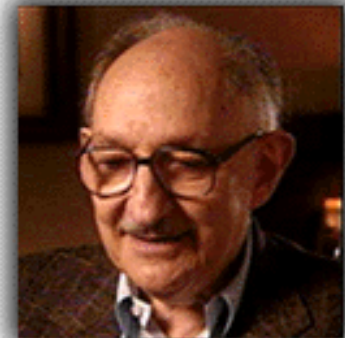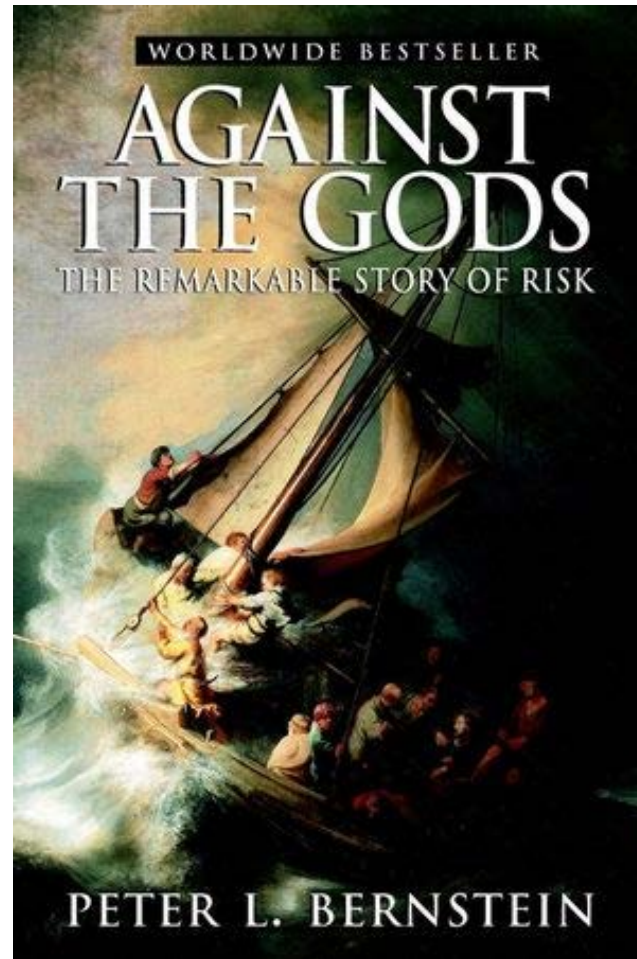
# Evolution of Risk Management

- Began With <u>Insurable Risks</u> - accidental loss.  Limited to **<u>Pure Risk</u>**: loss or no loss.
  - v. **<u>Speculative Risk</u>** – add possibility of *gain.*
- Over time has grown, with *definition of risk expanding and organizations taking on more risk themselves*
  - Expanded Scope of Risk Control
  - Further Expansion & Recognition of R.M.
  - Greater assumption of insurer functions, *especially financing* – <u>Alternative Risk Transfer</u>: captives, pools, Risk Retention Groups, etc.

# Evolution of Risk Management

## Traditional RM

- **Risk as individual hazards**
- Risk ID & Assessment
- Focus on all risks
- Risk mitigation
- Risk limits
- **Risks with no owners**
- Haphazard risk quantification
- Risk is not my responsibility
- **Top-down communication within silos**

## Enterprise RM

- Risk in the context of business strategy
- Risk "portfolio" development
- **Focus on critical risks**
- Risk optimization
- Risk strategy
- Defined risk responsibilities
- Monitoring & measuring
- **Risk is everyone's responsibility**
- **Communication across functional lines**

# *Evolution of Risk Management* Enterprise Risk Management
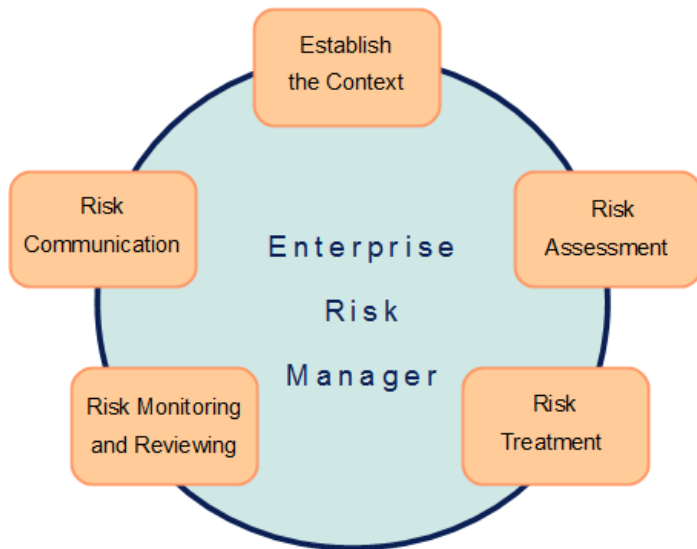


- **Goal is to balance risk/reward tradeoffs *across the entire organization***
  - **To do so, must aggregate information**

- Build risk thinking and accountability into the organization, *closer to the transaction,* and to *prioritize responses to risk,* making **wiser decisions regarding allocation of scarce resources**
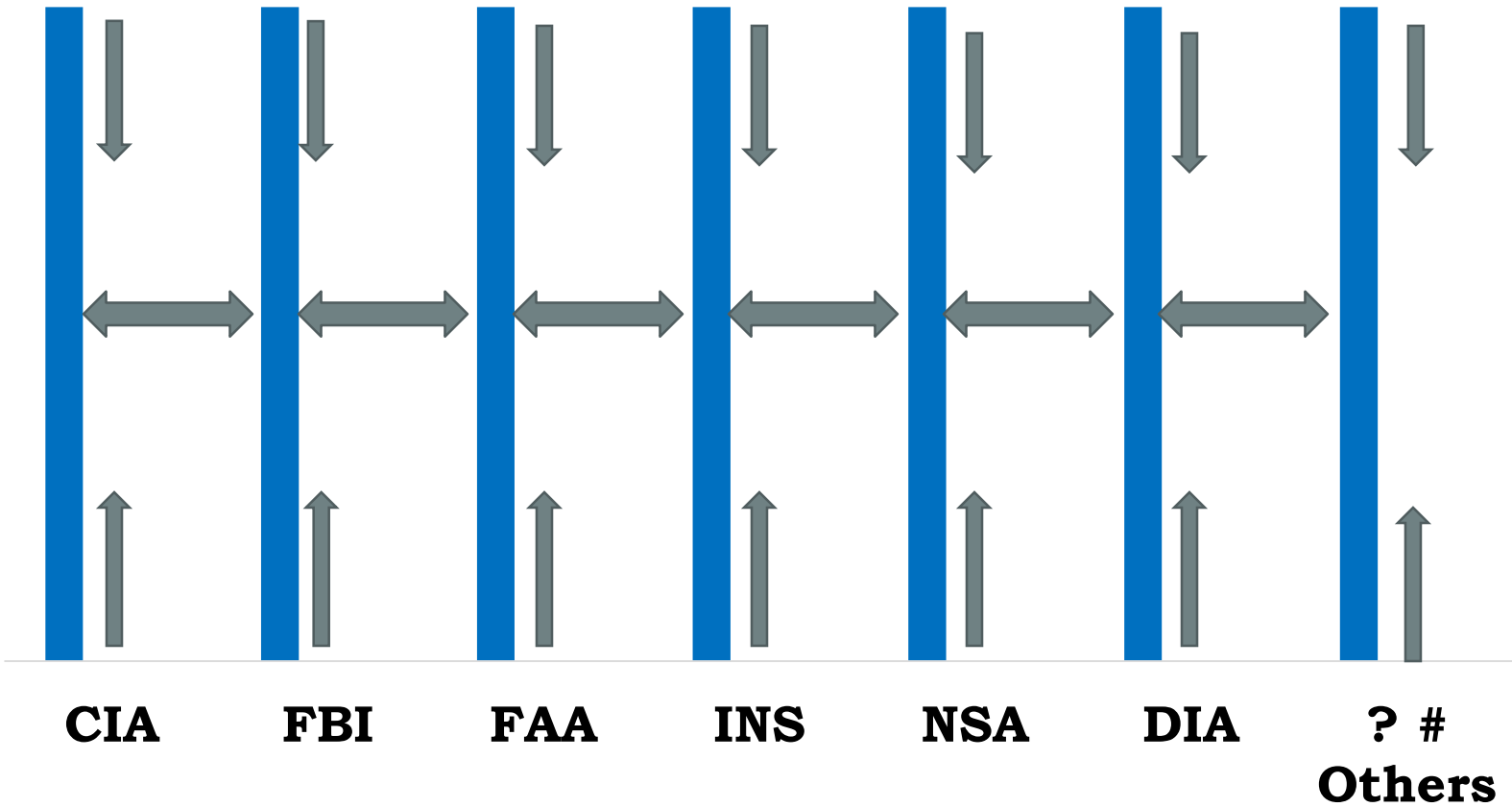
# Enterprise RM Case Study – 9/11

