CHAPTER 2: RISK MANAGEMENT ADMINISTRATION

An effective port risk management program depends on many factors, not the least of which is a sound administrative framework. No two ports design and implement their administrative frameworks in precisely the same way. However, risk management administration for all ports should feature certain key elements and attributes.

The most critical administrative element underlying successful port risk management programs is senior management support. The port's risk management strategy and objectives should certainly be closely connected with the port's overall strategy and goals. In turn, the port's overall mission, culture, and values should clearly demonstrate senior management's commitment to a culture that promotes safety for employees, the public and other constituents; focuses on protecting the assets and reputation of the port; and minimizes the organization's total cost of risk.

Grass roots risk management efforts are laudable but in the long run are not nearly as effective as those with clear senior management support. Senior management is uniquely positioned to direct port staff that "risk management is everybody's business". State of the art risk management programs involve staff throughout the organization, at all levels, in managing risk. Only with full senior management support and leadership can such sweeping risk management involvement become a reality.

Other key elements and attributes of effective risk management administration include:

- A formal, written, and widely disseminated risk management policy statement.
- A written manual that outlines business processes, procedures, responsibilities, systems, and documents that support the risk management program.
- Qualified risk management staff, appropriately positioned in the port's management hierarchy, with well-defined responsibilities and clear authority for carrying out the organization's risk management mission.
- An annual report to senior management that recaps risk management's achievements and presents goals and objectives for the coming year.
- Sound criteria for selecting agents, brokers, and consultants, and well-defined approaches to managing these relationships.
- A structured process for collaborating with agents, brokers, or consultants to design, market, implement, and assess the port's risk financing program.
- A risk management information system for tracking costs and trends and providing timely, accurate, and actionable information for management decision making.
- Regularly scheduled audits to evaluate the port's risk management status and to solicit objective assessments of the effectiveness of current risk management business processes.

These key elements and attributes are described in more detail below.

Risk Management Policy Statement

All ports have some sort of risk management policy. In many cases, the risk management policy is a by-product of the port's regulations, directives, or procedures with respect to risks. The combination of existing regulations, directives, and procedures define an informal risk management policy for the port. Unfortunately, this approach fails to provide a formalized set of guiding principles to direct and focus the port's risk management and insurance philosophy, processes, values, and culture.

A formal, written policy statement is essential for communicating the port's risk management mission and objectives. A policy statement is also effective in advising port staff what actions they can take to promote the port's risk management efforts.

Ports who adopt a formal written policy statement enjoy several benefits:

- Greater attention by senior management on the risk management function and its importance to the port.
- Committing goals and directions to writing tends to clarify them in everyone's mind.
- Stimulates interdepartmental discussions among the risk manager and operations managers, financial managers, the controller, and possibly outside auditors, to establish safety programs, determine risk retention levels and reserves, etc.
- Clearly defined duties, responsibilities, and authority for risk and insurance related issues and diminished potential for organizational conflicts.
- A solid framework within which risk management program goals can be structured to be consistent with the port's overall goals.
- Coordinated application of fairly standard treatments for loss exposures throughout the organization.
- Improved communication between the risk management function and its various constituents, inside and outside the organization.
- Better management of risk information.
- Smoother transitions in the wake of changes in risk management personnel.

A formal policy statement also provides some meaningful benefits to the risk management staff:

- Serves as a basis for training personnel who are new to the risk management function.
- Provides a framework for assigning responsibilities for organizational risk control and financing.
- Underscores the importance of the risk management function to achieving the port's overall goals.
- Clarifies the position of the risk management function within the port organization.

Risk management policy statements vary in both length and content, depending on the philosophy and organizational requirements of the port. A typical risk management policy statement establishes:

- What risk management encompasses (insurance, loss prevention, claims management, risk identification, etc.) and its importance to the port.
- Risk management's position in the port organization.
- The scope of authority and responsibility for the risk manager and others involved in risk and insurance issues.
- The port's tolerance and capacity for bearing risk without insurance. This information establishes an upper limit on the size of deductibles and retentions and identifies properties or risks that may be deliberately uninsured. It also establishes a threshold above which insurance or another risk transfer approach must be employed.
- The degree to which individual divisions or cost centers should be responsible for their own losses.
- How reserves will be used to fund assumed losses at the corporate level.
- The port's attitude toward using in-house versus contracted services.
- The port's position on activities involving risk (such as how many executives may fly together on one plane).
- Insurance bidding or marketing procedures. A limitation on bidding frequency (such as every three years) may be appropriate.

The policy statement also clarifies such functions as:

- Insurance purchasing
- Broker selection
- Safety responsibility
- Fire protection design

- Claims administration
- Lines of communication

Preparing the Risk Management Policy Statement

In most cases, the risk manager prepares the first draft of policy, after consulting with all parties involved. He or she then submits the draft to the Port Director and other officers, who may suggest changes or additions. After all interested parties (sometimes including the Port Commissioners) have given their full consideration and approval, the policy is disseminated under the signature of the Port Director.

A typical port risk management policy statement might be worded as follows:

Figure 3
Sample Risk Management Policy Statement

This policy applies to all pure risks (risks which can cause losses and whose undertaking involves no possible profit) such as fire, liability suits, theft, workers' compensation, and other risks of property and liability losses, both direct and indirect. It does not apply to deliberately assumed costs of employee benefits.

Mission

The mission of Port U.S.A.'s risk management and insurance function is to prevent loss of life and personal injury and to minimize the organization's total cost of risk (defined as the sum of risk control costs, losses assumed under self-insurance and retention programs, insurance premium costs, and the cost of risk management administration).

Port U.S.A. is to be protected against accidental loss or losses that, in the aggregate, during any fiscal period, would significantly affect Port U.S.A.'s personnel, property, budget, or the ability of the organization to continue to fulfill its responsibilities. In no event shall any loss of life or disabling personal injury to employees, customers, or members of the public be acceptable to the public entity.

Port U.S.A. will apply to risks of an accidental nature a logical management process. This process will include a systematic and continuous identification of loss exposures, analysis of these exposures in terms of frequency and severity, application of sound risk control procedures, and financing of risk consistent with Port U.S.A.'s financial resources.

Risk Retention

Losses that individually do not exceed $250,000 will normally be expensed without insurance. On the other hand, risks with loss potential greater than $250,000 will normally be insured. Any exceptions to this rule made by the Risk Manager in recognition of the financial resources of Port U.S.A. must be documented in regular reports to management. Guidelines for maximum uninsured losses will be reestablished annually by the chief financial officer, subject to review by the Port Commissioners.

Cost of Risk Allocations

Operating entities will expense losses to a level acceptable to the division manager, but no less than $1,000 per loss. The Risk Manager will determine insurance charges to divisions. They will include a proportional share of the port's insurance and administration costs, plus a loading to cover losses between the division and organizational loss retention.

