SPECIMEN
COURSEWORK ASSIGNMENT
AND ANSWER

997 - (Advance risk financing and transfer)

The following is a specimen coursework assignment question and answer. It provides a guide as to the style and format of coursework questions that will be asked and indicates the depth and breadth of answers sought by markers. The answer given is not intended to be the definitive answer; well reasoned alternative views will also gain good marks.

Before commencing work on an actual coursework assignment, you need to fully familiarise yourself with the following documents:

- *Coursework assessment guidelines and instructions;*
- *How to approach coursework assignments;*
- *Explaining your results notification.*

Coursework assignments involve the application of knowledge to work-related questions. They require you to explore issues in the workplace relevant to the unit for which you have enrolled.

Coursework submission rules and important notes

Before commencing on, or submitting, your coursework assignment it is essential that you fully familiarise yourself with the content of *Coursework assessment guidelines and instructions.* This includes the following information:

- The maximum word limit for coursework assignments is 3,200 words.
- Arial font and size 11 to be used in your answers.
- Important rules relating to referencing all sources including the study text, regulations and citing statute and case law.
- Penalties for contravention of the rules relating to plagiarism and collaboration.
- Deadline for submission of coursework answers.
- There are 80 marks available per assignment. You must obtain a minimum of 40 marks (50%) per assignment to achieve a pass.
- The coursework marking criteria applied by markers to submitted answers.
- Do not include your name or CII PIN anywhere in your answers.

Top tips for answering coursework assignments

- Read the assignments carefully and ensure you answer all parts of the assignments.
- Ensure that each answer includes a relevant context, regardless of the country or countries to which it refers.
- You must include a context in each answer. You may use the same context for each of the three answers.
- For assignments relating to regulation and law, knowledge of the UK regulatory framework is appropriate. However, marks can be awarded for non-UK examples if they are more relevant to your context.
- There is no minimum word requirement, but an answer with fewer than 2,800 words may be insufficiently comprehensive.

Assignment
You are a risk manager for ABC Group plc (ABC), a multinational company. ABC predominately has sales and service operations and has a small manufacturing base.

ABC has completed due diligence ahead of acquiring XYZ Group plc (XYZ). XYZ is of similar size to ABC and contains a number of manufacturing subsidiaries that will support future growth.

The due diligence identified a number of differences between the two insurance programmes. ABC's corporate insurance programme is based on a loss sensitive approach. ABC has a captive insurer, based in an off-shore location, to manage the significant retentions in its insurance programme for property and liability.

XYZ's insurances are placed on a conventional standard insurance basis. The XYZ programme contains the following key insurances:

- Property and liability programme with low deductibles.
- Employers' liability on a standard basis.
- Motor on a guaranteed cost basis.

You are required to deliver a report to the Board containing proposals of how to structure a new corporate combined insurance programme, to ensure the optimum sustainable total cost of risk.

- Explain, with justification, the risk profile of the combined business, resulting from ABC's acquisition of XYZ.
- Analyse **three** potential options, based on your explanation above, for the new corporate insurance programme.
- Make a recommendation, based on your analysis, as to which option will deliver the optimum sustainable total cost of risk for the combined business.

Word count:	3080

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The Board will need to understand the risk profile of the merged organisation in order to make informed decisions as to how to treat the risks that it faces and ensure the organisation's long-term future. Risk management is a continuous exercise that existed prior to the acquisition, is highlighted quite urgently following the merger but will continue and be further refined as the organisation grows. Ronconi (2015) confirms when undertaking due diligence on a proposed merger or acquisition, that it is important to conduct an extensive review of the business to identify the risks that it faces, as well as ensuring that insurance policy limits are sufficient. Identification of the risk is the first step towards proposing an effective risk transfer and risk financing strategy. However, even with an extensive review there will be risks that remain uncertain, for example an emerging risk such as cyber, or risks that remain hidden, for example long-tail latency exposures.

For a manufacturing organisation there will be operational risks, risks to employee safety, risks to physical property, risks to the supply chain as well as product (liability) risks. At present, we do not understand the complexity of risks that XYZ present to the merged organisation and it may be prudent for the Board to adopt a cautious risk appetite and transfer risk where possible to begin, but with a vision to move towards a sophisticated programme of risk retention, as knowledge and understanding of the risks are better appreciated. The risk appetite decision making will inevitably need to be made in conjunction with the overall business objective, in order to grow the existing business of ABC Group plc (ABC) through the acquisition of XYZ Group plc (XYZ). A cautious risk approach needs to be tempered with the inevitable depletion of financial resources that could otherwise be used to grow profit for the company.