- **Traditional "silo" approach** to risk –pre 9/11
- Enterprise Risk Management Model – post 9/11
  - Break Down the Silos!
  - Communicate across, up & down
  - Aggregate & act on information
- Lessons learned
  - Insurance Industry
  - Government
- Is it working?
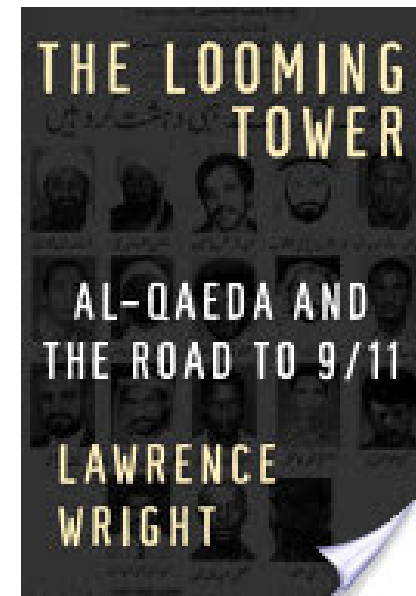
# Why Implement Enterprise RM?
## <span style="color:red">CFO</span> Research Services Study

- 38%- Respond Better to Full Range of Risks
  - **Avoid being too myopic/narrow** & miss something in planning or execution that <u>could prove catastrophic</u>
- 28%- Improve Capital Allocation
  - Risk based capital
  - **Focus scarce resources on best alternatives**
  - <u>Lower overall cost of risk</u>

Sooner or later all organizations are faced with a crisis or galvanizing event that <u>forces them to think across the broader organization</u>. Start preparing for that event *before* it happens, not after.

# *Impediments to Enterprise RM*

- Can't do a Return on Investment (ROI) on ERM.
  - How do you measure the loss that never happens?

- Value proposition hard to quantify in $.
  - Use people, services, health, safety, etc. instead

- You haven't had that crisis - *yet*


"Bold and comprehensive changes are sometimes only possible in the wake of catastrophic events - events which create a new consensus that allows us to transcend old ways of thinking and acting."

- Condoleeza Rice, 9/11 Commission Testimony

# Impediments to Enterprise RM

"It seems to me that people have vast potential. *Most people can do extraordinary things if they have the confidence or take the risks.* Yet most people don't. **They sit in front of the telly and treat life as if it goes on forever."**    - Philip Adams

# Impediments to Enterprise RM



**HUMAN NATURE!**
**We don't want to think about the bad**
**things that could happen**

# *What is Risk?*

**Risk is anything that could prevent you from achieving your goal.**
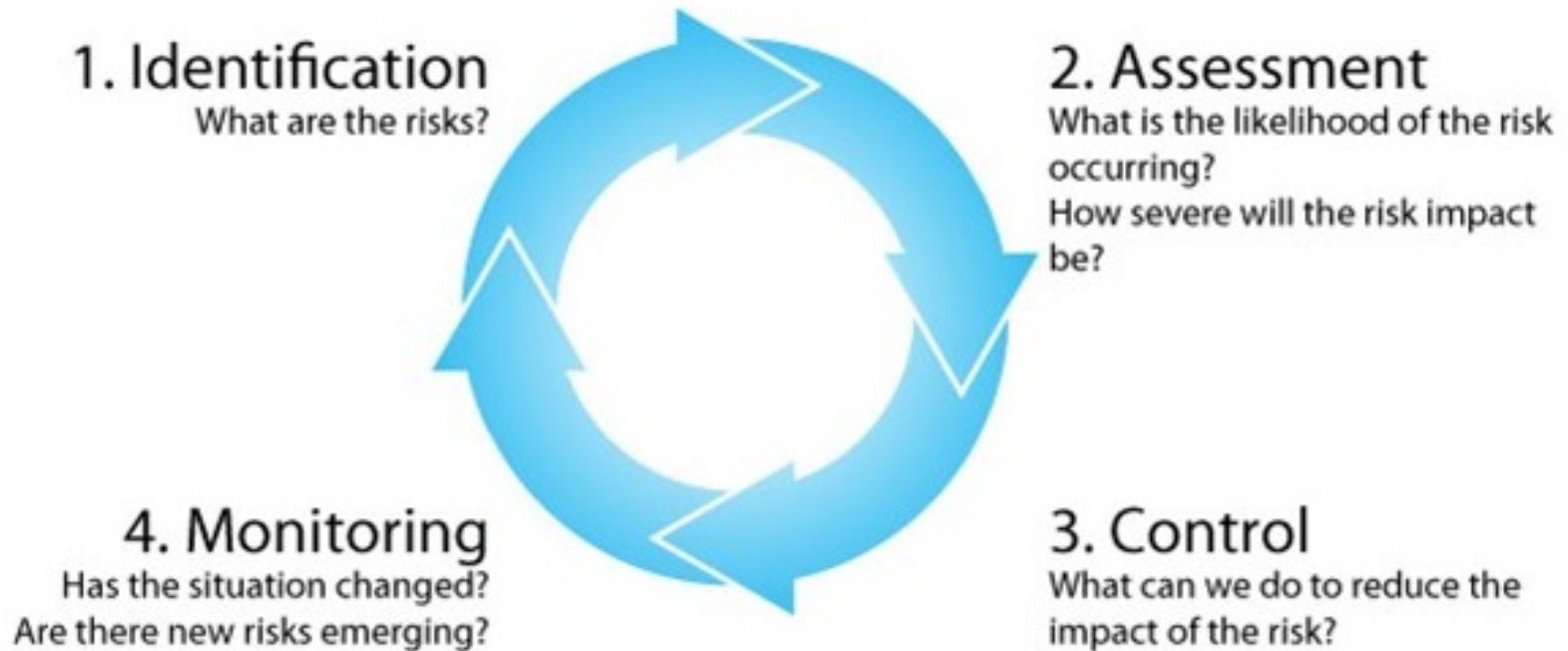
**ISO 3001 Definition**

**The effect of *uncertainty* on objectives**

- Risk is the obstacle that stands between us and a predictable future.

- Thus, risk management means taking steps to improve the chances that our plans, hopes, and actions lead to the intended results!

# *The Risk Management Process*
# *Traditional ARM Steps*

## 1. Identification
What are the risks?

## 2. Assessment
What is the likelihood of the risk occurring?
How severe will the risk impact be?

## 4. Monitoring
Has the situation changed?
Are there new risks emerging?

## 3. Control
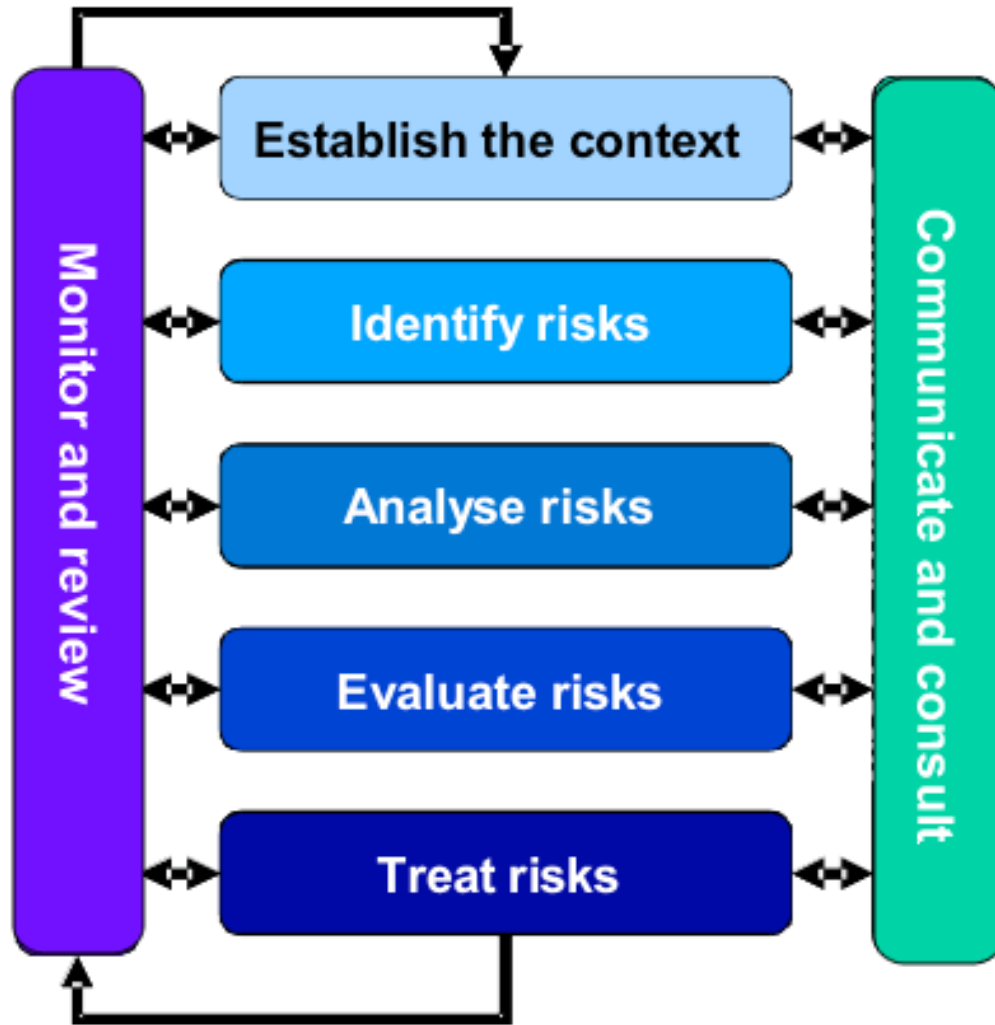What can we do to reduce the impact of the risk?

# What is Risk Management?



- *System* For Making Decisions
- Process v. Product
- **Never Finished**
- Last step is to monitor results and make changes as needed to improve
- **No "cure"** or vaccine to prevent risk