(Continued)

Roles and Responsibilities

The Risk Manager is responsible and accountable for administering Port U.S.A.'s risk management and insurance program and will direct the activities of the Risk Management Department.

The Risk Management Department is responsible for directing and coordinating all risk functions, including:

- Risk analysis
- Purchase of insurance
- Claims adjusting
- Selection of insurance agents or brokers
- Development of risk charges to operating entities

The Risk Management Department will coordinate information and act in an advisory capacity with regard to fire protection, safety, security, and risk aspects of contracts or other legal documents.

Each division manager is responsible for conducting operations in accord with Port U.S.A.'s risk management standards and statutory requirements. Divisions must report all losses or claims, regardless of size, to the Risk Management Department or designated claims adjuster.

The Port Safety Director is responsible for keeping abreast of company activities and for advising proper safeguards to protect employees and the public.

The Legal Department is responsible for all contract wording. However, contracts that involve insurance, indemnity, or other risk provisions must be cleared with the Risk Manager prior to execution, unless exigencies of the situation make this impossible.

Communication

The Risk Manager and Safety Director must continually bring up to date their knowledge of all port operations. They or their representatives will visit major operating units (those with values subject to loss in excess of $5 million) at least annually.

Division managers are responsible for reporting new property values, disposal of assets, and significant changes in operations to the Risk Manager.

"Authorization for Funds"

The Risk Manager must clear all "Authorizations for Funds" associated with risk and insurance prior to final approval.

Risk Management Manuals

Definition

In order to deal responsibly and quickly with the extraordinary events contemplated by the port's insurance coverage, employees need an authoritative, easily accessible risk management reference. A well-conceived risk management manual can substantially reduce the risk manager's workload and facilitate communications between the risk management function and other departments within the organization.

A risk management manual can be:

- A field guide for personnel on how to handle claims, report values, keep records, etc.
- A tool for establishing and advancing lines of communication between the port's head-

quarters, field locations, and outside parties such as claims adjusters and loss control engineers.

- A reference for corporate policy on such day-to-day questions as how to insure rental cars, use of personal cars on company business, and coordination between workers' compensation and the port's employee benefits plan.
- Public relations material for the risk management department. Better understanding by port personnel of the scope and complexity of risk management and its positive impact on employees, third parties, the public, and the port's bottom line, the more port personnel will support the function and contribute to its success.

Risk management manuals are more widely used than written policy statements. A well-planned and executed risk management manual can be one of the risk manager's most useful tools. A user-friendly document that addresses frequently asked questions (How does the port's automobile insurance apply to me? What do I do in the event of a loss? How are insurance and loss costs allocated to my division?) and accurately describes the port's insurance program will be put to good use by staff throughout the organization. And each question answered by the risk management manual is one less phone call, e-mail, fax, or memo for the risk manager to respond to.

Purpose

The risk manager can employ the risk management manual to:

- Broadcast the port's risk management policy to all employees.
- Identify risks that fall within the purview of the risk management function.
- Provide a reference for field personnel on topics of exposures, risk control, insurance, and claims.
- Define responsibilities and authority for carrying out policy.
- Instruct employees as to their responsibilities and rights with respect to issues of risk and insurance.

Distribution

Every port will have a unique approach to disseminating its risk management manual. As a general rule, the manual should be provided to:

- Department heads or managers who need the information for planning or responding to questions about risk and insurance.
- Employees whose work involves risk. This may include the chief financial officer, human resources director, labor relations manager, engineers, and safety manager.

To account for all copies and ensure that changes and corrections are incorporated quickly, the risk manager should number each manual and issue it to a position, not to an individual.

Some ports have found that posting the risk management manual on their intranet provides easy access for all employees, streamlines the process of making updates and corrections, delivers near real-time availability of the most current information, and reduces supply and printing costs.

Contents

Some important items to consider for inclusion in a written risk management manual are:

- The port's risk management policy statement. (See the Sample Risk Management Policy Statement on page 2--3 for a detailed discussion of policy statements.)
- A directory of names, addresses, telephone numbers (business and home), and e-mail addresses of key risk management department personnel who employees can contact at any time. Making risk management personnel readily accessible to other staff can lead to discovery of new risks and reporting of losses that might otherwise be overlooked.
- The port's rules on risk, such as limits on the number of executives flying together, re-

strictions on the chartering of aircraft or boats, and requirements for reporting of dishonest acts by employees.

- A requirement that the Risk Management Department be advised of all proposed leases, agreements, or contracts. This requirement ensures that the Risk Management Department is aware of new activities, changes of a contractual nature, and the port's extension of hold harmless or indemnification or contractual assumption of risk of accidental loss. It also provides the Risk Management Department with the opportunity to advise of any contract amendments that should be considered to minimize the port's exposure to loss, and provides the information necessary to include in the system for monitoring for compliance with insurance requirements placed by the port on facilities' users and contractors.

- Detailed instructions regarding automobile insurance and coverage for employees driving a company car on port business or for personal use and those who receive a mileage allowance. Generally, the mileage allowance should cover payment for insurance because the employee's own insurance is usually primary. If this is not clearly stated and understood, employee dissatisfaction may result after an accident.

- Designation of individuals responsible to report significant changes in risk, such as leasing an outside warehouse, chartering aircraft or boats, starting a bowling team, etc.

- Standards for notifying the Risk Management Department as early in the process as possible of any plans for acquisitions, sales, or closings of facilities. Sufficient lead-time must be provided for the risk manager to properly place desired insurance. Further, a risk analysis prior to the transaction can make a significant difference in the attractiveness and the valuation of an acquisition.

- Establish (1) when the risk manager enters the picture when the port is planning an acquisition, sale, or facility closing and (2) what he/she is to do. The risk manager's task should begin at the time of evaluation when financial data are gathered. Everyone involved should be aware of the need to evaluate the entire spectrum of risks that may be assumed. Overall "underwriting desirability" is also another matter to take into consideration. A proposed acquisition may be a type of facility that the port's underwriters would not want to insure under any circumstances. Any property to be acquired should also be reported to the risk manager so he/she can arrange for a fire protection inspection. An inspection by a qualified fire protection engineer can identify any serious deficiencies such as inadequate water pressure or unprotected operations that might be costly to correct.

- Designation of appropriate field personnel to inform the risk manager of significant changes in values at risk.

- General rules on safety, security, or fire protection. These include the need for fire protection approval on each new project that either (1) involves any fire loss potential or (2) is for fire protection equipment. Instruct field personnel to obtain approval through the risk manager, to ensure that qualified specialists representing both the port and its insurers are consulted.

