



# **ADVISEN STUDY:** The Current State of Property Risk Management and Best Practices

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## ADVISEN STUDY

# The Current State of Property Risk Management and Best Practices



## Executive Summary

Recent natural disasters such as the Tohoku earthquake and tsunami, Thailand floods and Super-storm Sandy, as well as the catastrophic fertilizer plant explosion in Texas, have brought renewed focus to the art of property risk management. Factors including heightened terrorism risk, risks associated with an increasingly interdependent global economy and an apparent escalation in major catastrophes has led many organizations to rethink how they are protecting their assets both at home and abroad. While the effectiveness of an organization's property risk management strategy can only be determined by how it performs in the face of catastrophes and other major property events, adherence to best practices can help assure that losses will be contained and the organization will remain functional after a catastrophic occurrence.

Property-related exposures are continuously evolving and therefore require a risk management approach that is both creative and flexible. The question for many is how to accomplish this. While every organization is unique, understanding what other leading risk managers are doing can provide valuable insights when deciding how best to allocate risk management resources. It is with this in mind that Advisen, in partnership with XL, produced this study. The purpose is to develop a profile of the current state of property risk management and provide the risk management community with a set of best practices that reflect the trends that are reshaping this domain.

In order to determine the current state of property risk management and to ascertain best practices in managing property risks, Advisen surveyed property brokers and a broad cross section of risk managers representing firms of varying sizes and industries, and interviewed risk managers identified by brokers and others as being superior property risk managers.

## Key Findings:

### **Current State of Property Risk Management**

- Certain practices vary materially by industry and size of company. For example:
  - Risk management departments of large companies (>\$1 billion revenue) are more likely to:
    - Be involved in decisions about building and acquiring facilities.
    - Play a role in managing supply chain risks.
    - Purchase terrorism insurance coverage.
- Other practices that might be expected to vary by size of company showed no material differences between large and small companies. For example, size of company is not correlated to whether the risk management department has a property specialist, nor does it have a clear impact on whether or not a company has a safety engineering department or similar function.
- Most companies have a partially or fully implemented enterprise risk management (ERM) program, of which the majority encompass property risks. Perhaps surprisingly, though, a large minority of companies that claim to have an ERM program do not include property risks in it.



*Most respondents classified themselves as chief risk managers/head of risk management department*

- Outside property risk management consultants are utilized at least occasionally by exactly half of the surveyed risk managers.
- The vast majority of organizations with one or more captives do not use them to manage their property risks.
- Risk management departments are involved in emergency preparedness planning as concerns protecting property in most companies.
- The vast majority of risk managers with assets in cat-exposed regions utilize catastrophe models to assess their exposures.
- Aside from purchasing insurance, the risk management department does not play a role in managing supply chain risks for the vast majority of organizations.
- Most organizations have not implemented a terrorism risk management program, but most do purchase terrorism insurance coverage

### **Best Practices**

Surveyed property brokers and interviewed risk managers identified the following as attributes of best-in-class property risk managers:

- Have a thorough understanding of the company and its exposures.
- Have procedures in place to thoroughly and accurately track changing exposures.
- Have a solid grounding in the forces driving the property market.
- Have a good understanding of insurance products and of the property insurance market, and how the various pieces, including self-insurance and contractual risk transfer, fit together to optimally structure a property program.
- Are relationship-oriented and insistent on working with the best brokers and underwriters.
- Understand underwriting criteria and underwriting perspective.
- Work with senior management to align risk management with corporate objectives.
- Have an emphasis on business continuity.
- Are adaptable and creative, organized and detail oriented, and proactive.