# ISO 3001
# Risk Management Process

# Risk Management Means Asking

- **What can go wrong?**
  - Risk ID & Assessment

- **How do I keep it from going wrong?**
  - Loss Prevention

- **If it does go wrong, how can I fix it?**
  - Loss Reduction
    *OR*

# Where Are The Alligators?



- **How do I keep them from biting me?**
- **If I do get bit, <span style="color:red">how do I stop the bleeding</span>?**

# Identify, Analyze & *Prioritize* Risks

- This is the most important step!
- Requires imagination & insight



If I had an hour to **solve a problem** and my **life depended** on it, I would use the first 55 minutes determining the **proper questions to ask.**

Albert Einstein

coschedule.com
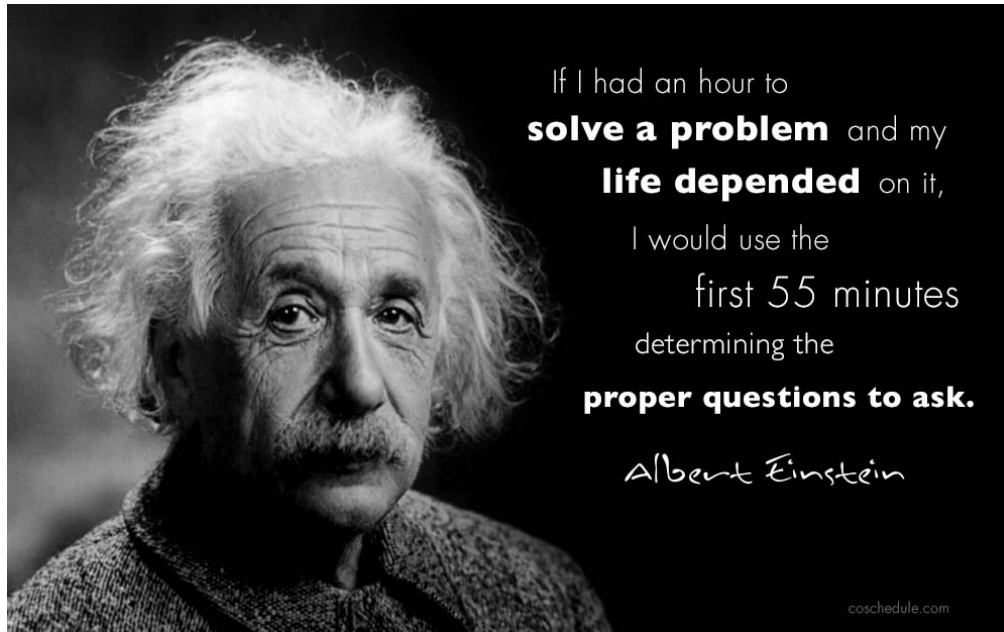
**"Risk comes from not knowing what you're doing."**

- Warren Buffett

# Categories of Risks – "HOFS"

## Operational Risk
Bid Process

Information Transfer

Construction Management

Accounting Process

## Financial Risk
Cost of Capital

Growth Capitalization

Market Risk

Bank & Surety Support

**Four Quadrants of Business Risk**

## Strategic Risk
Customer/Industry Changes

Growth Strategy

Branding/Image

Competition

## Hazard Risk
Employee Injury/Illness/Theft

Third-party Liability

Natural Hazards

Property Loss

# *Categories of Risk - Internal v. External*

## *External*

- **Natural Hazards**
- Financial Markets
- **Legal & Regulatory**
- Competition
- **Political**
- **Technology Change**
- Industry
- **Customer & Community**
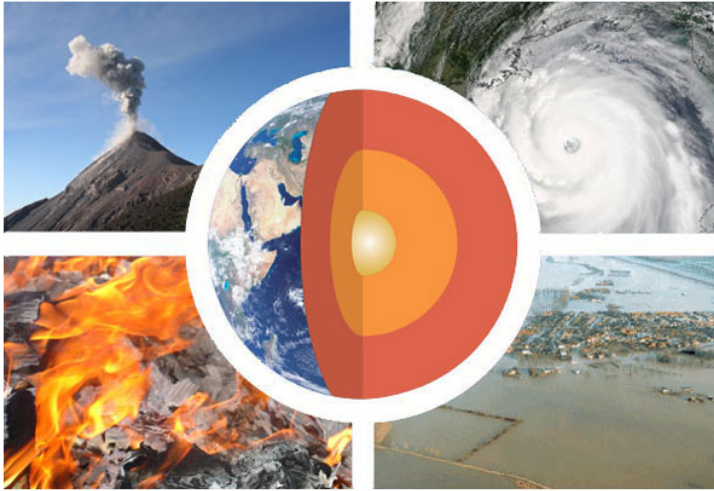
| Top 2013 IT Hot Spots | |
|---|---|
| 1 | Cyber Attacks |
| 2 | Big Data |
| 3 | Data Privacy |
| 4 | Mobile Devices |
| 5 | Cloud Computing |

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# Categories of Risk

# *Identify, Analyze & Prioritize Risks -* <span style="color:red">Methods</span>

- **Face-to-face** (internal experts)
- On-site inspections and audits
- **Claim history/loss runs**
- Historical Information
- **Financial Statements**
- Questionnaires & Surveys
- Charting/Graphing - **Risk Maps/Matrix**
- Outside Experts

# *To Identify Risks - Be Curious!*

## Ask Common-sense questions, like:

- What could go wrong?

- What must go right for us to succeed?

- What resources do we **need to protect** (physical, information, human)?

- ***How do we know whether we are achieving our objective?***

- What decisions are most important?

- On what information do we most rely?

- What are your goals for the next five years?

- What events affected your stability in the past?

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# To Identify Risks - Be Curious!

- How could someone **steal** from us **or disrupt** our operations?

- On what do we **spend the most money**?

- What decisions require the most judgement?

- What activities are **regulated?**

- What activities are **most complex**?

- What is our greatest legal exposure?

- What changes could you make to improve?

- *What keeps you up at night?*

# Top 10 Business Risks 2016
## Source: Allianz Global Corporate & Specialty

| | | | 2015 Rank |
|---|---|---|---|
| **1** | **Business interruption** (incl. supply chain disruption) | 58% | 1 (55%) |
| **2** | **Cyber incidents (cyber crime, data breaches, IT failures)** | 46% | 4 (25%) |
| **3** | **Natural catastrophes (storm, flood, earthquake)** | 37% | 2 (35%) |
| **4** | Market developments (volatility, intensified competition, market stagnation) | 35% | NEW |
| **5** | **Changes in legislation and regulation** (economic sanctions, protectionism) | 28% | 5 (17%) |
| **6** | Fire, explosion | 25% | 3 (27%) |
| **6** | **Loss of reputation or brand value** | 25% | 6 (16%) |
| **8** | Macroeconomic developments (austerity programs, commodity price increase, inflation/deflation) | 20% | NEW |
| **9** | **Theft, fraud, corruption** | 20% | NEW |
| **10** | Human error | 14% | NEW |

# *Prioritize* **Risks**

**#**

How Many?

**$**

How Much?

**?**

How Certain?

**!**

How Critical?