- Provide for advance notice to the Risk Management Department of any planned new construction (both expansion of present facilities or construction at new locations). An effective way to accomplish this is to require that the risk manager be provided a copy of all requests for approvals for capital expenditures. This approach normally provides the risk manager with sufficient time for input on loss prevention, safety, and other areas that impact the port's risk management programs during the planning stages of the construction project.

- Procedures for issuing, receiving, verifying, and renewal of Certificates of Insurance. The procedure should spell out what information is required to issue a certificate. A written procedure can reduce telephone requests for certificates.

- Risk Management should review contracts/proposals to establish insurance and bonding compliance/requirements.

- Risk Management should review incoming certificates and bonds to insure compliance with limits, required coverages, and additional insured status.
- Procedures/form letters should be established to communicate any deficiency, deviation, lack of compliance, or expiration.
- Certificate tracking/tickler systems should be developed (spreadsheets in-house or vendor software) to insure timely renewal of longer-term contracts, leases, and projects.
- Identification of fire protection, safety, and boiler inspectors, as well as rating bureaus, OSHA or other government agencies, who may legitimately visit port facilities. A manual should clarify how inspectors are to be treated and what to do with their recommendations. Recommendations of fire inspectors that involve spending money should usually be submitted in writing and channeled through the risk manager.
- Guidelines on insurance and hold harmless provisions to be included as part of any agreement or contract involving contractors, suppliers, or lessees. This procedure should describe the type and minimum amounts of insurance to be required before contractors, suppliers, or lessees will be allowed to commence any work. The guidelines should be written to cover most day-to-day situations.
- Instruction for controllers on how to allocate costs for insurance premiums, uninsured losses, risk management services, loss prevention costs, and other risk-related charges.
- General and specific procedures for claims reporting, processing, and settlement. These procedures should provide clear, step-by-step instructions for what to do in case of loss. They should also address who is to fill out and receive copies of claim reports, when and how such notice should be given, and what special and general procedures should be followed with respect to all types of claims. Samples of loss report forms should be included in the manual.

It may be helpful to include a general summary of insurance, risk management programs, and other pertinent information that is applicable to the risk management and insurance programs. However, the risk management manual should not be used to communicate details about the port's insurance coverage to the field nor should it include complete copies of the policies. When employees are given access to this kind of information, they are inclined to interpret coverage. Misinterpretation of coverage could result in unreported losses or unreported changes in operations. In addition, policies and coverages may change more quickly then the manual can be revised and redistributed. (Note that this is less of an issue if the manual is posted on the port's intranet.) Coverage information in the manual should be limited to summaries, deductibles, cost accounting, and reporting requirements.

The format should be loose-leaf to accommodate changes. It is helpful to print the words "Risk Management" or "Insurance" on the spine for easy identification. To enhance usability, the manual should be well-indexed, using divider tabs for major topics. A table of contents giving the title of all subjects and exhibits, with page numbers, should be included at the front of the book.

As mentioned above, the manual can also be posted on the port's intranet.

Structure and Staffing of the Risk Management Function

Several factors make it difficult to generalize about the level and reporting relationships of the risk management function within the port's overall organization.

First, risk management encompasses a multitude of disciplines, including law, finance, statistics, information technology, human resources, and industrial engineering. Further, the risk management function may also encompass insurance, loss prevention, safety, industrial hygiene, security, employee benefits, and other areas.

Second, the depth of senior management's concern about risk management and treatment of loss exposures varies greatly among ports.

Finally, some ports have a history of very strong risk management. Others have been less effective in this area.

Clearly, no single organizational structure can be ideal for all ports.

Risk Management Responsibilities

Principal areas of risk management responsibility generally include:

- Risk Determination and Evaluation – This involves identifying the loss exposures and size of potential loss inherent in the port's activities.
- Risk Financing – Determining whether to insure or self-insure, what alternative types of insurance and self-insurance to consider, how much insurance to purchase, how much risk to retain on a self-insured basis, and how to negotiate for desired insurance coverages and service arrangements.
- Claims Administration – Coordination of the handling and settlement of all significant claims and establishing and maintaining the administrative requirements of routine claims between involved parties, including legal.
- General Administration – Department budgeting and forecasting, planning for objectives, record and statistical keeping, accounting and cost allocation, and management of department personnel.
- Loss Prevention Engineering – Establishing systems and programs to prevent or minimize loss or damage to port assets or impairment of port earnings.
- Safety Administration – Establishing systems and programs to prevent or minimize injury to the port's employees.
- Security – Coordination or advising on security requirements and procedures to prevent or minimize loss of port property or assets by employees or others.
- Group Insurance Benefits – Supervising or advising on the benefits structure, financing of benefits, and administrative requirements.

A number of factors will bear on the organizational structure, staffing, and authority of a specific risk management department. Some of these factors include:

- The complexity of the risks. Generally complex risks with large loss potentials will require a more sophisticated and larger staff.
- Emphasis placed on the risk management department function by management often influences the location, staffing, and authority of the risk management department. Also to be considered is to whom risk management reports. If it reports to a financial officer, greater emphasis will be placed on risk financing and accounting controls. If it reports to a human resource officer, safety and loss prevention may be emphasized.
- Risk management history may also be a consideration. A large uninsured loss or a series of losses are generally well remembered by management. On the other hand, large losses that are appropriately insured may serve equally well in reminding management of the importance of the risk management function. Personnel strength of the risk management staff can also be an influencing factor. Recognized talent and ability can lead to increased development and expansion of the risk management department.
- The port's organizational structure and philosophy may also influence the risk management department. An organizational structure that stresses line management authority may desire to carve out certain risk management functions, such as safety or loss prevention, at an operational level while other ports may incorporate them in the risk management department as a staff function.

Roles and Responsibilities of the Risk Manager

Risks can arise out of any of the functions comprising a port's operations. The most effective risk management programs recognize that "risk management is everybody's business." Individuals with specific responsibility for various aspects of port operations are often best qualified to identify, assess, and control risks that fall within their specific areas of expertise. State of the art risk management programs involve staff throughout the organization, at all levels, in managing risk. However, in every port organization, a single individual has assumed or been assigned ultimate responsibility for issues associated with risk and insurance. In some organizations, this individual may hold the formal title of "Risk Manager" or "Director of Risk Management." In others, these responsibilities may fall upon finance or operations staff. At the smallest ports, the Port Director, an outside consultant, or the insurance broker may assume primary responsibility for directing the risk management program. Regardless of their formal titles, all risk managers share certain duties, responsibilities, and activities.

