

Risk Financing Due Diligence and Best Practices

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Notes:

The Risk Financing Process

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Notes:

The Risk Financing Process

- Identifying and Analyzing Exposures to Loss
- Examining Alternative Risk Financing Techniques
- Selecting the Best Technique(s)
- Implementing the Selected Technique(s)
- Monitoring the Results

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Notes:

Risk Financing Categories

- Risk Transfer
- Risk Assumption
- Combination of Both

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Notes:

The Risk Financing Process

- Reasons for Transferring Risk
 - Catastrophic Exposure
 - Inability to Credibly Estimate Exposure
 - No Other Option Available
 - Avoiding Barriers to Exit in M&A

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Notes:

The Risk Financing Process

■ Reasons for Assuming Risk

- Potential for Cost Savings
- Increase Focus in Loss Control
- Minimize Insurance Market Fluctuations
- Potential to Unbundle Services

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The Risk Financing Process

■ Factors Influencing Risk Assumption

- Attitude of Management
- Post-Loss Recovery Plans
- Line of Coverage and Loss Volatility
- Insurance Market Conditions
- Financial Concerns – Cashflow / Collateral
- State Rules and Regulations
- Third Party Insurance Requirements

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The Risk Financing Process

■ Reasons for Implementing Risk Assumption

- Assumption Cost Competitive with Guaranteed Cost
- Predictable Loss Experience is Low Relative to Guaranteed Cost
- Desire to Create Financial Incentive to Control Losses
- Desire to Unbundle / Reduce Dependency on Insurers
- No Other Choice is Available from Insurers

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Notes:

Choosing the Right Deductible / Retention

- Appetite for Risk
- Financial Ability to Retain Risk
- Availability of Reliable Data
- Volatility of Loss Frequency and Severity
- Current Price Level and Availability of Insurance

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Notes:

The Risk Financing Process

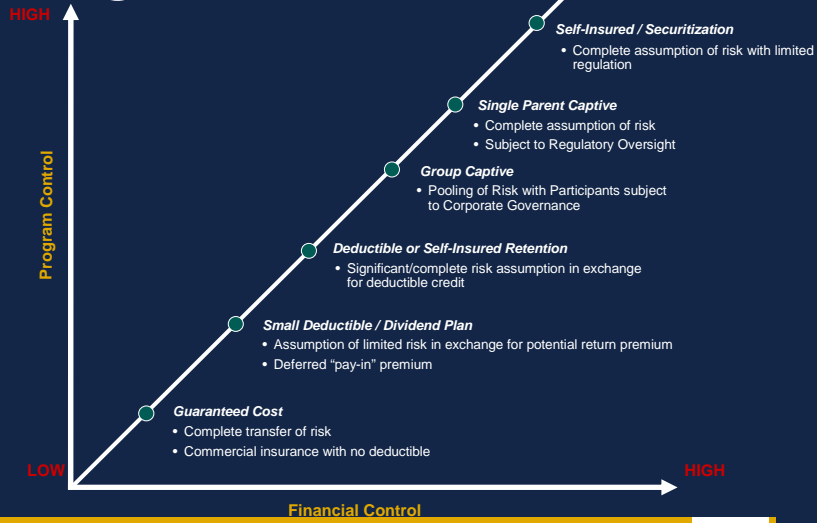
■ Risk Financing Alternatives

- “Guaranteed Cost” / Pure Risk Transfer
- Small Dollar Deductible or Dividend Plans
- Deductible or Self-Insured Retentions
- Captives, Self-Insurance and Securitization

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Notes:

Risk Financing Categories: the Basics



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Notes:

Securitization of Deferred Liabilities

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Notes:

Casualty Insurance

Long Tail Line Coverages – Payout Patterns

- Worker's Compensation: 1 – 30+ years
- Auto Liability: 1 – 5 years (avg.)
- General Liability Including Products: ????