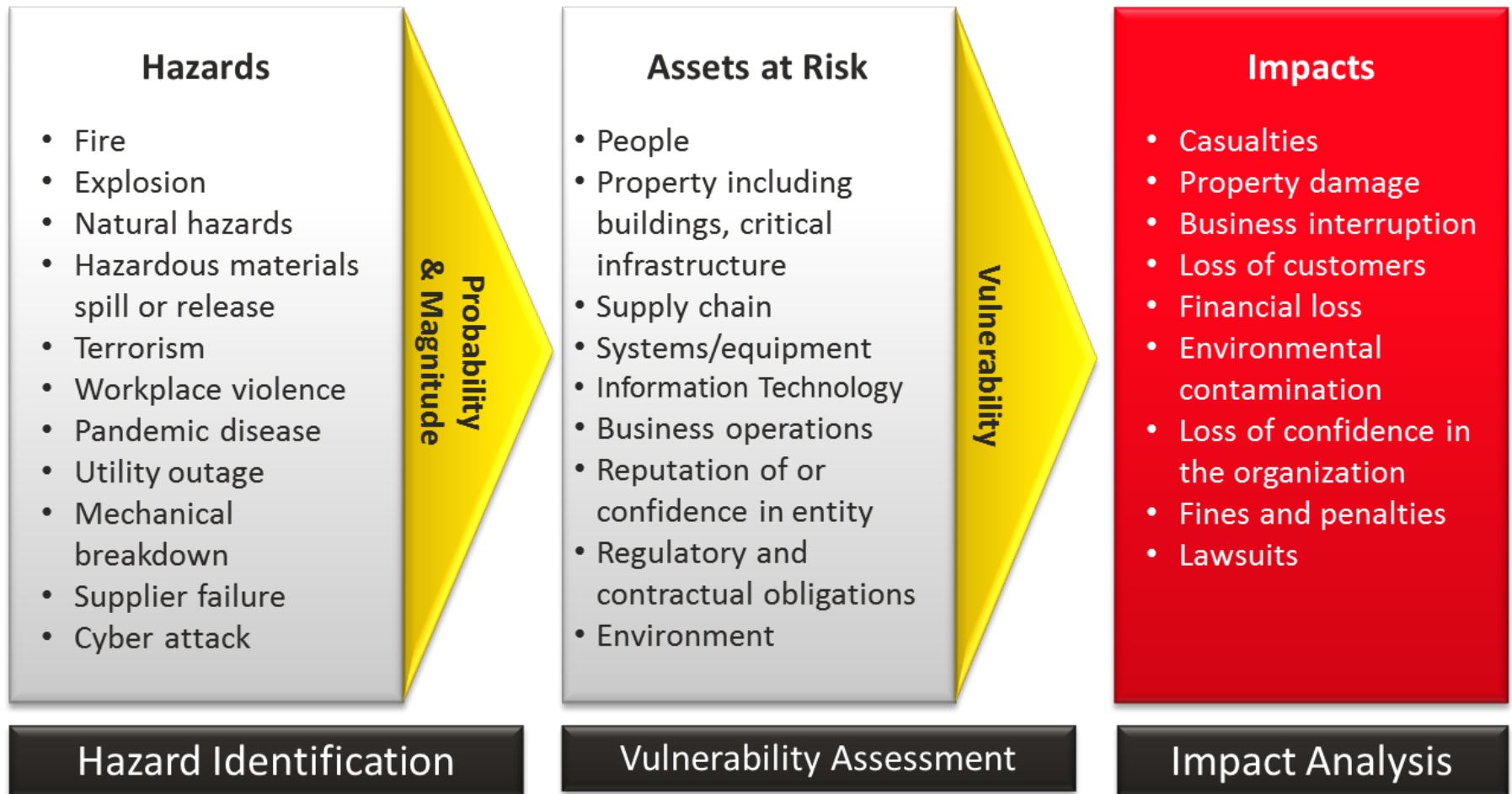Establish a means to ***estimate the likely significance*** of those possible losses

Increased significance means actual losses become:

- More **frequent** – "how often/many?"
- More **severe** – "how much?"
- Less predictable - **"how certain**?",
 or
- Interfere more with objectives - **"how critical**?"

# Components of All Loss Exposures

- **Value** exposed to loss - assets, people
- **Peril** causing/threatening loss
  - <u>Natural</u>:  Fire, flood, earthquake, molds, subsidence, wind, etc.
  - <u>Human</u>:  Arson, assault, negligence, fraud, riot, theft, etc.
  - <u>Economic</u>:  strikes, stock market, budget impasses, interest rates
- **Consequences** of the loss:

  <u>Financial</u>, <u>operational</u> & <u>political</u>, *not necessarily proportionate to physical loss*
  - Cost of repair
  - Loss of sales or rental income
  - Hard drive or network crash
  - Resignation of key manager, or
  - Negative media attention

# Peril – Value - Consequences

## Hazards

- Fire
- Explosion
- Natural hazards
- Hazardous materials spill or release
- Terrorism
- Workplace violence
- Pandemic disease
- Utility outage
- Mechanical breakdown
- Supplier failure
- Cyber attack

**Probability & Magnitude**

## Assets at Risk

- People
- Property including buildings, critical infrastructure
- Supply chain
- Systems/equipment
- Information Technology
- Business operations
- Reputation of or confidence in entity
- Regulatory and contractual obligations
- Environment

**Vulnerability**

## Impacts

- Casualties
- Property damage
- Business interruption
- Loss of customers
- Financial loss
- Environmental contamination
- Loss of confidence in the organization
- Fines and penalties
- Lawsuits

**Hazard Identification**

**Vulnerability Assessment**

**Impact Analysis**

# Prioritizing Risks
## Key Concept - Risk Mapping

## What's it all about?

- **FREQUENCY**
  - "How Often?"

### AND

- **Severity**
  - "How Much?"

*Plot the results using a Prouty Approach Diagram, also called a Risk Matrix or Risk Map*

# Application – Poor Man's ERM

- Gather 5-8 people you consider the best and brightest - senior managers, technical experts, etc.

- Give them one definition of risk – <u>anything that can prevent you from achieving your goals,</u> and ask:

- **What are our top 3 risks?**

  - Emphasis on *critical risks* - things that could severely impact or even end your business.

  - **Analyze and prioritize using a Risk Map (**Risk Matrix or Prouty Approach Diagram)

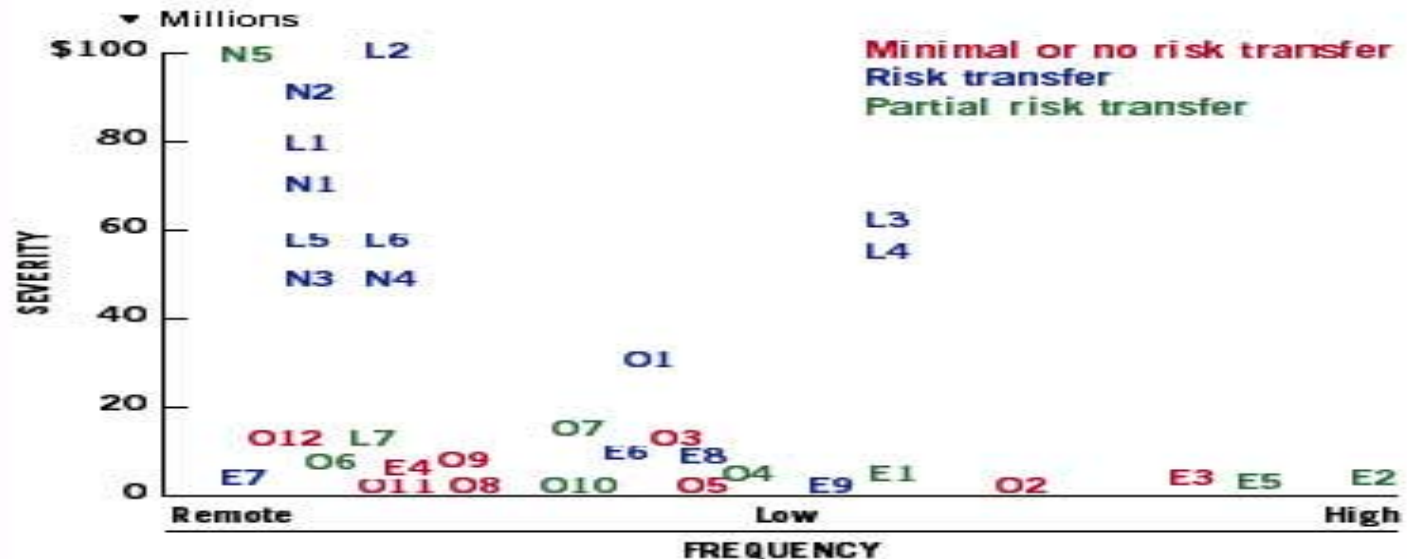  - Take action to prevent or reduce impact