Directing the Risk Management Function

The risk manager should know more about the port's risk management program than anyone else in the organization and more than any outside consultants. For this reason, the risk manager is the focal point for shaping the port's risk management strategy, designing an overall program, and establishing meaningful objectives. As the leading risk management executive for the port, the risk manager is called upon to:

- Work with the port's senior management to establish a risk management policy as the basis for consistent functioning
- Plan, organize, and direct risk management department resources
- Collaborate with senior management in establishing and implementing organization-wide risk management areas of responsibility and channels of communication
- Monitor the port's changing risk landscape and adjust the risk management program as necessary to maintain strong risk control and cost-effective risk funding
- Enlist the cooperation and support of managers and other employees throughout the organization
- Communicate to senior management through regular (at least annual) reports on progress, status, and future plans
- Communicate with the field and department heads through the risk management manual, telephone, e-mail, and inspections
- Provide senior management with a variety of progress, status, and planning reports, such as status reports of risk management activities; analyses of losses and special communications of individual large losses; requests for approval or significant new projects; and requests for additional funds, personnel, or other resources
- Create incentives for action that promote the port's overall risk management strategy and objectives by equitably allocating cost of risk to the port's operating units
- Document all risk and insurance related activities and information
    - Data on insured and self-insured losses
    - Management decisions on risk
    - Telephone calls or e-mails regarding coverage and other important discussions
    - Correspondence related to risk management or insurance
    - Insurance policies (including expired liability policies)
    - Data pertaining to insurance policies
    - Property valuations, broken down by fire divisions
    - Fire protection maps showing separate fire divisions
- Administer a variety of risk management functions, including supervising contractors' certificates of insurance; directing Public Officials Liability policy preparation; assisting the legal department in developing standards for purchase orders, leases, and other documents; and handling bid, performance, and permit bonds
- Assemble a port risk management manual including instructions on how to handle claims, how to report values and changes, how to deal with loss control engineers, etc.

- Select an agent or broker to assist in marketing and servicing the port's risk management program

Identifying and Assessing Loss Exposures

The risk management process begins with an identification and assessment of loss exposures. This may be the risk manager's single most important function. Comprehensive risk identification and assessment requires the risk manager to undertake a rigorous ongoing process of:

- Conducting annual physical inspections of major port facilities
- Reviewing and evaluating contracts, leases, bond indentures, and similar documents entered into by the port
- Staying informed about relevant laws, regulations, and requirements
- Communicating regularly with key staff and operating managers
- Estimating ultimate costs for direct and indirect losses
- Studying the port's financial, budget, and operating reports
- Examining all insured and self-insured losses
- Reviewing capital budget requests from operating units
- Reading minutes of Port Commissioners' meetings

Risk managers, particularly those at larger ports, may not carry out all of these activities personally. However, the risk manager is responsible for identifying qualified individuals to whom these tasks can be delegated and monitoring performance to ensure timeliness and quality.

Risk Control

Port risk managers have at their disposal several techniques for controlling the risks associated with port operations. These include exposure avoidance, risk prevention, risk reduction, segregation of exposure units, and contractual transfer for risk control. The specific tasks supporting each of these techniques vary. However, the objectives of these activities, for which the risk manager and risk control department are accountable consistently include:

- Enlisting the support of senior management for an organization-wide culture of "safety first" and developing incentives that encourage and reward safe performance
- Ensuring that every constituent of the port, including employees, vendors, and lessees, understands their role in identifying and communicating hazards and taking appropriate control measures
- Within the limits of the risk manager's authority, directing the activities of the risk control department, particularly in emergencies
- Selecting and implementing alternative risk control techniques with the greatest potential return on investment to the port
- Training line managers in accident prevention techniques custom-tailored to their operations
- Resolving disputes between line managers regarding the most effective approaches to risk control

Transferring or Financing Risks

The risk manager must maintain thorough knowledge of the port's financial structure and organization in order to select optimal methods of funding risk. Risk funding techniques can generally be classified as either risk retention or risk transfer. Alternatives setting up lines of credit, using a captive insurer, pooling with others, and insuring.

Risk retention alternatives include expensing, reserving, setting up lines of credit, and using a captive insurer. Risk transfer techniques include contractual transfer and insuring.

Another option, pooling with others, combines elements of risk retention and risk transfer.

Regardless of the funding option, the risk manager will be required to conduct the same planning, negotiating, record keeping, and administrative activities. Responsibilities include:

- Working with senior management to determine the port's retention capacity for particular exposures
- Evaluating risk funding alternatives that satisfy the port's appetite for risk bearing and identifying optimal approaches
- After determining what insurance is needed, negotiating with underwriters (often in conjunction with the port's agent or broker) to obtain the best conditions of coverage and cost
- Following a loss, activating the chosen financing mechanism
- Measuring and controlling risk financing costs to ensure continuing cost-effectiveness
- On liability and workers' compensation claims, verifying that reporting procedures are adequate, that claims adjusters are the best available, that reserves are checked frequently, etc.
- Overseeing property and self-insured claims
- Initiating and following through on subrogation (recovery) procedures against third parties
- Monitoring claims expenses (investigations, expert witnesses, legal, etc.)

Risk Management Annual Report

The Risk Management Annual Report is one of the most important communications that the risk manager is required to prepare and present. Annual reports are as diverse as the ports that prepare them. No two ports are alike nor are their risk management accomplishments. The following outline lists some subjects that could be included in the annual report (see Exhibit B, page B--2).

Summary and Highlights

Financial

- Summary of premiums
- Comparison to probable full coverage costs
- Summary of other costs: payroll, overhead, outside services, appraisal, salvage, security
- Summary of losses, insured and retained
- Incurred losses, number of cases and amount
- Reserves, number of cases and amount
- Large or unusual losses, including how they will be funded and steps taken to prevent recurrence
- Litigation, cases currently litigated; potential litigation cases
- Insurance recoveries

Loss Prevention and Safety

- Training and education
- Specific loss reductions achieved
- Liaison and communication regarding safety
- Safety committee activities
- Safety inspections, in-house, contracted, and insurer: cost/benefit analysis
- Action on fire protection recommendations and status of future action
- Security: computer and other
- Comparison of contracted employee guard force versus in-house security

Insurance

- Changes in coverage, limits, retentions, or underwriters
- Broker activities, remuneration and evaluation
- Plans for change

Claims and Other Services

- Evaluation

Administration

- Major plans for the coming year

SELECTING BROKERS, AGENTS, AND CONSULTANTS

In theory, there is a legal distinction between insurance brokers and agents. Brokers represent the insurance buyer. A broker represents many insurance companies and is free to shop the market for their customers to find the right kind and the right amount of insurance. However, a broker has no legal authority to bind an insurer to a policy without prior agreement. An agent is the insurance company's legal representative and is authorized to bind the carrier to an insurance contract. This theoretical distinction has blurred in the wake of court precedents and the apparent overlap of services and activities performed by brokers and agents.

