ARI RISK MANAGEMENT
CONSULTANTS

The Dollars & Cents of Independent Navigation: Five Client-Partner Success Stories

2003 was a dynamic year for the risk business. The U.S. began a modest recovery, the global equity markets rallied with double digit gains, the insurance brokers saw one of their most profitable years and insurance companies started making money again in the “hard market”.

What this rosy picture doesn’t tell is, most non-insurance industry companies are not enjoying a similar economic revival; rather they are struggling to get back to and maintain profitability. As the last several years have proven beyond question, effective management of risk is essential to achieving and perhaps more importantly, sustaining profitability. Rather than provide you with insight into a specific risk management topic or the application of a particular theory this quarter, we thought it would be good to share with you a few of our client-partners’ situations and the successful outcomes they achieved as part of their overall efforts to improve and sustain profitability.

Client-Partner #1:

Organization: Privately-held, multi-state metal processor with 350 employees and multiple collective bargaining agreements.

Situation: After experiencing a series of direct (property and boiler & machinery) and indirect (business income and extra expense) damage losses, the Company’s long time property insurer refused to renew and the best alternative was a five fold premium increase. Despite contacting several additional brokers, 120 days before the policy’s expiration, renewal indications were still for an additional 30%+ increase. Given the difficult economy in combination with the prospect for a significantly increased insurance bill, the company was confronted with the possibility of having to lay off union employees in order to pay insurance premiums.

ARI: After we identified and worked with our client-partner to correct several asset preservation and interdependency issues, we developed detailed models and specifications, which illustrated financially and visually, our client-partner’s new risk profile and their substantial improvement in *value at risk* despite the total insured values increasing more than 20%.

Outcome: Instead of an anticipated 30% increase, the renewal premium decreased in excess of $200,000 with the direct damage deductible staying constant and the indirect damage deductible decreasing substantially. Total insured values increased 22% and coverage was added for direct & indirect damage at key contingent locations (more than a dozen sole source and dependent locations) and for transit for back-haul operations. Coverage was also modified to include functional replacement cost (certain machinery), precious metals (20%+ of inventory values), and to change the indirect damage deductible from 3 times the Average Daily Value to a straight 72 hours. All was accomplished with the incumbent broker and insurer without competition.

ARI Fee: < $40,000

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Client-Partner #2:

Organization: UK publicly-listed conglomerate with over 3,000 employees spread throughout the world.

Situation: After a series of successful acquisitions, it became apparent to management that there was a need to consolidate the global insurance program. Initially, the Company sought to do so with its incumbent broker. After eight months and little progress, the Company decided to delegate the insurance decisions to the CEO's of the company's 8 divisions.

ARI: After being engaged to restructure the insurance programs for two divisions (US/Canada and Latin America) we quickly realized how acute the problem was – between the two divisions there were 26 brokers and over 80 insurers. Not only did we discover that some entities were not covered, we also found entire business segments that were not insured. Although the publicly-listed UK parent had purchased worldwide Directors' and Officers' Liability insurance we found that several operating units had purchased Directors' & Officers' Liability policies for "private companies" (3 with the same insurer).

Outcome: From an administration viewpoint, in less than 6 months we consolidated the brokerage relationships from 26 to 3, insurers from 81 to 16 (plus two governmental insurers), and policy renewals from 39 to 11 per year. Our client-partner estimates this streamlining alone will save them over 100 hours of management's time annually.

By eliminating just the redundant coverage, our client-partner saved more in premiums than the cost of our services, added coverage for all entities (including discontinued operations), and added errors and omissions, intellectual property infringement and "entity" employment practices liability, all of which had not been purchased previously. To leverage their favorable historical loss experience, we structured the U.S. workers' compensation and auto liability so our client-partner could share in the underwriting profit, and if losses are as projected for the 2003 policy year they will save an additional $175,000.

ARI Fee: < $100,000

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Client-Partner #3:

Organization: Publicly-traded information services company with 300 employees.

Situation: Company market capitalization dropped $2B in the year prior to our involvement. Ninety days before renewal, their broker indicated a 70% plus increase on their $20,000,000 Directors' & Officers' Liability program with a $900,000 premium. After the previous year's triple-digit increase, the Company did not have the willingness to pay more than expiring and the independent Board members were not comfortable with reducing the limit.

ARI: After reviewing the breadth of coverage being offered it was our opinion that the insurer had received more than their fair share in the *Coverage Value* equation (see 4th Quarter 2003 article) and we indicated to our client-partner that a competitive bid would increase the probability of improved coverage and a premium lower than expiring. Initially, the client was reluctant to bring in another broker and felt that their current broker could obtain competitive quotes. Hearing our client-partner's wishes, we suggested that we have a meeting with the incumbent broker to understand their strategy for accomplishing our client-partner's objectives. During the meeting, the client informed the broker that we were suggesting that we bring in another broker and orchestrate a limited competitive bid. The broker responded that if they were given all the markets (insurers) to work with exclusively, they could match the expiring premium. Although happy to hear the good news, the client was upset because just weeks before the same broker had indicated that it was a tough market and a 70% increase was competitive for technology companies. Our client-partner now seeing firsthand what all our references had told them (the first meeting yielded our client-partner a $600,000 savings), took our advice to go to a competitive bid.