# Risk Mapping and Risk Treatment
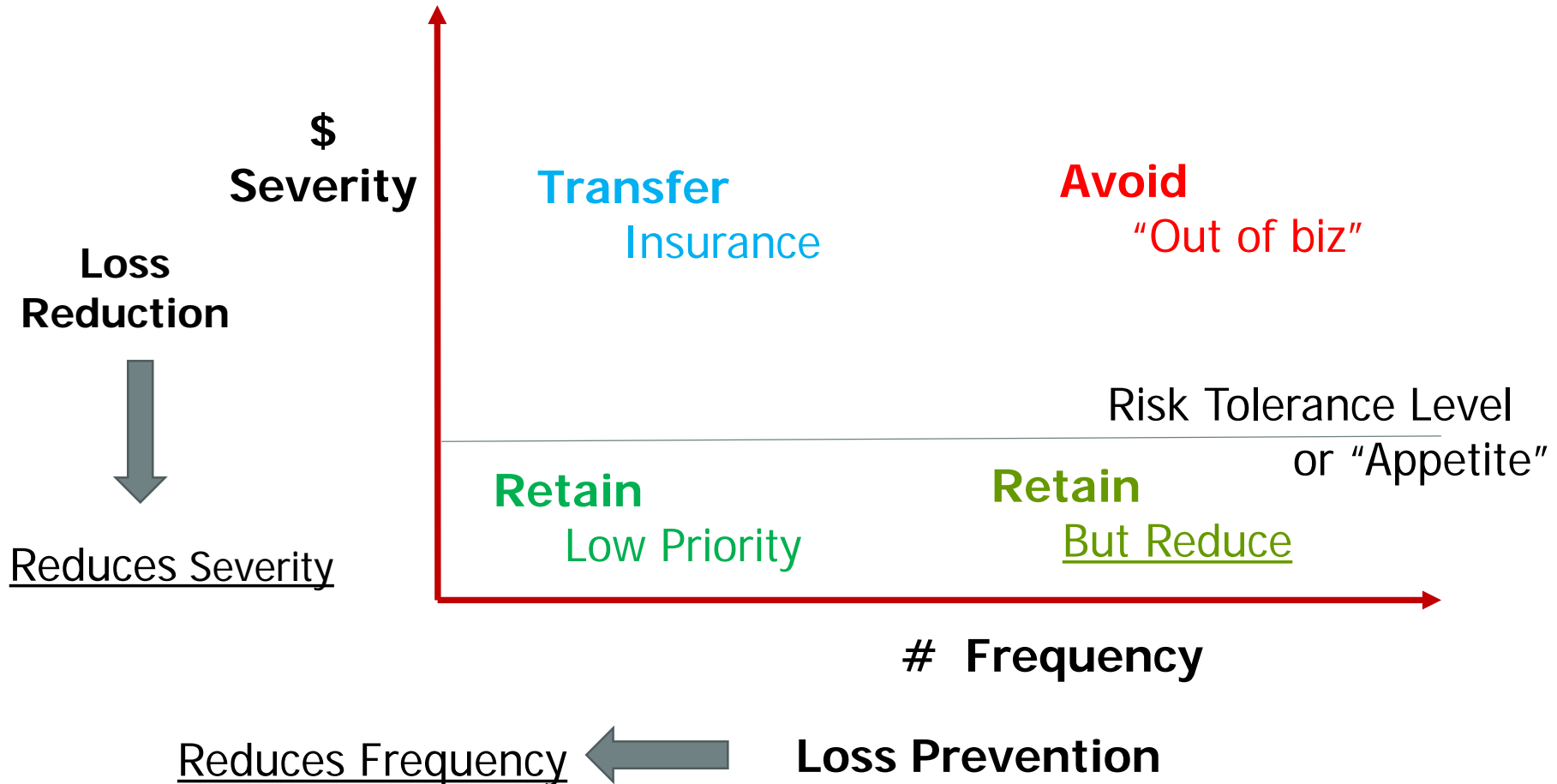
# Risk Map Locations

- **High Frequency & High Severity**
  - Rarely turn up in audit - should already be known and dealt with or you'd be <u>out of business</u>!

- **High frequency & Low Severity**
  - Also should be known & often considered <u>operational risks</u> that should still be addressed with <u>risk control</u>

- **Low Frequency & High Severity**
  - "Catastrophic" risks often treated with <u>emergency plans</u> and <u>insurance</u>, if available

- **Low Frequency & Low Severity**
  - Who cares?  <u>Morale Hazard</u>?  *Lead to More FQ or $?*

# PEABODY'S RISK MATRIX



**Millions**

Severity axis (top to bottom): $100, 80, 60, 40, 20, 0

Legend:
- Minimal or no risk transfer
- Risk transfer
- Partial risk transfer

Frequency axis: Remote — Low — High

Plotted points: N5, L2, N2, L1, N1, L3, L4, L5, L6, N3, N4, O1, O12, L7, O7, O3, O6, E6, E8, E4, O9, E7, O11, O8, O10, O5, O4, E9, E1, O2, E3, E5, E2

## OPERATIONAL—EMPLOYMENT
E1 Employers' liability
E2 Workers' compensation (State)
E3 Federal black lung
E4 Employment-practices liability
E5 Employee benefits
E6 Fiduciary liability
E7 Kidnap & ransom
E8 Employee dishonesty (Crime)
E9 Employee conduct

## OPERATIONAL—LIABILITY
L1 Directors' & officers' liability
L2 Aviation
L3 General liability
L4 Auto liability
L5 Products liability
L6 Marine
L7 Vendor & contractor liability

## OPERATIONAL—NATURAL
N1 Underground property
N2 Surface property
N3 Business income
N4 Contingent business income
N5 Business continuity

## OPERATIONAL—OPERATIONS
O1 Joint-venture operations
O2 Inventory obsolescence
O3 Key supplier
O4 Contractor
O5 Equipment availability
O6 Explosive-material safety
O7 Power interruption
O8 Labor interruption
O9 Geological conditions
O10 Safety
O11 Hazardous material & environmental issues
O12 Technology

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# Risk Rating = Likelihood x Severity



| Severity | | | Likelihood | | | | |
|---|---|---|---|---|---|---|---|
| Catastrophic | 5 | | 5 | 10 | 15 | 20 | 25 |
| Significant | 4 | | 4 | 8 | 12 | 16 | 20 |
| Moderate | 3 | | 3 | 6 | 9 | 12 | 15 |
| Low | 2 | | 2 | 4 | 6 | 8 | 10 |
| Negligible | 1 | | 1 | 2 | 3 | 4 | 5 |
| | | | 1 | 2 | 3 | 4 | 5 |
| | | | Improbable | Remote | Occasional | Probable | Frequent |

**Likelihood**

| | | |
|---|---|---|
| Catastrophic | (red) | STOP |
| Unacceptable | (orange) | URGENT ACTION |
| Undesirable | (yellow) | ACTION |
| Acceptable | (light green) | MONITOR |
| Desirable | (green) | NO ACTION |

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RISK = HAZARD x EXPOSURE



**HAZARD**
Anything that can cause harm
(eg. a chemical, electricity, ladders, etc)

**RISK**
How great the chance that someone will be harmed by the hazard

# What Is Your <span style="color:red">Risk Appetite?</span>

**Risk appetite** is the level of **risk** an organization is prepared to accept. **Risk appetite** constraints are not easy to define; every organization can tolerate different levels of **risk**.

# What is *Your* Appetite For Risk?

- I am going to flip a coin. If it's heads, you will win $1,000.  If tails, you get nothing.

- Your friend says "I'll give you $300 right now to take your chance at $1,000.

- Do you take $300?
  - How about $500?
  - How about $700?

- Are you risk averse, risk neutral, or risk taker?

- What is the "Expected Value" of this transaction?

# Risk Treatment

Now that you've identified risks, what are you going to do about it?

- Systematic consideration of ALL techniques
- <u>Avoid jumping to conclusions</u>
- **Feasibility of costs & benefits**
- Far beyond "insurance" and "safety"

"Be wary of the man who urges an action in which he himself incurs no risk."  - Joaquin Setanti

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# Risk Treatment

- **Avoid**
- Retain (Accept)
- Modify (Reduce)
  - Likelihood &/or
  - Impact
- Transfer
- **Exploit**

# Risk Treatment



**Avoidance** - any measures taken to avoid becoming exposed to a risk or to discontinue an exposure to risk.

This is widely considered the least expensive risk management tool.  (Or is it?)

- Example:  close teen center to avoid crimes

# Risk Treatment – Modify
# Risk Control Techniques

**Loss Prevention** - measures taken to reduce the likelihood, or ***frequency***, of losses.

- Example - **video cameras**

Ideally, these measures would seek to reduce losses to zero, but this is often not possible.

Key question:  How much prevention do we need to undertake?

**What are the _costs and benefits?_**

# Case Study – Ford Pinto



"Safety Doesn't Sell"
– Lee Iacocca

- Foreign Small Car Competition
- No more than 2,000 pounds or $2,000
- 2 yrs v. average 3-4 yrs to produce
- **Design flaws known**
- *Cheaper to accept claims than retool*
  - Cost = $11 per car = <u>$137 million</u>
  - "Benefit" = <u>$49.5 million</u>
    - 180 Burn deaths x $200,000
    - 180 Burn injuries x $67,000
    - 2,100 Burned Cars x $700
  - **Very Poor Cost/Benefit Analysis!**
  - **+ <u>What did they forget to include?</u>**

TRUST

**A Good Name Matters**
Areas of risk management most important to boards (aside from financial risk)

| Area | Percentage |
|------|-----------|
| Reputational risk | 66%* |
| Regulatory compliance risk | 59% |
| IT risk | 54% |
| CEO succession planning | 53% |
| Crisis management | 47% |
| Privacy and data security | 36% |
| Risk due to fraud | 22% |
| Outsourcing risk | 18% |
| Tax strategies | 9% |

0%    20    40    60    80%

*Percentage of survey respondents
Source: EisnerAmper LLP

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# Risk Treatment – Modify Risk Control Techniques

**Loss Reduction** - measures taken to <u>reduce **severity** of losses</u>

**<u>Loss has occurred</u>, reduce its size or extent**

Examples:  alarms, sprinklers, seat belts, <u>emergency plans</u>

- **<u>Pre-Loss</u>** - Design Features, good hiring, training, controls, construction materials
  - **Segregation** – two warehouses miles apart v. one
  - **Duplication** – back up your data!
- **<u>Post loss</u>** - Mitigation response, <u>claims management</u>

*BOTH require pre-loss commitment!*

# Risk Treatment
## *Risk Financing* Techniques



**Risk Retention**:  using <u>your</u> money:

- Passive Risk Retention

- Retention by "oops"

- Deductibles

- Self-Insured Retentions (SIRs)
  - <u>Current expense</u> - good for predictable low impact losses <u>if have good cash flow</u>
  - <u>Funded Reserve</u> - set aside cash or semi-liquid funds to ***pay for expected losses and liabilities***

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# Risk Treatment
## *Risk Financing Techniques*

## **Risk Transfer**

using <u>others'</u> money

- <u>Contractual Risk Transfer</u>
  - Only for specified types of losses, related to the services being performed
  - Reimburse via indemnity provision
  - Pay on behalf of via <u>hold harmless agreement</u>
  - Pay direct via <u>additional insured endorsement</u>
  - Only as good as the person making the promise
  - Organization still ultimately responsible

# Risk Treatment
## *Risk Financing Techniques*



## **Risk Transfer**

using <u>others'</u> money

- <u>Commercial Insurance</u>
  - only for specified losses & only up to policy limits, in exchange for premium
  - insurer can become insolvent
  - coverage disputes
  - read the exclusions!
- Combination:  sharing/pooling money
  - Intergovernmental Pools/JPAs, Mutuals

# Risk Treatment - *Exploit*

- **Hedging** – using futures options to buy or sell your key commodities or limit financial losses

- *Beyond pure risk to speculative risk*, traditionally the province of financial risk management

- If your income is dependent on interest or exchange rates, **weather**, or commodities prices (fuel, food, metals), you can manage your risk through hedging.