The primary duties of agents and brokers include:

- Placing insurance coverage
- Selecting underwriters
- Negotiating premiums
- Analyzing policies
- Identifying and analyzing risks
- Conducting feasibility studies for alternative financing techniques
- Assisting in filing claims and facilitating claims adjustment
- Providing engineering and loss prevention services
- Maintaining records of historical premiums and losses and premiums

The selection of a broker or agent is important because this individual is often the port's only link to its insurers and its primary source of risk management advice and assistance.

In selecting a broker, a port should consider several factors, including:

- *Experience with the risks* – The port's broker or brokers should have knowledge and expertise in all of the exposures comprising the port's risk profile. In cases where the port faces unique, complex, or hard-to-place exposures, it may be necessary to use more than one broker to achieve the requisite breadth and scope of knowledge, experience, and market presence. Keep in mind that a broker whose expertise spans only a subset of the overall risk profile may not be competent to fulfill all of the port's risk management and insurance needs. The selected broker or brokers should be qualified to handle the full spectrum of risks, whether stevedoring exposures, terminal building property exposures, public officials' liability, crime, protection and indemnity, aviation, environmental liability, employment practices' liability, or any unusual exposure(s) the port faces.
- *Services* – The extent of brokerage services required will vary from port to port. In selecting a broker, the port must define the scope of services that will be required. If port staff, insurers, or outside contractors perform most services, requirements for the broker may be minimal. On the other hand, if the port intends to rely on its broker for engineering or loss prevention, policy evaluation, feasibility studies, loss runs, etc., the broker's service capabilities in these areas must be evaluated in the selection process.
- *Geographic Locations* – The proliferation of e-mail, fax, and other electronic communications tools has reduced the importance of geographic proximity between the port and its broker(s). However, in situations where frequent contact with the broker is required or where the broker may be relied on for on-site services, geographic proximity to the port is a valid consideration.
- *Brokers* – Generally an agency or brokerage house will assign primary responsibility for handling and servicing a port account to an individual. If this individual serves as the account executive for other accounts, the port may find itself contending with other clients for the account executive's time. Therefore, evaluate the size and experience of the broker's staff in gauging its ability to meet the port's needs at times when the account executive is serving other clients. If the broker also provides claims, risk control, analytical, or other services, the port should assess its capacity and capabilities in these areas, as well.

Another factor to consider is the broker's premium volume, particularly in lines of insurance similar to the port's own coverage. Premium volume is another indicator of the scope of the broker's experience in relevant lines of business and may be helpful in gauging the broker's clout or ability to obtain concessions from the insurance market that benefit the port.

Perhaps the most important factor to consider is the port's relationship with its broker. A port that is unable to communicate and closely work with its broker will have difficulty achieving the objectives established for its risk management and insurance program.

Broker Selection

A capable and motivated broker is one of the risk manager's most valuable assets. The selection process is vital. Unfortunately, selecting a broker is no easier than selecting an auditor, attorney, architect, or any other professional. Some preliminary issues to consider include:

- The ability of the account executive handling the port's account is more important to the success of the port/broker partnership than are the overall capabilities of the brokerage firm. The account executive must possess the experience, knowledge, and competence to consistently meet or exceed the port's expectations, as well as having good chemistry with port personnel.
- Many firms are concerned about the size of a brokerage firm. Quality outweighs size, even in marketing. Be skeptical of brokers who claim that their size brings clout in the market.
- Define the port's needs clearly (a written contract is important) and relate the broker's compensation (whether commission or fee) to actual services rendered. This approach gives the broker added incentive to focus time and effort on services that are essential to the port.
- Negotiated fees, where a broker's income is based on a proportion of insurance premiums, are gaining acceptance as a more professional means of compensation.

Selection Techniques

A broker is generally selected in one of four different ways, each of which present particular advantages and disadvantages (see Figure 4, page 2--14).

The approaches are discussed in greater detail in the Insurance Purchasing section on page 2--18.

Marketing

The function for which the broker is most indispensable is marketing, which involves:

- Selecting from the hundreds of insurers the few who are likely to be most suitable.
- Deciding how to structure an offering to the insurer; that is, whether it should be put in one or several packages, whether special risks such as aircraft products or professional liability should be taken to separate underwriters, whether it would be better to have many underwriters share in a single offering (vertical layering), or have one primary insurer with other underwriters taking different layers of excess insurance (horizontal layering), etc. Only a seasoned broker can properly make these kinds of critical decisions.
- Negotiating with underwriters on terms and conditions of coverage and price. Much skill, both professional and psychological, is needed here. Individual underwriters have their own strengths, weaknesses, and predilections. The broker who knows them from personal experience has an advantage.

Direct Writing Insurers

Many large and capable insurers pay no commission to a broker. There are two ways the insured can handle these direct writers: (1) deal with them directly, omitting the broker entirely or (2) use the broker as an intermediary, paying the broker a negotiated fee for his/her services. Both techniques have their place.

Figure 4
Broker Selection Techniques

TECHNIQUE	ADVANTAGES	DISADVANTAGES
Appointment without competitive bids	• Does not disturb markets. Underwriters give their best efforts to a broker who has the account in hand. With several brokers coming to him or her, an underwriter will not extend themself as much and may even refuse to quote. • Broker can negotiate alternative proposals in domestic and foreign markets, creating a competitive atmosphere between underwriters rather than between brokers. • Suggests a long-term arrangement offering continuity to underwriters, particularly important if good experience credit has been built up. Be wary here, though. Good experience could mean excessive premiums. • The broker and insured can spend more productive time together to arrange the best possible program.	• May be more expensive. • May create an appearance of impropriety. This technique is least suited to public and quasi-public bodies, such as ports. • Reduces insured's exposure to new ideas and developments of other brokers.
Broker selection without competitive quotes	• Does not disturb markets. • You receive a variety of ideas. • You receive a cost indication. • Allows continuity with existing markets after selection is made.	• Broker can overstate coverage and understate premium. • It does not allow any one broker to achieve much depth of understanding of the insured's special characteristics. However, the understanding could come after selection and the proposed program can then be appropriately modified.
Qualified Competitive Quotes	• Does not disturb markets. • Creates competition between underwriters and brokers, and probably lowers premium.	• Each broker loses the opportunity to utilize the combination of markets where they best fit, as with primary and excess layers. • Complete separation of markets is not always possible where high limits and reinsurance are involved. If so, competition could be limited to primary lines only. Excess lines involve relatively little premium and are often best handled by the broker on a non-competitive basis. • Some markets will refuse to negotiate until a broker is appointed, though in most cases, letters of broker authorization as described above should overcome this problem.
Unrestricted competition	• Possibly lower premium cost. • Elimination of political criticism.	• Underwriters do not extend themselves and sometimes refuse to quote when many companies are bidding. Because of this, ultimate costs may be higher. • Insurance markets may possibly be substandard, though this can be avoided by prequalifying markets (minimum rating by Best) or reserving the right to reject companies. • Low cost could last only one year. • The emphasis is on price rather than service and skill. However, if specifications have been adequately drawn and services properly detailed, coverage should be complete. Price can then represent the major variable. • Some markets may have been blocked (committed to only one broker or the price fixed at an unrealistically high level) by an unsuccessful bidder. Brokers sometimes go to an underwriter with a "suggested" price. If several brokers advise different levels, the highest will often prevail for all. • Markets could be blocked and not used.