Most Common Forms

- Letter of Credit
- Cash Collateral Program
- Trust Program
- Surety Bond
- Promissory Note

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Notes:

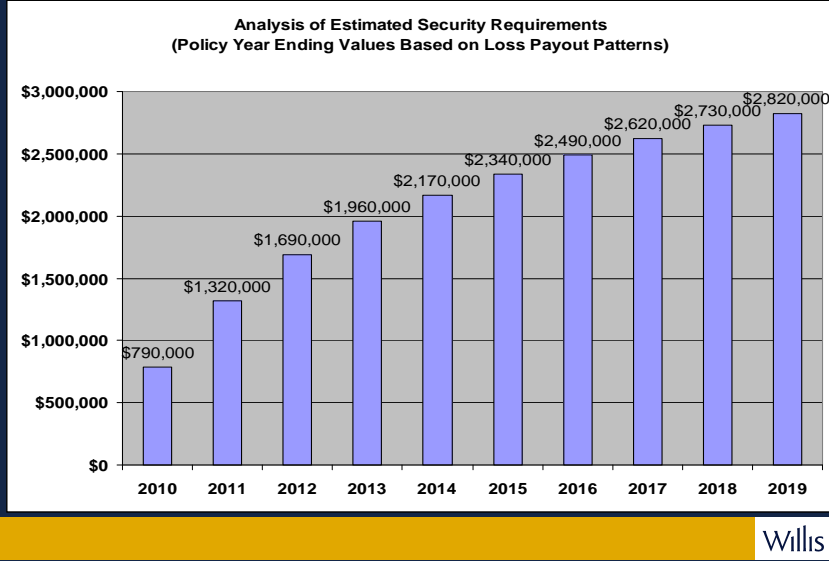
Uses of Letters of Credit for Risk Financing

- Incurred but not paid losses in cash flow plans
- Satisfaction of captive collateralization requirements
- Securing obligations under self-insured workers compensation programs
- Collateralizing surety bonds issued to workers compensation self-insurers
- Satisfaction of the security requirements of the excess insurer in “fronted” deductible programs
- As an asset by fronting companies for statutory accounting purposes

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Notes:

Collateral Requirements Grow Over Time !



Notes:

Therein The Problem Lies...

- Letters of credit begin to stack upon one another
- Reduced borrowing capacity
- Insurer gains increasing leverage over the insured regarding the amount of collateral required to support the program
- Difficulty is compounded if the insured changes insurers – new insurer will require “fresh collateral” and former insurer will be more stringent in setting the ongoing requirement
- Insurers imposing limits on which banks and the aggregate amounts they can provide in letters of credit
- Problems for Banks – imposition of risk-based capital requirements – expend capital to support letters of credit

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Notes:

Strategies To Manage Insurer Collateral Requirements

- Negotiations Prior to Policy Inception
- Negotiations in Collateral Adjustments
- Quantitative and Expert Support

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Notes:

Negotiations Prior to Policy Inception

- Determine Initial Collateral Deposit for the Policy Year
 - Projected Losses
 - Anticipated Cashflows for Projected Losses
 - Paid Loss and/or Discounting Credit
 - Collateral Installment Schedule

- Terms of Adjustment to Collateral Over Time
 - How Often To Be Reviewed and Adjusted
 - Methodology for Projecting Ultimate Losses
 - Basis for Loss Development and Other Factors to be Utilized

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Quantitative and Expert Support

Quantitative Tools:

- Loss Projection Analysis
- Reserve Analysis
- Loss Development Factor Analysis
- Confidence Level Analysis
- Payout Schedule

Expert Support:

- FASB 5 / GASB 10 Requirements
- Perform Your Own Actuarial Analysis
- Broker or Agent Support
- Independent Actuaries

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Notes:

Selecting and Implementing the Risk Financing Technique(s)

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Notes:

Factors To Consider in Selection and Implementation of Risk Financing Technique(s)

- Third Party Insurance Requirements
- Ease of Administration
- Budgetary Stability
- Upside Benefit versus Downside Risk
- Ability to Credibly Measure Risk
- Budgetary and Cashflow Considerations
- Collateral Requirements
- Regulatory Considerations
- Capital Requirements
- Ease of Entry / Exit

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Notes:

Questions ?

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