- See [www.guaranteedweather.com](www.guaranteedweather.com)

# Risk Treatment

## Uncertainty reduction

All efforts taken to improve knowledge or understanding of risk.



Sometimes the only option available is to reduce our uncertainty
- as some risks cannot be managed.

Achieve "tolerable uncertainty," to extent possible

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# *Select Best Treatment Techniques*


WARNING
INDECISIVE

- Choose "apparent" best techniques
  - Don't wait for perfection
  - Don't limit your options
  - **Risk control *and* risk financing can be used**
  - Another chance to be *creative*

# Select Best Techniques

- Organizational Objectives
  - Appetite for risk
  - Legal constraints (Ordinances, Codes, etc.)
- Technical Considerations/Approach
  - Retentions v. transfers
  - SIR program v. insurance
  - Employees v. outsourcing
- Operational (Practical) Considerations
  - Where to put additional staff
  - Training levels, turn-over, interest
  - Computer and IT support
  - Liability for errors and penalties

# *Select Best Techniques*

**WHAT INFLUENCES DECISIONS?**

Political complexities

Party preferences

Other evidence

Social, religious and cultural norms (acceptablity)

Relative benefit/harms of other options – cost, impact, equity, speed etc...

Ecological impacts

Other actors – lobbyist, activists, media, epistemic communities, stakeholders, funders

Operational practicality

- <u>Managerial Considerations</u>
  - Financial Criteria: time, money, people
  - Morale
  - How soon major retirement or reorganization
  - Support for risk management among Line Managers

- <u>Political Considerations</u>
  - "Turf" issues
  - "Votes" and high profile stakeholders
  - Acceptance of reality v. fantasy
  - Election cycles

# Key Tool - Risk Registers
## Document Risk, Priority & Control

| STRATEGIC OBJECTIVE | RISK EVENT | OUTCOMES | RISK INDICATORS | LIKELIHOOD/ CONSEQUENCES | MANAGEMENT CONTROLS | ACCOUNTABLE MANAGER |
|---|---|---|---|---|---|---|
| Guarantee reliable and competitive supplier-to-manufacturer processes | Interruption of deliveries | Overtime<br><br>Emergency freight<br><br>Quality problems<br><br>Production losses | Critical items report<br><br>Late deliveries<br><br>Incoming defects<br><br>Incorrect component shipments | (risk matrix chart) | Hold daily supply chain meeting with logistics, purchasing, and QA<br><br>Monitor suppliers' tooling to detect deterioration<br><br>Risk mitigation initiative: Upgrade suppliers' tooling<br><br>Risk mitigation initiative: Identify the key supply chain executive at each critical supplier | Mr. O. Manuel, director of manufacturing logistics |

# Risk Communication
# Getting the Message Out

## Gaining Trust is the First Step!

**"People don't care about how much you know,**

**until they know how much you care … about them"**
- Zig Zigler

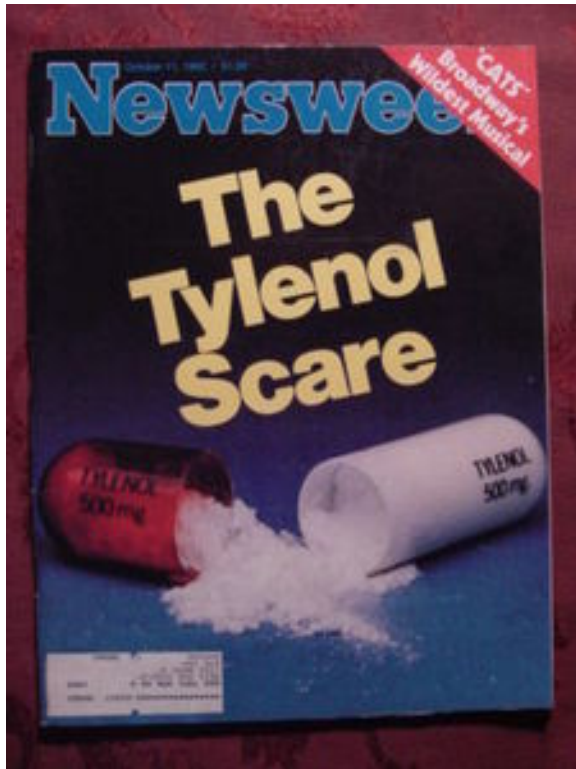### *You have to sell yourself first*

## Must have trust & credibility

"Trust me, I'm a Risk Manager"

# Risk Communication – Need Trust & Credibility.  Key Elements



- Caring/Empathy
- Honesty/Openness
- Commitment/Dedication
- Competence/Expertise

http://www.centerforriskcommunication.com

# Case Study – Tylenol Poisoning

- 1982 – Six deaths in Chicago area
- **Product Tampering** – cyanide
- Nationwide scare
- Copycats followed
- Marketing **experts predicted doom**

# Case Study – Tylenol Poisoning



- Implemented comprehensive response, <u>more than was expected at the time</u>
  - **Total recall**
  - Reintroduced with *new design and safety features*
- What did they recognize as the **key ingredient** of their product?
- What did that **force everyone else to do**?
- Lesson learned – safety first.
  - The beginning of ERM?

# Risk Communication
## Understand The Public's View

RISK

=

+
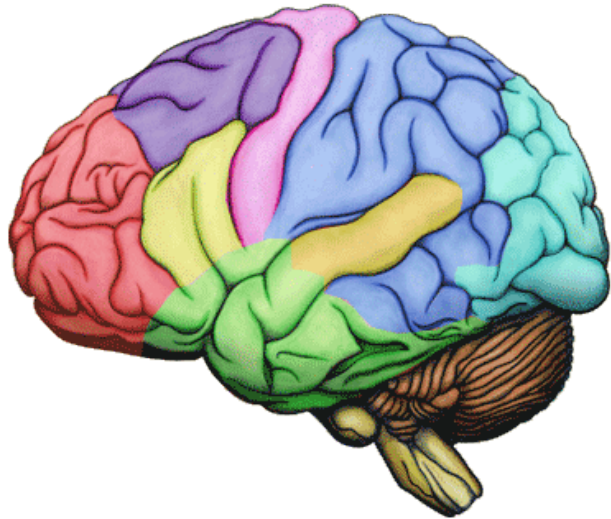
Hazard    +    Outrage

# Risk Management Communication <span style="color:red">Resource</span>

## www.petersandman.com

# Peter Sandman
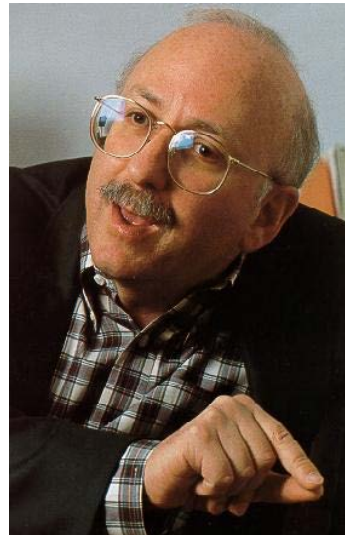


"Risk = Hazard + Outrage"

# Risks Are Overestimated When

- **Coerced** rather than voluntary. (In home gardens, where the risk is voluntary, pesticides are typically overused.)

- **Industrial rather than natural.** (Natural deposits of heavy metals generate far less concern than the same materials in a Superfund site.)

- **Dreaded** rather than not dreaded. (Cancer, radiation, and waste are all powerful stigmata of dread.)

- **Unknowable** rather than knowable. (The experts endlessly debate the risk, and only the experts can detect where it is.)

# Risks Are <span style="color:red">Overestimated</span> When

- **Controlled by others** rather than controlled by those at risk. (Think about the difference between driving a car and riding in an airplane.)

- In the hands of **untrustworthy** rather than trustworthy **sources.** (Who believes what they are told by the nuclear, waste, and pesticide industries?)

- Managed in ways that are **unresponsive** rather than responsive. (Think about secrecy vs. openness, courtesy vs. discourtesy, compassion vs. contempt.)