The first technique is preferable when the insured knows the direct writer has the best overall program and periodically has a broker offer competitive quotations. The second is preferred in companies where the broker plays a dominant role in the risk program and coordinates all insurance.

The broker's fee for acting as intermediary with a direct writer is often based on the net premium (10% is common). Unless special services such as loss prevention are included, this is often excessive.

The direct-writing company has built-in sales expenses that agency-writing companies do not, and the port should not have to pay twice for sales costs. Basing the fee on premium is a disincentive for the broker to push for the lowest possible cost. It is better for the port to negotiate a flat fee with the broker based on the broker's presentation of precisely what is to be done and the amount of time and expense entailed. Usually, this will be somewhat less than 10% of premium, unless extensive services are involved, such as engineering or claims adjusting.

Fees Versus Commissions

The issue of whether brokers should be compensated on a percent of premiums or on a professional fee related to services rendered generates spirited debate. Most brokers prefer commissions because:

- Commission income is usually higher than the fees the broker believes could be negotiated.
- The broker's remuneration is not readily visible to the insured and thus is not subject to cost-cutting attacks.
- Brokers are often unable to cost account their time and expenses in a way needed to develop reasonable but not excessive fees.
- If salary and overhead of a major account executive are translated into an equivalent hourly fee, it may be embarrassingly high.

The anti-rebate laws in many states restrict brokers. A few states (Michigan, for example) do not license brokers and, therefore, do not permit fee-based compensation.

However, in most instances, brokers can negotiate any commission, down to zero on some lines. Liability is normally more flexible than property, allowing the desired fee to be attained.

Risk managers, by a large majority, favor the negotiated fee over commissions. Some reasons are:

- Many believe commissions are too high.
- Fees give more flexibility in paying for services needed and omitting services not needed.
- Fees eliminate the financial incentive to sell more insurance.
- Fees are more professional since compensation is based on service rather than on the amount of a product.
- Fees generate better cost accounting and greater broker efficiency.

We should mention, however, that a number of quite sophisticated risk managers are satisfied with the commission arrangement and even believe they can get more work from the broker under commissions than they would under a fee.

Commission Income

The amount of commission received by brokers varies widely. In most property and liability lines it lies between 10% and 15%. Agents generally receive a little more than brokers and in some states and in some lines, such as bonds, specific commissions go to 20% and even 30%.

Every port risk manager should know what his or her broker is receiving in compensation for the account. Some risk managers say this does not matter to them as long as they believe total costs are in line. However, as in any field, knowledge is preferable to ignorance. It is surprising how often a little information can raise questions or suggest actions that would otherwise be overlooked.

Some brokers refuse to divulge their income, using the analogy that a store does not tell you how much they mark up their goods. This is a merchandising approach, not a professional approach sought by the better brokers. The more professional firms will rarely refuse to tell their clients what they are receiving; they know they are worth it.

Access to Insurance Markets

The insurance market is composed of hundreds of insurance companies, each specializing in different types of insurance. Even when brokers work on a fee basis, they rarely can be totally objective with regard to market utilization because insurance marketing is a highly individualized function. The largest brokers theoretically have access to the entire marketplace but in practice use only a fraction of the sources for most placements.

Close relationships are developed between broker and market personnel. Some markets are therefore used much more heavily than others, not only because of the personal business relationship, but also because of the broker's need to deliver large amounts of business to insurers in order to develop rapport and leverage.

At a minimum, the port's selected broker should be familiar with the London market, the U.S. insurance exchange, and surplus lines firms, as well as most local insurers. ("Surplus lines" is insurance not usually available from admitted carriers that is written with non-admitted companies.)

No matter how large the brokerage firm, it will not be able to establish a close working relationship with all insurance companies. Each broker will have insurance companies with which they can produce better results than others. Many different factors may influence the broker's ability to produce good results. Brokers have varying degrees of influence with individual insurance underwriters. Size of the broker is one factor in market clout, but overall size worldwide may not be as important as volume of placements of a particular type. A more important factor is the broker's reputation for character and ability, which is quite independent of size. Sometimes, a smaller broker has a larger volume of a specialty line of coverage than a larger broker, thus obtaining greater expertise and leverage. The size of a brokerage firm should have little to do with the decision except as it affects the availability of specific services.

Test your program periodically through competing brokers or consultants. Do not open the program to direct competition at every renewal but keep enough contact with competing brokers to be aware of trends and new developments. Whatever your insurance sources, do not let them become complacent.

Other Functions

Some other functions the broker may perform include:

- Check policy wording and accuracy. Each policy, as it is received from the underwriter, should be read carefully to see that the wording actually provides the desired coverage. Mistakes are common and should be corrected by the broker before the policy is passed on to the port. Brokers often become careless with this function, and even when they are not, the port should read each policy as it is received. Note that in *Parre & Sons vs. Campbell, 196 SE2d 334,* the judge stated that the insured had a duty to read the policy and should not rely on the agent.
- Fire protection and safety. Some of the larger brokers have staff specialists, including engineers, to make inspections, advise on new construction, analyze fire rates, and review recommendations from insurance company inspectors. Some of this work is excellent but a great deal is a wasteful duplication of effort. For instance, for a company with adequate in-house fire protection engineers, the use of a broker's engineer may just pyramid the bureaucracy. Only you can decide what is needed. Such services should be performed only when they serve a purpose.
- Valuations. A potentially useful function of the broker is assistance in establishing insurable values. While this process does not give very accurate results, it is often adequate for insurance needs. Even when the broker does not perform the actual valuation, he/she can be the source of data for updating old valuations.
- Draft policy wording. The broker's ability to word a policy properly can be important to

the port. Wording must be tailored to fit the risk, yet still make it acceptable to underwriters. The broker must know how to structure unique wording to stand the test of a large loss but also understand when standard language is more effective.

- Audit reserves. General liability and workers' compensation cases often drag on for years. The underwriter estimates each case to its ultimate cost, and the reserve (the total estimate minus amounts paid to date) is charged to the insured in the year the loss is incurred. Two points require special attention. First, the reserve amount should be reasonable and adjusted as conditions change. Second, the reserve should be taken off the books as soon as the case is closed. Underwriters are not always meticulous about this. The broker can be quite helpful in this regard. On some large accounts, the broker may actually audit the procedures of the claims adjusters, checking timeliness of the adjuster's response and reports, judgment in settling or resisting, follow-up on subrogation potentials, and general effectiveness.