Data and Information required

Operational efficiency of the manufacturing subsidiaries will depend upon the management culture, expertise of their employees, the reliability of machinery and the facilities to produce quality products. An assessment of the management oversight of XYZ will assist our understanding of the organisation's risk profile. Management plays an important role in setting and monitoring safe working practices as well as the housekeeping and maintenance of property and machinery. Where management is active in monitoring and enforcing safe working practices and maintaining property and machinery, there will inevitably be a positive correlation, with a reduced number of incidents of property damage, business interruption and injury.

However, the nature of a manufacturing business means that XYZ will invariably suffer from a higher incidence of employee workplace injuries when compared with ABC. It can be expected that there will be slip/trip type incidents, manual handling incidents, as well as incidents of a more serious nature that can arise from unsafe acts or unsafe working conditions. In addition, as alluded to earlier, there is also the potential for unknown latent risks from employee exposure to harmful substances that may cause injury/illness in time. Another specific risk that the manufacturing business faces, which we appreciate from their current insurance arrangements, is that they have a motor fleet, presumably for delivery, that will also pose a risk that ABC are currently not exposed to. Driving incidents can cause financial loss, both in terms of physical property (own and third party) and personal injury (to employees and the public). There are known increased risks associated with drivers that have licenses with driving violations and also from distracted drivers, for example, mobile phone use. Further, we know that some of the most catastrophic, and costly, personal injuries arise from the use of motor vehicles.

Therefore the information we require includes copies of the existing risk identification and assessment frameworks, as well as risk surveys that have been produced by or for XYZ. In addition, a comprehensive claims history will be required for each of the current key insurances to understand how claims have arisen and their financial cost. The data needs to be capable of manipulation so that trends can be identified and risk management strategies can be considered to control risk. For example, if the motor claims history is poor, it may be possible, through the closer monitoring of driver selection, coupled with driver training, to improve the risk posed by this activity. In addition to this information, it will be crucial to undertake our own risk identification/assessment of the XYZ business to assist our overall understanding of the risk profile. Our own review will be important to assess both the adequacy of past assessments but also because the acquisition will have created new risks to the company.

Risk Profile of the combined business

The merged company is a multinational manufacturing, sales and services company with aims to achieve growth through the combined offering of the new company footprint. To begin, the companies are likely to continue operating as two distinct entities. As management decisions are made in respect of the organisation design for the merged company, synergies will be created and the risk profile will continue to emerge and change.

The risk profile of the company will produce claims losses that will be immediate and will require immediate financing (such as property damage) and other financial liabilities that may take years to materialise (such as latency exposures). It can be anticipated that the business will sustain a proportion of ‘expected losses’, i.e. losses that are likely to occur on a frequent basis that are limited in their financial impact. Such losses are relatively easy to predict and can, to an extent, be considered to be one of the natural expenses of running a business. It is expected that these losses will be paid for out of normal cash flow and will be budgeted and priced for in the normal cost of operations. For example, there will be some retained risk, and cost, associated with accident damage repair to the company’s motor fleet which would likely be held back as reserves in the company balance sheet.

The addition of manufacturing operations to the business adds an increased risk of unexpected losses, and possibly, catastrophic loss. The percentage of products sold by the company has increased and this increases the risk of financial losses arising from defective products causing physical damage or personal injury to the end purchaser of their products. Further, manufacturing operations contain a risk of serious personal injury during the normal operation of the business, the risk of the substantial failure to process such as explosion and the fact that either of these events can result in an interruption to business operations. In the event of a catastrophic injury, the company can be exposed to significant costs in terms of general damages, special damages (such as loss of earnings, care and other medical services) along with the potential costs associated with regulatory intervention and prosecution. In the event of an explosion, the continued operation of the affected business operation will be threatened requiring urgent attention and financial resources. Such incidents can also lead to possibly expensive pollution, contamination and clean-up costs. There is also risk to manufacturing equipment and business interruption from electrical malfunctions, derangements and the like, of key items of machinery in important production lines. Similarly, the business can suffer interruption due to disruptions to their supply chain.