# Outrage Components

## "Safe" - Underestimate

1. Voluntary
2. **Natural**
3. Familiar
4. Not memorable
5. **Not dreaded**
6. Chronic
7. Knowable
8. **Individually controlled**
9. Fair
10. Morally irrelevant
11. **Trustworthy sources**
12. Responsive process

## "Risky" - Overestimate

1. Coerced
2. **Industrial**
3. Exotic
4. Memorable
5. **Dreaded**
6. Catastrophic
7. Unknowable
8. **Controlled by others**
9. Unfair
10. Morally relevant
11. **Untrustworthy sources**
12. Unresponsive process

# Public's Risk Response to Risk



|  | **Hazard** *Objective Risk* | | |
|---|---|---|---|
|  | **High** | **Low** | |
| **High** | *Crisis RM* | Overreact | **Outrage** *Subjective Risk* |
| **Low** | Underreact | Who Cares? | |

# Risk Management Communication

**Overreact?**
## Don't Worry

**Underreact?**
## Watch Out!





**Apathy**     **Interest**     **Advocacy**     **Outrage**

# Risk Management Communication
## Matrix



"Calm Down"

"We'll get through this"

Outrage Manage-ment

Crisis Commun-ication

Pre-caution Advocacy

"Watch Out"

"What do you think?"

OUTRAGE

HAZARD

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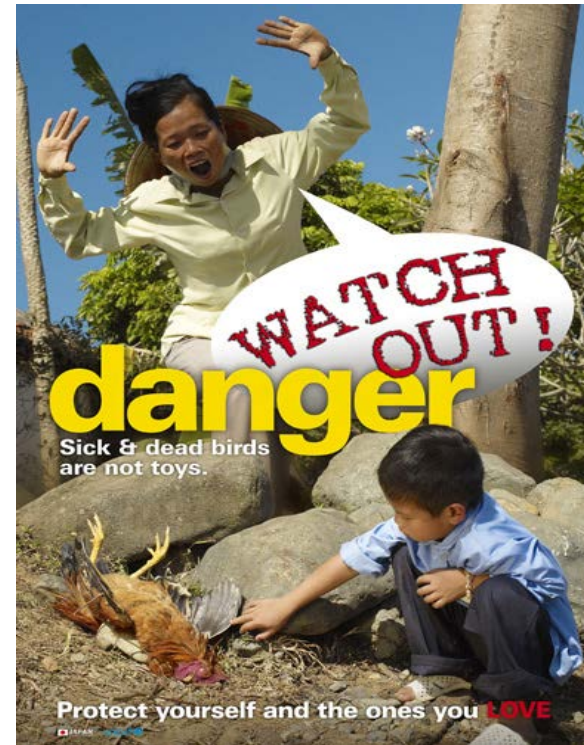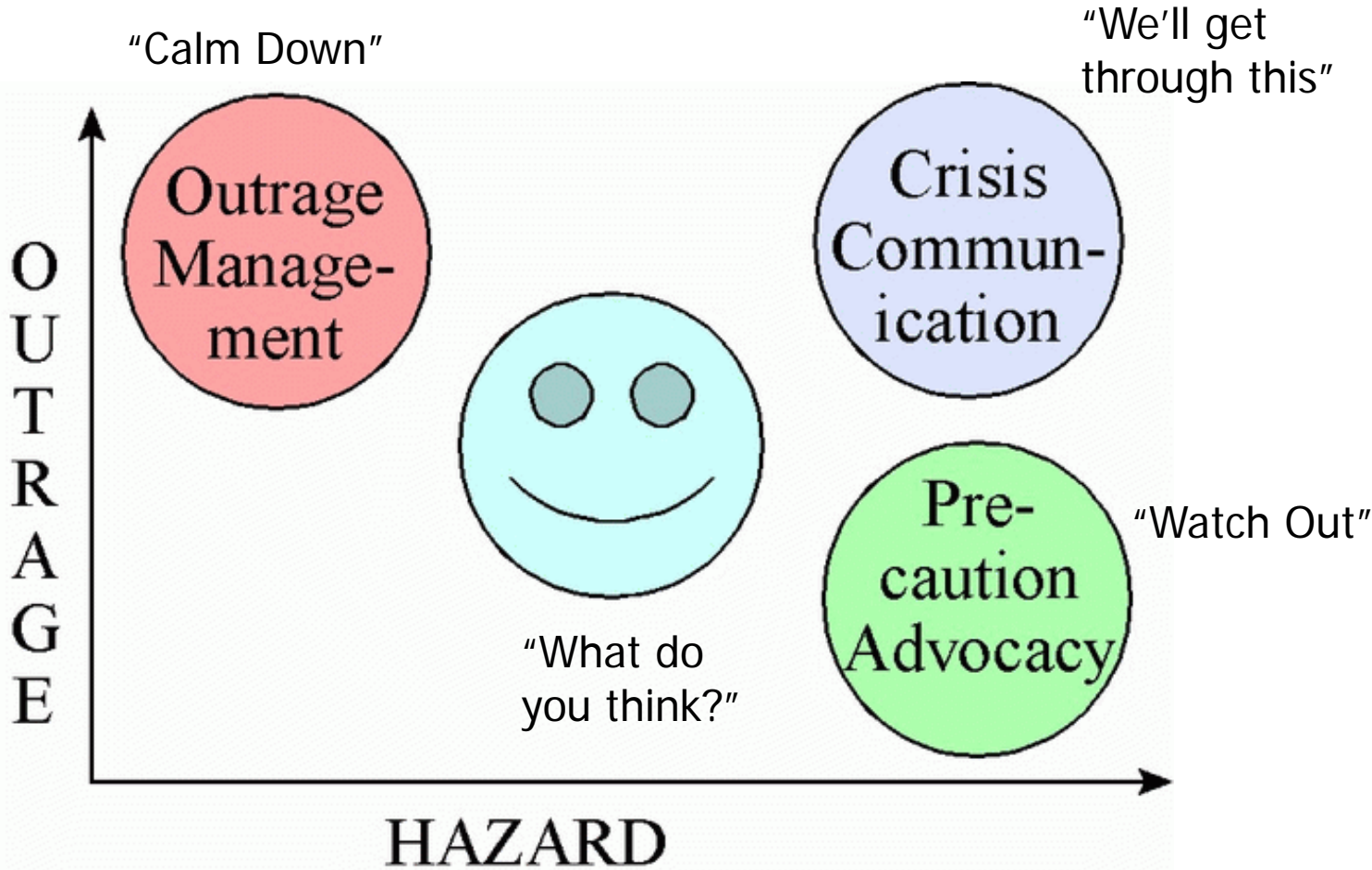
# Reducing Outrage

- Stake out the middle, not the extreme
- Acknowledge prior misbehavior
- Acknowledge current problems
- Discuss achievements with humility
- Share control & be accountable
- Pay attention to unvoiced concerns and underlying motives

# Risk Communication Guidelines

**REAL RISK**

EXPERTS → REASSURING FIGURES

↓

**MASS MEDIA**

PUBLIC OPINION → ALARMING HEADLINES

↓

**PERCEIVED RISK**
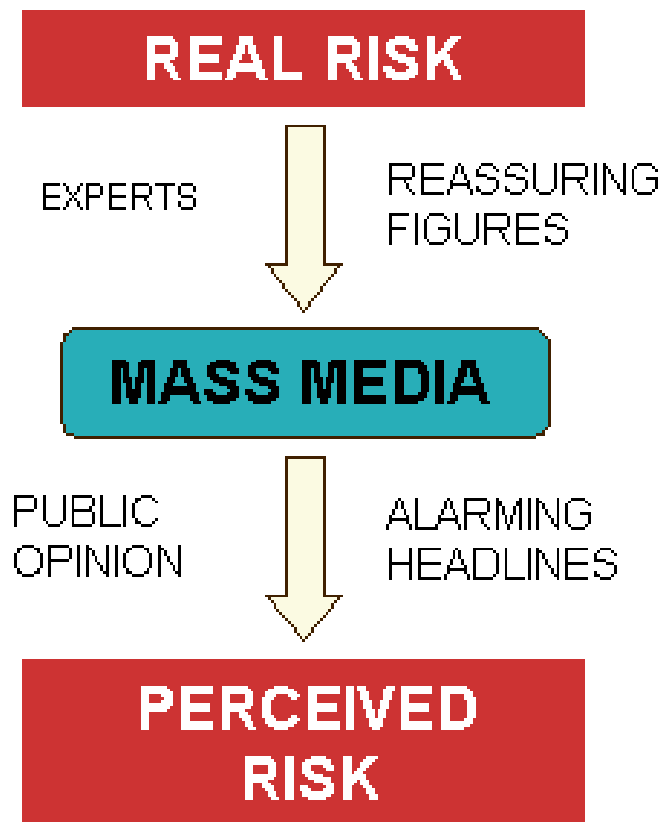
- **Don't keep secrets.** Be honest, forthright, and prompt in providing risk information to affected publics.

- **Listen to people's concerns.** Don't assume you know what they are, and don't assume it doesn't matter what they are.

- **Share power.** Set up community advisory boards and other vehicles for *giving affected communities increased <u>control</u> over the risk.*

# Risk Communication Guidelines

- **Don't expect to be trusted.** Instead of trust, aim at accountability; prepare to be challenged, and be able to prove your claims.

- **Acknowledge errors,** whether technical or nontechnical. Apologize. Promise to do better. Keep the promise.

- **Treat adversaries with respect** (even when they are disrespectful). If they force an improvement, give them the credit rather than claiming it yourself.

# "Selling" Risk Management Any "Takers"?

Excessively Dangerous Thing Don't even think about it!