- Verify rates and premiums. Most policies utilize rates established by rating bureaus, sometimes with complicated rating formulas. Premium calculations can be involved. Errors occur which the broker can detect.

- Identify and evaluate risks. All brokers must be thoroughly conversant with the port's activities to help identify and measure risks. Needs vary greatly.

- Collect losses. Brokers can help an insured collect losses, but abilities vary, as do needs. Some straightforward settlements require a claims adjuster who has more expertise than is possessed by most brokers. Use of a good public adjuster (one who works only for the insured) may be preferable.

- Computer services. Some larger brokers offer risk information management services ranging from loss and claims analysis and insurable value printouts to probability forecasts. Check these carefully to see that they represent the most efficient way to achieve your goal and do not lock you in to one broker's services.

Consultants

A survey conducted by Tillinghast and the Risk and Insurance Management Society in 1997 found that the cost of risk at U.S.-based organizations dropped in 1996 to $5.70 per $1,000 of revenue, from $6.49 in 1995. Cost of risk has been steadily declining since 1992, when it peaked at $8.30 per $1,000 of revenue. Declining workers' compensation costs and reduced property losses are seen as the main causes for the improvement.

This is a very different environment then the one ports faced in the 1980s and early 1990s. In that period, risk management and insurance costs were very significant for ports worldwide, which led to the development of complex alternatives not previously available. Some of these alternatives, including self-insurance, retrospective rating plans, and pooling, were advanced by or required the expertise of independent risk management and insurance consulting organizations. As a result, port management became increasingly aware of the value of independent consultants, and many of the port/consultant relationships that were initiated fifteen or twenty years ago continue today, despite recent declines in cost of risk.

To be truly independent, these consulting organizations should have no agency, insurer or insurance service provider affiliation, otherwise there could be a potential bias.

All types of organizations including governmental entities, service enterprises, nonprofit organizations, and manufacturers need to know how well their risk management and insurance requirements are being satisfied, what alternatives are available, and if and how their present insurance and risk management programs can be improved. Risk management consulting services are available from many sources including insurance companies and independent brokers, agents, consulting firms.

As is the case with virtually all consulting firms, there are some good firms, some bad, and some in between. Be as careful choosing a consultant as you would your broker. The experience and capabilities of risk management consulting firms vary. General categories of services that might be offered by firms include:

- Audits of an organization's exposure to loss and insurance coverage to ensure that existing programs are adequate and appropriate for the organization.

- Insurance specifications and assistance in marketing the insurance programs of an organization.

- Feasibility studies and assistance in developing and implementing an ongoing maintenance of captive insurance companies, self-insurance plans, or other cash flow loss funding techniques.

- Actuarial evaluation of self-insurance plans or the reserves of captive insurance companies.

- Claims audits and evaluations of self-insurance programs.

- Evaluation of the administration of an organization's risk management and insurance program.

Generally, in seeking assistance from a consultant, it is advisable to first define the particular project and the objectives that the port hopes to achieve by undertaking the project. Sometimes it is helpful for a port to talk to a consultant, in its efforts to formulate and define the project's scope. The consultant should then be requested to provide a proposal. The proposal may be a formal written document or merely a verbal agreement worked out in a meeting with the consultant. Included in the proposal should be a general outline of the work and methodology to be used to accomplish the work.

The port may also request that the consultant's proposal provide a breakdown of the number of man hours projected for the project, a list including resumes of the individuals who will participate in the project, hourly rates or fixed fees to be charged, any expenses which may be in addition to the fees, and a list of references.

INSURANCE PURCHASING

A port may adopt any of several approaches to the placement of insurance contracts. This section of the *Guidebook* describes possible approaches and discusses their advantages and disadvantages.

In most cases, the available approaches are:

- Competitive bidding based on rigid specifications.

- Competitive bidding with the potential for accepting alternative proposals by innovative carriers, agents, or brokers.

- Informal bidding without specifications.

- Placement through a designated agent or broker on a more or less permanent basis, with the designated agent or broker responsible for providing the best available coverage terms, conditions, and pricing.

- Placement of insurance through an agents' association, with responsibility on the part of the association to provide best coverage terms, conditions, and pricing for the port.

- Periodic bidding, coupled with interim negotiated renewals.

Competitive Bidding Based on Rigid Specifications

Advantages

Under a system of competitive bidding based on rigid specifications, the port is likely to secure the lowest cost for the specified program, with minimal confusion in comparing alternatives.

Disadvantages

- Competitive bidding on every insurance contract, including renewals, may be counterproductive in several ways, particularly for ports regarded by insurance companies as unfavorable risks.

- Qualified underwriters may be discouraged from bidding because the port's target pricing allows little opportunity for profit. This is particularly true if the port invites an unlimited number of bidders to quote.

- Where there are a limited number of markets for a particular type of insurance coverage, one or more of those markets may be lost as a result of uncertainty about the port's designated broker or agent. Most insurance carriers react negatively to multiple approaches by several brokers and agents. At best, the underwriter will give the same quote to every broker or agent who requests a proposal on the account, leaving the port in a quandary as to which of two or more brokers or agents to finally recognize if that quote turns out to be lowest. Alternatively, the underwriter may recognize the first broker or agent to submit the risk, and that broker or agent may be the weakest, or simply may have tied up all the markets at the earliest opportunity, or the carrier may decline to quote at all, until a broker of record is designated. This places the port in the middle of an uncomfortable bidding situation.

A pre-bid company allocation system often will reduce confusion inherent in the open bidding process. Under this system, the port asks interested agents or brokers to submit, by a designated date, a sealed list of insurance carriers they want to use in quoting on the insurance in question, in order of preference. When the lists are submitted, the envelopes containing them are noted as to date and time of submission. On the designated date for their opening, they are examined and insurance companies or company groups are allocated on the basis of the following rules:

- Carriers currently writing the coverage being bid will automatically be assigned to the current broker or agent of record.
- Each agent or broker is allocated one company until each has been awarded one, if possible. Following the first round of awards, a second company is awarded to each, to the extent possible, then a third, fourth, etc., until requests are exhausted.
- Where conflicts exist by reason of more than one agent seeking the same company in the same round, these can be resolved using predetermined criteria, such as time of request receipt or highest agency volume or share transacted with the company in question.
- When any company in a "group" has been awarded, that group is closed to any other award. Identification of members of a company group can readily be made from several sources, such as A.M Best, or by a consultant.
- After all requested markets have been assigned, the port provides a letter of record to each agent or broker addressed to the insurers. The letter states that the broker has sole authority to represent the assured in this insurance bid.
- Reinsurance markets should not be allocated but should remain completely free for access by all primary carriers.
- After the initial allocation of markets is completed, agents or brokers presenting later requests for markets should have those requests honored on a first-come/first-served basis, providing the allocation of the insurance company requested or any sister company in the same group has not been made.