## **Respondent Demographics**

### **The Risk Manager Survey**

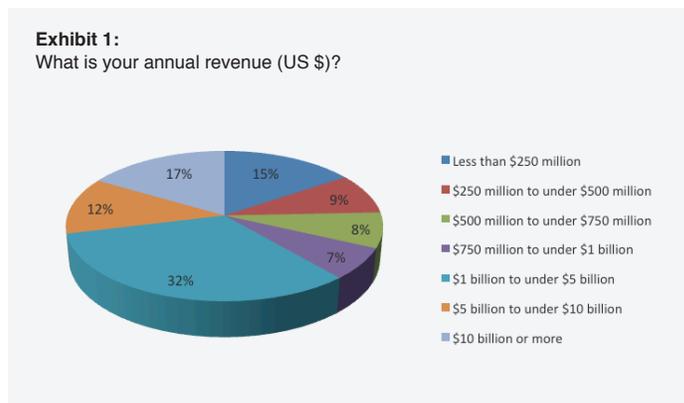
The survey was conducted for one week, beginning May 2, 2013 and ending May 9, 2013. Invitations to participate were distributed by email to 7440 risk managers, insurance buyers and other risk professionals. The survey was completed at least in part by 507 respondents, for a response rate of 7 percent.

Most respondents classified themselves as chief risk managers/head of risk management department (58 percent), followed by member of risk management department (not head) at 40 percent and other executive management at 2 percent. Respondents with more than 20 years of risk management and insurance experience represent the largest group at (51 percent) of the total, followed by 26 percent with between 11 and 20 years, 16 percent between 6 – 10 years and 7 percent with 5 years or less.

A variety of industries are represented. The industry choices were based on the two digit North American Industry Classification System (NAICS). Manufacturing accounts for the largest industry sector with 20 percent of the total respondents, followed by Healthcare & Social Assistance at 11 percent, Public Administration at 10 percent and finance & insurance at 9 percent. The survey includes businesses of all sizes but is weighted towards the large companies with 61 percent of respondents having revenues greater than \$1 billion. (Exhibit 1)



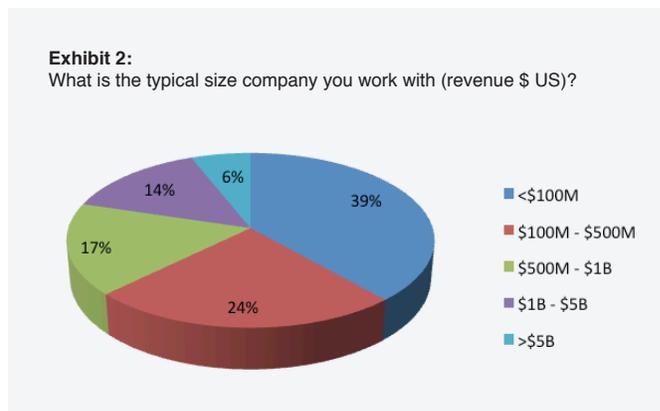
*Many organizations found themselves unprepared and vulnerable to exposures which either they did not contemplate or chose not to address*



**Broker Survey**

The survey was conducted for four days, beginning May 6, 2013 and ending on May 10, 2013. Invitations to participate were distributed by email to 4749 brokers. The survey was completed at least in part by 282 respondents, for a response rate of 6 percent.

Sixty percent of the total respondents claim to place what they consider to be “quite a bit” of property business with another 22 percent claiming to place at least some property business. Of the respondents who place at least some property business, 46 percent consider themselves property specialists. More than 9 percent of respondents said that they at least occasionally work directly with risk managers. The size of companies that the brokers typically worked with varied but leaned towards smaller firms with 39 percent at less than \$100 Million. (Exhibit 2)



**The Current State of Property Risk Management**

The catastrophes of the previous few years – the Thailand floods, Tohoku earthquake and tsunami and Superstorm Sandy in particular – caused many businesses both small and large to sustain significant and unexpected property losses. Many organizations found themselves unprepared and vulnerable to exposures which either they did not contemplate or chose not to address. Extensive property, business interruption and contingent business interruption losses were sustained due to direct damage from wind, flood and earthquake, as well as from supply chain disruptions. More recently, the tragic bombing at the Boston Marathon affected hundreds of local businesses, causing widespread concern among those that had not bought terrorism insurance. The devastating explosion at a Texas fertilizer plant highlighted the fact that an accident can literally wipe a company off the map.



*At most organizations there is good communication between the risk management department and the safety engineering department*

Property risks are fundamental to most companies, but managing them effectively has never been more challenging. This report first examines current risk management practices, with emphasis on the management of catastrophe exposures, supply chain exposures and terrorism risk. The findings are based on survey results of more than 500 risk managers.