Big Scary Laser Do not look Into beam with remaining eye

Flammability

Health

Reactivity

Special

POISON HELP! 1-800-222-1222

# Selling Risk Management

- No one wants to "buy"!

- People want to assume everything will be OK

- Ask questions to ID the risk

- Often the answer presents itself

- <u>The best solution is the one you helped them to create, not one you imposed or "sold"</u>

- **Your job is to get others to start asking the questions on their own**

# Implementing RM
# Resource v. Roadblock

**How do others see your role?**

**Are you a resource?**    **Or a "roadblock?"**

**Do you listen, ask questions, and make suggestions, or tell them why they can't do that?**

# Implementing RM
# Resource v. roadblock

- If you are a resource, **people will seek you out**
  - Is your phone ringing?
  - Get invited to the meeting?
- If you are a roadblock, **people will find a way around you**
  - "Here Comes Mr. No"
  - Do people turn around in the hall when they see you?

Telling people they are wrong doesn't work, no matter who it is or what the situation.

**"Find a way to say yes"**

# *Monitor Results & Improve*

- Include in up-front planning

- Make everyone responsible for results and improvement

- <u>Activity</u> measures – "4 trainings this year"

- <u>Results</u> measures – "reduce claims by 10%"

- **Comparison with standards, benchmarking**

- Bottom-line, dollar measures

- **Even if subjective or imprecise - measure it!**

- If you keep getting poor results change your approach!

- <u>Reassess risks and start all over</u>

# Monitor Results & Improve
# Key Risk Indicators (KRIs)

KRIs provide an early signal of increasing **risk** exposures in various areas of the enterprise.

- **Deferred maintenance**
- High volume of complaints
- **Poor technical experience in key areas**
- No regular communication with customers
- **Lack of training**
- No process for root-cause analysis
- **Poor record keeping**
- Lack of defined service standards
- **Lack of contracted services oversight**

# Monitor Results & Improve
## Key Performance Indicators (KPIs)

KPI - A quantifiable measure used to evaluate the success in meeting objectives for performance.

| SMART Goals | |
|---|---|
| **S** | **SPECIFIC and Clear**<br>• What exactly should be realised? |
| **M** | **MEASURABLE**<br>• How will we measure this? |
| **A** | **ACHIEVABLE**<br>• Is it feasible?<br>• Do we have control/infulence over it? |
| **R** | **RELEVANT & RECORDED**<br>• Is this goal recorded and relevant to my life or business right now? |
| **T** | **TIME-BOUND**<br>• What is a realistic timeframe? |

- Employee turnover rate
- Frequency and/or severity of claims
- Loss Ratio
- Customer Satisfaction Surveys
- Cost of Risk
- Audit Results
- Actual to Budget Percentage
- Trainings Completed

# Monitoring Results
# Management Dashboards
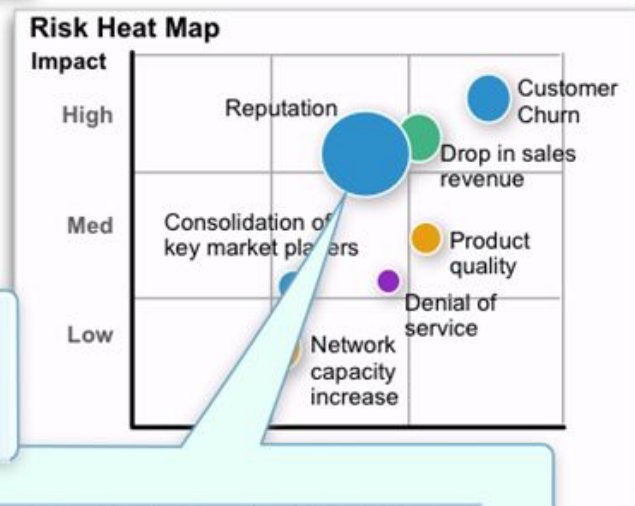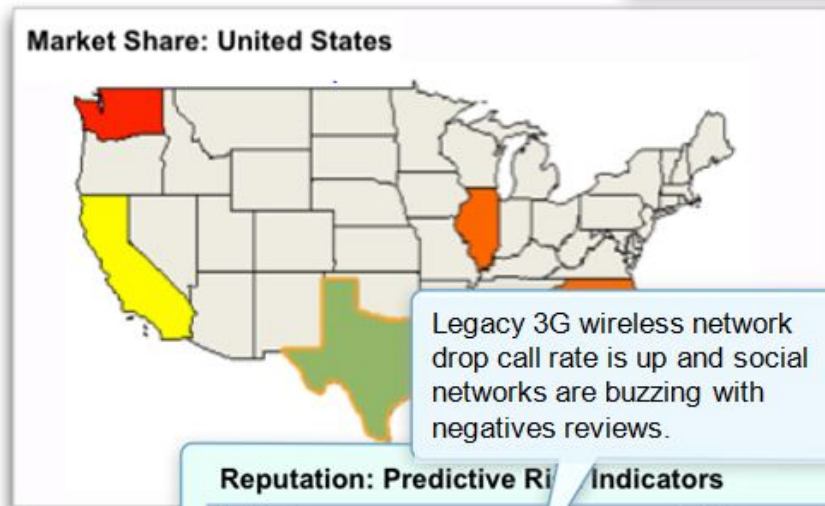
# Making Risk Management Work For Your Organization

Integrating risk management into your organization involves a collection of activities that can be categorized as:

- Necessary-to-do activities

- Nice-to-do activities

It's important to *emphasize that in many ways you are already practicing risk management*, you're just **putting some structure and thought into managing the risks you face every day.**

# *Making Risk Management Work For Your Organization*

Necessary-to-do activities

Create a **Risk Management Framework**

- Establish a **Risk Management Policy** Statement
- This is the authorizing document and blueprint for risk management activities.

**MUST have support from the top!**

# *Making Risk Management Work For Your Organization*

## Necessary-to-do activities

- Assign responsibility for risk management activities to one person, an existing committee, or, if possible, **create a risk management committee.** This <u>person or group</u> translates the policy statement into action.

- *You have OSHA on your side* – all organizations must have an **Injury and Illness Prevention Program (IIPP)**.

It's the <u>first thing OSHA will ask for</u> if you are ever audited or investigated.

# *Making Risk Management Work For Your Organization*

## Necessary-to-do activities

- The person or committee responsible for risk management activities must:

    - Take responsibility for procuring insurance or pooling services

    - Confirm that the organization is in compliance with safety requirements and other legal standards

    - **Take responsibility for emergency preparedness planning**

# Making Risk Management Work For Your Organization

The responsible person or group would be advised to:

- Establish **Operational Best Practices**

- Review all contracts, purchases and proposals for risks

- Develop safety training programs

- Establish claims and accident reporting procedures

- Provide rewards and incentives for employees

# Making Risk Management Work For Your Organization

## Nice-to-do activities

Additional activities could include:

- Creation of a risk management manual

- Production of **annual performance reports**

- Public forums and community safety programs

- Periodic risk audits

**Set goals & tell them how you're doing!**

# *For More Information*

- Professional Public Entity RM organizations
  - PARMA, PRIMA, CAJPA, AGRiP

- Governmental Entities: FEMA, OSHA, DIR
  - https://erm.ncsu.edu/library/article/US-Government-RM

- Insurance Educational Association: www.ieatraining.com

- The Institutes: https://www.theinstitutes.org/

- ISO 3001 Risk Management
  - http://www.iso.org/iso/home/standards/iso31000.htm

- International Risk Management Institute (IRMI)
  https://www.irmi.com/

- RIMS – Risk and Insurance Management Society: www.rims.org
  - Managing Risks in Government:
    www.rims.org/resources/ERM/Documents/Risk%20in%20Government.pdf

# Summary
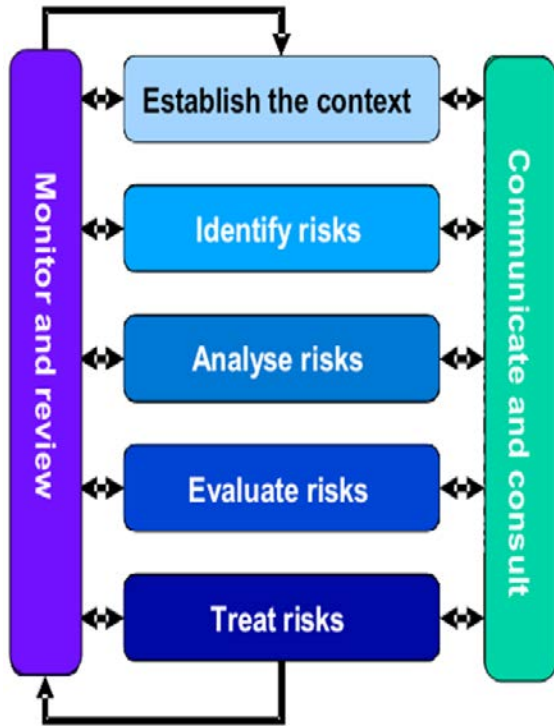


- Risk Management is GOOD Management
- Demonstrate value
- Get support from the top
- Integrate the process into current procedures
- ID, Assess & Prioritize Risks
- Take action to treat risks
- Monitor & improve
- Understand your audience's view of risk
- Be a trusted resource!

# Questions or Comments?

## THANK YOU!

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