Outcome: By bringing in just one competing broker and allocating the insurers in a way that optimized the leverage of the bid process, we were able to obtain full prior acts, full severability, the choice of legal counsel, removal of the failure to maintain adequate insurance exclusion, and a premium decrease of more than $300,000 versus expiring. Further, with the use of our detailed specifications and underwriting presentation, our client-partner did not have to complete any renewal applications. In the end, even after the incumbent broker and insurer had told our client-partner face-to-face that "premiums were definitely going up", they acquiesced and said they would match the reduced price, but unfortunately they could not match the enhanced coverage. Our client-partner is now a firm believer in independent navigation and optimizing *Coverage Value*, not just price.

ARI Fee: < $50,000

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Client Partner #4:

Organization: Publicly-listed software and professional services firm with 1,500 employees, half of which are spread throughout 25 foreign countries.

Situation: The Company was comfortable with its long-standing relationship with its insurance broker, but wanted an outside opinion regarding the structure and thoroughness of its global insurance program. The impetus for seeking independent advice was the Board's concerns about Sarbanes – Oxley (SOX) – related exposures and concerns following a recent large casualty claim for which it was not covered as the management had thought, forcing the Company to take an earnings hit.

ARI: In addition to requesting an audit of the global property and casualty program, senior management developed several hypothetical, but not unlikely, loss scenarios and wanted us to "stress test" the insurance program to determine how well it would respond to their concerns.

Outcome: Our client-partner anticipated receiving (and we expected to deliver) a 10-page report highlighting potential issues with its insurance program and how the program would perform given the proposed scenarios. However, shortly after our review commenced, we identified such severe problems that we had to notify our client-partner to make changes to the program even before our report was completed. Once completed, the report was over 40 pages and covered a couple hundred issues ranging from simple policy administration flaws to complete omissions of contractual and compulsory coverage. Of the six scenarios presented for our analysis, the current insurance program responded (up to the client-partner's expectations) to only one of them.

Over the four months following the delivery of our report we worked side-by-side with our client-partner to prioritize and solve the most critical issues highlighted by our analysis. In the end, by restructuring the program and implementing some contractual transfer techniques, our client-partner was able to effectively address 5 out of the 6 scenarios that concerned senior management.

The collateral benefit of the audit and our holistic process, though it was not the initial focus of our efforts, was a reduction in premium that occurred as a result of the rationalization of our client-partner's global insurance program. The *Coverage Value* of our client-partner's Property, Workers' Compensation, and Errors & Omissions Liability insurance products in particular, was significantly improved as a direct result of our strategies and navigation.

ARI Fee: < $100,000

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Client Partner #5:

Organization: Chinese conglomerate looking to grow in North America through an U.S. acquisition program.

Situation: Management was given the directive to grow business in North America by embarking on an aggressive acquisition program. The Conglomerate had a wide target interest but the internal due diligence professionals were mainly focused on private companies with strong brand value. In addition to the internal due diligence professionals, the team also included a global investment bank and a national legal firm.

Being fully aware that liability, risk management and insurance are very different in the United States than what they were accustomed to in China, they sought help in navigating the risk issues they would face. Initially they were referred to an insurance broker but grew frustrated as it became apparent the broker was really only interested in providing insurance after the transaction was completed, not risk and insurance assessments before they made an offer(s).

Perturbed with the broker and confused by the myriad of insurance and risk financing products the I-bankers and legal counsel would reference throughout their due diligence, the Chinese team added ARI to the due diligence team.

ARI: As part of the identification, vetting, and execution process, our client-partner's other advisors worked through a due diligence checklist which included questions regarding risk and insurance, but only at the extremes (compulsory or catastrophic). As we became involved in the process, we were able to drill down on the insurance and risk financing programs of the targets and get beyond the "Summary of Insurance" level. We advised the professional team and our client-partner regarding inadequately funded liability sources such as, environmental impairment, discontinued products, employment practices, contingent bodily injury, privacy, intellectual property infringement, and product recall.

Outcome: Based on our analysis, the team was able to more effectively negotiate from a risk-adjusted perspective. Not only did they dodge several risk- and insurance-related "bullets" in asset deals, but now with a western legal view of past liabilities, many deals that started off as stock transactions, became assets deals or required a significant (risk-adjusted) discount to continue on a stock basis.

Conversely, in one of our reviews, we identified that the target had overfunded (posted more collateral than the outstanding reserves) its retrospectively rated casualty (Workers' Compensation and General Liability) insurance program by allowing the last 6 years of collateral ("evergreen" Letters of Credit) to stack. We informed our client-partner that once they took control of the target's voting stock we could "true-up" the previous collateral requirements with the three insurers and unlock millions of dollars in cash.

ARI Fee: Based on size and complexity of target.

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Conclusion

As the experiences of these client-partners demonstrate, whether you are publicly-traded or privately-held, a high-tech or low-tech company, regional or global, you and your risk management program can benefit from independent navigation. We can help you optimize the *Coverage Value* of your insurance program. While price is very important, in the case of a major claim, you are far more likely to field questions from the Board of Directors or senior management like, "Are we covered?", rather than "How much did we pay for that coverage". That being said, we have successfully helped organizations around the globe ensure that their stakeholders will be happy with the answers to both questions.

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