## **General Property Risk Management Practices**

### **Risk Management Functions**

In response to the question “Does your organization have someone devoted entirely or substantially to property risk management?” 54 percent of the total responded yes and 46 percent responded no. Interestingly, the size of the company (greater or less than \$1 billion in revenue), did not have a material impact on the response.

Enterprise risk management (ERM) adoption has trended upward in recent years. This was reflected in response to the question “Does your organization have a partially or fully implemented ERM program?” 61 percent responded yes and 39 percent no. Of those who responded yes, the majority at 56 percent include property risks as part of the ERM program. A surprising large minority – 44 percent – do not include property risks in their ERM programs, calling into question the enterprise-wide scope of these programs.

An internal department specifically focused on safety engineering and loss control is one way to identify and proactively mitigate property risks. In response to the question “Does your organization have a dedicated safety engineering department or similar function?” 60 percent of respondents said that they did. While common sense may lead one to believe that the larger companies (those greater than \$1 billion) with more resources would be more likely to employ such a department, this in fact is not the case: exactly the same percentage of both large and small companies has this type of department.

At most organizations there is good communication between the risk management department and the safety engineering department, and in some cases the safety engineering department reports to the risk management department. In response to the question “what is the relationship of that department to risk management?” the largest percentage of respondents, at 59 percent, said it is independent of risk management but there is regular communication between the departments, followed by 21 percent who said it reports to risk management, 17 percent who responded it is independent of risk management with sporadic communication and 4 percent who said it is independent with little or no communication with risk management.

Outside property risk management consultants are used in lieu of or in combination with internal departments. In response to the question “Does your organization use property risk management consultants?” 28 percent said yes (routinely), 22 percent said yes (occasionally), 18 percent said yes (rarely) and 32 percent said no.

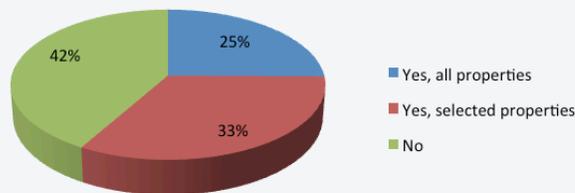
Respondents were asked “is the risk management department involved in decisions about building or acquiring facilities such as where to build a new facility, construction and protection standards, etc.?” Twenty-four percent said yes to all properties, 33 percent said yes to selected properties and 42 percent said no. (Exhibit 3) The results varied by industry, however. For example, the two industries most represented in the survey, manufacturing and health care & social services, had divergent responses: risk managers of 76 percent of manufacturing companies report being involved in decisions at least on selected properties as compared to 52 percent of health care & social service companies.



Recent catastrophes have brought much attention to the importance of building resiliency into supply chain systems

**Exhibit 3:**

Is the risk management department involved in decisions about building or acquiring facilities such as where to build a new facility, construction and protections standards, etc.?



**Captives**

Relatively few surveyed organizations manage their property risks through captives. Self-insuring through captives is a risk financing option practiced by 38 percent of survey respondents. Of those who employ captives only 33 percent said yes when asked “are property risks managed through the captives?”

**Emergency Preparedness**

The vast majority of risk management departments play a role in protecting property in the event of an emergency. In response to the question “Is the risk management department involved in emergency preparedness planning as concerns protecting property?” 80 percent said yes and 20 percent said no.

**Foreign Exposures**

In response to the question “Does your organization have physical assets in foreign countries?” 45 percent said yes and 55 percent said no. The respondents with foreign assets were then asked “do you purchase insurance coverage locally for those risks?” 40 percent said yes in most or all cases, 34 percent said yes when advisable due to local regulations, 14 percent said yes selectively, and 12 percent said no.

**Catastrophe Risk**

Forty-four percent of the risk managers surveyed said that they have large accumulations of physical assets in cat-exposed regions. The vast majority of risk managers with these exposures are utilizing catastrophe models to assess their exposures. In response to the question “Does the risk management department use cat models (itself, through a broker, or through a consultant) to assess the organization’s exposure?” 73 percent responded yes, 20 percent no and 7 percent did not know. Many risk managers also rely heavily on outside consultants, brokers and carriers to provide assessments through on-sight engineering services.