The sales and services aspects of the business are less likely to pose the same risk to employee safety and physical property. It is also the case that business interruption can be minimised to sales and service operations with immediate relocation to warm sites or similar. There are nonetheless, inherent risks to the business from this sales and services aspect of the business. The business stores and processes large amounts of sensitive customer data that is held on computer servers, personal devices, in cloud services; cyber security is a growing concern. There is an increasing threat, and financial exposure, associated with the loss of customer data, can be expensive to remedy and can lead to loss of customer confidence and reputational damage.

Current Corporate Insurance Programme

XYZ Group plc: XYZ currently operate a traditional insurance arrangement whereby insurance is placed on a conventional standard basis. Employers' liability is placed on a standard basis, property and public/products' liability with low deductibles and motor, on a guaranteed cost basis. This approach is typical to many manufacturing companies who consider the cost of insurance to be a static cost on their balance sheet. Insurance coverage is purchased up front for an agreed premium and it has the advantage of ensuring that the company is not hit with the financial shock of claims as and when they occur. It is a sensible option for many small to mid-sized manufacturers, so it is not unexpected that XYZ operate their insurance programme in this manner.

ABC Group plc: In comparison to XYZ, ABC operates a loss sensitive approach to our insurance arrangements, with a captive arrangement off-shore managing significant retentions for our property and casualty insurance programmes. A loss sensitive programme is ideal for larger companies that are able to incur additional risk and can manage the costs that self-adjust primarily on the cost of claims. This approach does not provide the consistency of cost that is experienced by the programme operated by XYZ. However, ABC have been able to deliver significant savings on the upfront premium costs and compliment this with an effective risk management programme to reduce claim's costs. Our low claims activity has, over a number of years, produced significant savings for the company when compared to the costs that would have been incurred under a conventional guaranteed cost programme.

Options for the New Corporate Insurance Programme

As ABC and XYZ merge their respective insurance arrangements, decisions need to be made as to the most appropriate insurance programme for the combined company footprint. There are many advantages to a captive notwithstanding the fact that it is relatively expensive to set one up and it is difficult to recruit key skilled individuals to administer it. However once set up, Somerville (2016) confirm they do save a company money overall. Therefore it should be accepted that ABC do not wish to reverse from their previous decision to retain risk via a captive arrangement, and all three options set out below will keep the captive in some form. Conversely the key difference in the three options will be how to reduce the amount of XYZ's insurance which is currently placed on a conventional standard basis and in the longer-term to incorporate this into the captive.

It would be advisable to adopt a cautious approach in the short-term and only integrate a limited amount of XYZ's arrangements into the captive. ABC may wish to utilise both our own risk management expertise and that of XYZ's insurers, until we fully understand the new risks that the company is exposed to and have implemented effective strategies to mitigate risks.

The proposed options are as follows:-

Option 1 – low risk retention

The first option would essentially be to keep ABC's exposure in the captive and allow a limited amount of XYZ's programme to transition from their standard insurance basis into the captive.

The captive arrangement operates similar to an insurance company and premiums are calculated in accordance with standard underwriting principles. The captive has typical underwriting and reserving policies and reinsurance arrangements. Being domiciled off-shore, Niven (2015) confirmed that a main advantage is that we benefit from limited corporation tax payments and premiums paid into the captive are tax deductible. In addition, we are able to hold significant reserves without having to pay tax on these. With our current expertise, it is expected that we could effectively price and reserve for the property and liability programme, which currently operates with a low deductible. We would mitigate the risk by presenting the risk to our reinsurers and arranging a facultative reinsurance contract for any exceptional or large losses.

The most appropriate area of XYZ's programme to move to the captive is the property and liability risks (including public and products' liability). In this manner we would achieve significant savings on the upfront premium payments being paid by XYZ. Under this option, we would maintain employers' liability insurance and motor under their current standard, guaranteed costs programmes. As outlined earlier, the risk profile of XYZ has an increased risk of personal injury type accidents arising both from its manufacturing operations and also its motor operations, which represents a relatively unknown risk to ABC and therefore may cause difficulties if the captive tried to handle them.