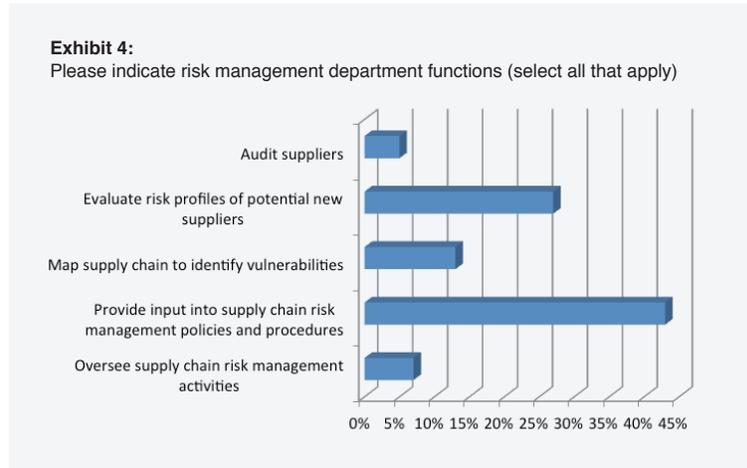
**Supply Chain Risks**

Recent catastrophes have brought much attention to the importance of building resiliency into supply chain systems. Other Advisen surveys have shown that the role of risk managers in addressing supply chain exposures is evolving in many organizations. In response to the question “Aside from purchasing insurance, does the risk management department have a role in managing supply chain risks?” 31 percent responded yes, 54 percent no and 15 percent responded N/A.



*To be “best in class” is to operate at the highest current performance level in a particular industry*

The risk management departments that play a role in managing supply chain risks were asked what functions they perform. Provide input into supply chain risk management policies and procedures received the highest response at 43 percent, followed by evaluate risk profiles of potential new suppliers at 27 percent, map supply chain to identify vulnerabilities at 13 percent, oversee supply chain risk management activities at 7 percent and audit suppliers at 5 percent. (Exhibit 4)



The survey respondents were then asked, “What supply chain-related insurance coverages do you purchase? (Select all that apply)” 69 percent purchase contingent business interruption (CBI), 15 percent logistics extra expense, 8 percent political risk and 8 percent supply chain insurance.

**Terrorism**

Since the September 11th terrorist attacks, property loss due to terrorism has been recognized as a possibility for most organizations. Recently, the Boston Marathon bombings caused physical damage to some buildings and lost income to many more businesses in the vicinity of the event. In response to the question “Does your organization have a terrorism risk management program in place?” 38 percent said yes and 62 percent said no. However, while most have not implemented a comprehensive terrorism risk management program, most do purchase terrorism insurance coverage. In response to the questions “Does your organization purchase terrorism coverage?” 70 percent responded yes and 30 percent no.

**Best Practices**

To be “best in class” is to operate at the highest current performance level in a particular industry. Risk management is a profession – or some may say an art – that is fluid and constantly evolving. No two companies have identical exposures, which make every risk manager’s responsibilities unique to their particular company.

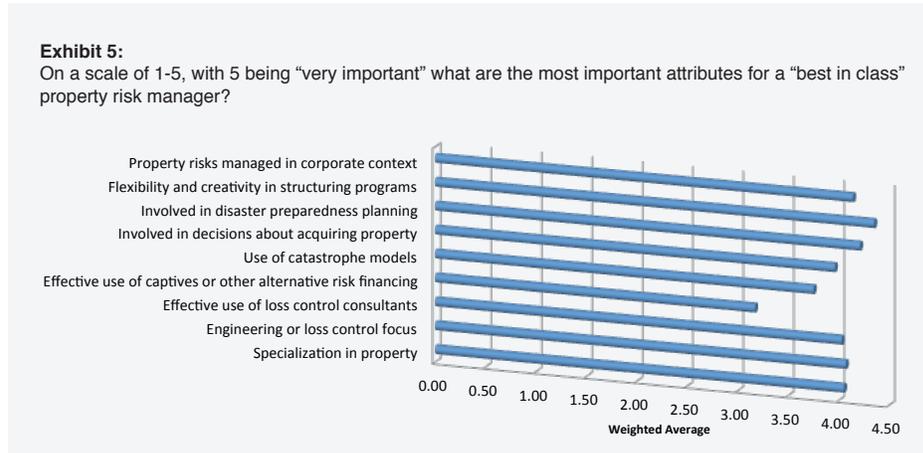
Because exposures vary so widely, it is difficult – if not impossible – to quantitatively determine what constitutes best-in-class attributes. Instead, we believe a qualitative approach of identifying specific attributes and practices of the top risk managers provides the most useful insights. These insights can then be used as a guideline to assist risk managers in exceling at their craft.