Option 2 – medium risk retention

The second option would move the employers' liability risks into the captive arrangement. Therefore the captive arrangement would absorb not only the property and public/products' liability programmes (as in Option 1) but also the employer's liability programme. At present, the employers' liability insurance is arranged on a standard basis, which will not be subject to any financial risk retention. As such XYZ are incurring the cost of premium payments, which are priced to include the payment and handling of routine claims as well as the insurer's profit. Significant savings could be available to the company in absorbing the financial risk for employers' liability claims within a financial threshold. Under this option, we would continue to insure via a convention insurer relationship whilst retaining a financial interest/cost of each claim. For example, it is not untypical for large manufacturing companies to incur all claims under a limit of £250k or even £500k. If the captive were to absorb such claims we would need to ensure that they have, or employ, appropriate individuals to manage both standard employers' liability claims as well as those of a more complex nature. It is anticipated that our current employers' liability claims handled by the captive will not demonstrate the same complexity as the manufacturing injuries that we shall see from XYZ. Typically employers' liability claims above a financial reserve of £150k can be difficult to negotiate and have potential to deteriorate in value.

Under this option, the motor insurance would continue under the current guaranteed cost programme. There is an argument to absorb the low value property damage and personal injury claims but there are risks to this approach. Firstly, the captive currently does not handle claims of this nature so does not have access to the same motor repair networks, and the like, that the insurance companies do. Secondly, there are significant complexities associated with motor claims – inflated damage costs, complex hire car arrangements, phantom passengers, whiplash, staged accidents, that make the handling and control of this risk more complex. There is also, as referenced earlier, the known propensity for motor accidents to produce the most catastrophic personal injury claims. It may be advisable to consider whether the motor fleet can be outsourced in its entirety to a service company that could take over these responsibilities and therefore assume the associated property damage and personal injury risks.

Option 3 – high risk retention

Under the third option, the insurance arrangements for all of the current insurance programmes with XYZ would be brought under the captive arrangement. The risks will be limited, via the purchase of appropriate reinsurance protection.

Since this would result in the captive handling motor claims for the first time, to minimise the operational risk associated with the motor operation, it would be advisable (assuming we don’t outsource the entire fleet to a service company) to look at our available options for outsourcing the handling of the motor claims to a specialist third party administrator. This would require a tender process and due diligence of the proposed provider to check their capability to handle the claims in a professional and cost effective manner. A service level agreement would need to be drafted to accommodate the details of the service we require and the expected financial outcomes. Given the specialist nature of this field of claims handling, a market exercise would need to be undertaken to ascertain best practice in this area and ensure that the chosen third party administrator was providing a best in class service. It may also be possible that we could agree a similar arrangement with one of the leading insurers, subject to a handling fee.

Recommendations for Optimum Sustainable Cost of Risk

The current captive model that ABC operates is the model of choice and presents us with the optimum sustainable cost of risk for the future profitability of the company. As a large multinational company, a loss sensitive approach has been proven to be more cost-effective than the guaranteed cost approach. Accordingly, the way forward is to plan an appropriate strategy to transfer the entire XYZ insurance programme from the current conventional programme to our loss sensitive approach.

It is recommended that the Board proceed on a cautious basis as set out in Option 1 for the first year, with the transfer of XYZ’s property and public/product liability risks into our captive. We will be able to utilise our existing expertise in these risk areas and realise significant premium savings, compared to the current arrangement.

During year one, we should undertake careful analysis of the employers’ liability risks that the manufacturing operation present to the company and implement risk improvement and mitigation where appropriate. This would include skilled risk managers visiting all manufacturing sites and conducting a full analysis of the risk profile and how improvements can be made. Once this exercise is complete and all improvements implemented, we should transfer the employers’ liability programme into our captive arrangement. Subject to the risk managers completing their analysis, we should be able to implement Option 2 from the beginning of the second year of the merged company.

It is strongly advised that the motor arrangement be outsourced to a service company as this aspect of XYZ’s operation represents the most significant risk. Although it is possible to handle this aspect with the assistance of a third party administrator, this still retains a financial risk and monitoring cost that would be transferred by a full outsource arrangement. Therefore it is recommended that Option 3 is kept under close review and only implemented if the risk profile of the motor book is under control and all drivers have completed advanced driver training courses.

Conclusion

The acquisition of XYZ poses the business with opportunities to increase the underlying profitability of ABC but it also presents new threats to its financial security. With careful risk assessment, analysis, risk mitigation and strategic staged transfer of insurable manufacturing risk from the XYZ’s current costly programme to our risk retained model, we will deliver the long-term sustainability of the new company.

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