To identify best-in-class attributes and practices, a survey was administered to the broker community. It is the brokers who experience firsthand both the stylistic and operational differences of their various clients. The data compiled by this survey was then supplemented with information obtained through a series of one-on-one interviews with risk managers identified by brokers and others as being superior property risk managers.

... best risk managers are those that have a thorough understanding of their company and its exposures

**Best-in-Class Attributes**

Brokers were asked to rank “on a scale of 1-5, with 5 being ‘very important,’ what are the most important attributes for a best in class property risk manager?” among a list of practices, brokers scored flexibility and creativity in structuring property insurance programs as the most important attribute of a best in class property risk manager with a weighted average score of (4.35). Other important attributes included being involved in disaster preparedness planning (4.21), managing property risks within the context of broader corporate finance objectives (4.14), engineering or loss control focus (4.07) and specialization in property (4.05). (Exhibit 5)



The survey participants were then asked to describe in their own words the characteristics of leading property risk managers. The responses were readily grouped into a number of key attributes.

**Knowledge of exposures, the property insurance market, and coverage program structure**

A consensus among the brokers surveyed was that the best risk managers are those that have a thorough understanding of their company and its exposures. According to one survey participant “the best in class property risk managers should be focused on knowing his/her facilities inside and out, which is key for loss prevention and mitigation. They should also understand the importance of providing accurate information to his/her broker to help with modeling which will improve insurance results.” Another broker explains that risk managers must have, “a deep knowledge about their own company including knowledge about suppliers/customers, interdependencies and bottlenecks.”

Exposures are rarely static, which is why a common best-in-class quality identified by brokers was to have procedures in place to thoroughly and accurately track changing exposures. According to one respondent, the top risk managers make sure that “insurable values and replacement costs are reviewed regularly and are accurate.” Another explains that paying “attention to detail in maintaining full, accurate and complete COPE data” is a must.

These statements were echoed by nearly all of the risk managers interviewed. Mike Horvath, Sr. Vice President of Risk Management, Simon Property Group Inc. believes it is important to “place a strong focus on proper engineering, proper maintenance of COPE data as well as understanding total insured values and be meticulous about maintaining current and up-to-date information.” Janice Ochenkowski, Managing Director, Jones Lang LaSalle explains that the “foundation of excellence in property risk management is having a very thorough understanding of the basics of the business because all property is not the same.”

*... the best risk managers are those that are relationship oriented*

Aside from having a thorough understanding of the organizations exposures, having a solid grounding in the forces driving the property market is also key. One broker explains that his best risk manager clients are those that have a thorough “understanding of market cycles.” Another says that “staying abreast of property market conditions” is essential. Another observes that best in class risk managers have a “thorough understanding of market cycles and how the more recent global CAT loss experience is affecting reinsurance markets; thus, resulting in less capacity and more and/or greater sublimits.”

The risk managers interviewed tended to agree. They all explained the importance of staying current with events that could impact their business and the industry. According to one leading property risk manager “it is important to understand what is happening in the industry and to stay on top of how it could impact you.”

Lastly, according to the brokers surveyed, the best risk managers have a good understanding of insurance products. They understand how the various pieces, including self-insurance and contractual risk transfer, fit together to optimally structure a property program.

#### **Broker and Underwriter Focus**

A recurring theme by many involved with the study is that the best risk managers are those that are relationship-oriented and insistent on working with the best brokers and underwriters. One broker explains that the best risk managers “want to develop a partnership with his or her broker.” Another said risk managers that “appreciate long-standing carrier relationships and see carriers and brokers as partners” are best-in-class. A third explains that his best risk managers “work closely with the broker team, and consider their brokers as an extension of the property risk management function.”

Horvath agrees. He refers to his brokers as risk management services providers. He explains that “brokers buy insurance and recommend what to buy, but risk management service providers are third party staff who assist in anything that needs to get done from the standpoint of a property or case evaluations.”

From a carrier perspective Ochenkowski believes that “Long term relationships with insurers are very important. Over time the insurance company understands the processes and procedures of the risk manager and the manner of which her company operates, the valuation of property and disclosure of property risk for example, and a confidence level in the integrity of process develops on both sides, which is extremely important.”

This is echoed by the other risk managers, Christopher Nassa, Director CBRE Global Risk Management explains that “Long term relationships are extremely important which is why we strive to maintain quality relationships with the people who do right by us, we do right by them.” Another leading risk manager explains that she feels strongly in developing relationships with insurers and likes to get in front of them once or twice a year. She says “we like to stick by insurers that stick by us. We don’t want to hide behind brokers.” “If they know you’re going to be in it together, it’s going to be a much better relationship.” Horvath explains.

Part of developing a good relationship with a carrier is having a thorough understanding of underwriting criteria and the underwriting perspective. In this regard the top risk management professionals “understand the parameters used by underwriters in rating and modeling.” They also “understand company’s risks and the insurers’ perspective, and are responsive to underwriter questions.” Comprehending what is behind insurance rates and pricing is also important; one broker says that the best risk managers are those that are “sensitive to carrier reinsurance renewals and storm season.”



*... the best risk managers are those that are able to convey to key decision makers how their department is vital to the success of the organization.*

### **Focus on Organizational Objectives**

Best in class risk managers not only excel at developing relationships with third party vendors (partners), they also cultivate relationships internally, especially with senior management. A common theme from the broker community is that the best risk managers are those that are able to convey to key decision makers how their department is vital to the success of the organization. According to one broker “they should be connected to senior management to make sure they see risk management as a priority for its business so improvements can get authorized.” Far too often risk management is looked at as a cost center and independent of core operations and functions of a business. In most instances, this could not be further from the truth. The best-in-class risk managers understand the importance of aligning risk management with corporate objectives. The best risk managers “understand their portfolio operation from both a corporate and risk management point of view,” according to one broker. “[They] can keep both profit goals and risk mitigation goals in perspective.”

According to Horvath “you have to know your business. It is important to know specifically what is important to your organization and what key metrics are important to senior executives. You need to be able to communicate using their language and their terms.” He explains, “Best in class is being knowledgeable about all aspects of your organization from leasing, to financing to operations, knowing what is important to all members of the executive team. They all have specific areas of focus and they all have to be a part of the equation when you are talking about risk transfer.”

Ochenkowski believes that “Risk managers need to work with internal clients as well as external and spend time making sure they understand the process and benefits of risk management.” On the flip side she explains “Having a degree of internal communication helps the risk management department know what is in the pipeline, what folks are working on and when we can actually take responsibility for an exposure.”

### **Strong Personal Attributes**

The personal attributes that define a best-in-class property risk manager include being adaptable and creative, organized and detail oriented and proactive. Below are quotes from brokers to the question “what are some other important attributes of ‘best in class’ property risk managers?”

- “Flexibility in embracing new, but well-grounded, program options.”
- “Adaptability, knowledge of market conditions, realistic expectations, open minded for new ideas.”
- “Willing to discuss issues of all types, and not allow assumptions to prevent an open dialogue.”
- “Thinking outside the box”
- “Should be thorough and precise.”
- “Being proactive not reactive.”
- “Proactive in dealing with key issues and taking appropriate steps following industry losses.”

## **Conclusion**

To be best-in-class, a risk manager must not simply possess certain qualities and attributes, but must execute on them at a consistently high level. According to brokers and leading risk managers, much of what is required to be at the top of the profession does not pertain specifically to property risk management, but instead applies to the art of risk management as whole. The risk managers that are well rounded and excel at all aspects of their profession, from being knowledgeable about their business, to having high technical expertise, to being both detail oriented and creative, to understanding the importance of building both internal and external relationships are those who are regarded as being at the top of their craft. Some of the factors identified by both brokers and risk managers as essential to being best-in-class seem like basic blocking and tackling: know your business, track your exposures, develop good relationships with your brokers and underwriters. The difference between the best risk managers and all the rest is in how well these fundamental elements of risk management are executed.