The above procedure is fair and equitable, eliminates confusion in the insurance marketplace, and ensures that the port receives bids from all interested carriers. It also prevents brokers or agents from "blocking" the market or employing other strategies that may be detrimental to the port.

There are other disadvantages to repeated bidding of insurance contracts at frequent intervals. The insurance carriers will tend to build into their quotations the entire cost of setting up services for the account (costs that they might otherwise absorb over several years). The carrier will have to project a sufficient margin over expected losses to diminish the probability of an underwriting loss, since the carrier will not be able to count on future years' profits on the account offsetting a first year loss.

There are also high costs involved for the port, not only in terms of the time and expense involved in writing specifications and evaluating bids but also the time and expense of getting new insurance carriers acquainted with the port operations, conducting inspections, shifting claims reporting procedures, etc.

Finally, rigid specifications can limit the benefit that might be drawn from new or innovative approaches on the part of carriers, agents, or brokers.

Competitive Bidding With Alternate Options Acceptable

Advantages

This approach is likely to produce the lowest costs for a given insurance program. It also allows carriers, agents, and brokers to be creative and innovative in designing and marketing the port's insurance program.

Disadvantages

Comparisons of bids will be somewhat more difficult, but if each carrier, agent, and broker is required to bid on the same basic program, the port can make initial comparisons on the basis of that program. Then, alternate proposals can be compared with the best of the basic program proposals. This approach may require a greater degree of sophistication, and the advice of an insurance consultant may be desirable.

This approach, if employed for every insurance award, involves the same disadvantages as those listed earlier, i.e.:

- Loss of interest by qualified carriers
- Possible confusion in the insurance marketplace.
- High initial costs of both insurer and insured in any changes of carriers.
- Padding of premiums by the bidding carriers against loss contingencies.

Informal Bidding Without Specifications

Advantages

This approach usually involves letting all interested carriers, agents, and brokers bid by examining the port's existing insurance policies. It eliminates the cost of preparing specifications and may stimulate innovation and creativity in coverages and rating plans.

Disadvantages

Informal bidding without specifications shares the four previously cited disadvantages of frequent bidding. It also makes apples-to-apples comparisons more difficult and is unfair to the incumbent carrier, who becomes a target for all of the competitors.

Placement Through A Designated Agent Or Broker

Advantages

This arrangement enables the broker or agent to develop in-depth knowledge of the port's operations, needs, and insurance program. The agent can establish a truly professional relationship with the port, as part of the port's "family" of advisors. One argument in favor of this approach is that the port does not seek bids on legal services, so it should not seek bids on other professional services.

Cost of changeover is avoided by long-term relationships with the agent, and probably with the insurance carriers. Time or expense to draw up specifications or evaluating bids is eliminated, or greatly reduced.

Disadvantages

Brokers or agents in the situation described above may do an exceptional job and be valuable members of the port's team, or they may take the port's account for granted.

Not all agents or brokers who have a "lock" on an account take their client for granted, but some undoubtedly do. These agents or brokers may shelve the problems or challenges of a locked-in client in favor of those of less-secure clients. When seeking renewal quotations, these agents tend to go along with whatever the existing market offers, rather than creating more work by soliciting bids from other markets. As a matter of fact, agents who do a thoroughly competent job of getting quotes from various markets on existing accounts will be viewed unfavorably by the incumbent carrier and may impair their relationships with that carrier, particularly if they move the business to another carrier. On the other hand, other carriers will view them unfavorably if quotes are repeatedly solicited without realizing any business. Most agents will take the easy way out and recommend a renewal proposal from the existing carrier, unless it is outrageous.

Given these tendencies, unless a detailed and objective evaluation indicates that the incumbent broker or agent is performing exceptionally well, competition at intervals of four to six years will usually be beneficial to the port.

Placement Through An Agents' Association

Advantages

For a political body, placing insurance through a local or state insurance agents' association will avert accusations of favoritism. All members of the association share in the commissions, after the agent servicing the account is paid a portion of the commissions off the top. In some cases, the agents' association will donate the commissions, other than the service portion, to a public service project or charity.

Disadvantages

While averting accusations of favoritism, this process can be the most expensive.

First, working through an agent's association frequently means that the port receives very little attention. The agent assigned to handle the port is only receiving a share of the commissions, and as such, will not devote as much time to the port as to a full-commission client.

The other agents in the association receive commissions in the name of avoiding favoritism. These commissions ultimately come out of the port's pocket and pay for little or no service. In fact, the port is paying the agent's association to prohibit its members from competing.

The agents' association approach stifles price competition and discourages innovation. There is no motivation, other than civic duty, for the servicing agent (or civic insurance committee, etc.) to design new plans or programs. Furthermore, the servicing agent (or committee) will be strongly inclined not to change the status quo. If the servicing agent advises the port to assume a larger deductible, drop its vehicle collision insurance, or use a reduced commission specialty market, the agent will be forced to explain to other association members why their commissions were reduced.

Another undesirable situation can exist when the agents' association parcels out shares of the port's coverage to its individual members. In this scenario, the port ends up with numerous policies, and the workload associated with accounting, policy examination, or collecting small losses is much greater than it would be under a consolidated program.

Of all the approaches available to a port, the handling of insurance by the agents' association may start off with the highest ideals but can end up with the worst service and pricing. It may also lead to antitrust complications.

Periodic Bidding With Interim Negotiations of Renewals

Advantages

Under this approach, the port awards insurance contracts through the process of competitive bidding periodically, such as every six years, and negotiates renewals with the same agent and carrier in the interim.

This has the advantage of keeping competition alive, with resulting reductions in premium and with innovation in coverage arising out of the competition. At the same time, the turnover of insurance agents and carriers is not so great as to introduce a recurring changeover cost to either the port or the insurer. The insurer can count on a moderately long-term relationship so that premiums need not be padded to absorb all loss contingencies within the immediate policy period.

Furthermore, the port can avoid accusation of favoritism under this approach if (1) rules for good bidding procedures are used at the time of competition for the insurance, and (2) certain guidelines are followed in the interim negotiation of insurance renewals.

Disadvantages

This process can create confusion in the insurance marketplace, as described earlier in the discussion of competitive bidding. The port can avoid confusion by allocating markets as described in that earlier discussion.

The agent and insurance carrier awarded the insurance may believe that they are "locked-in" for the next six years and take the port's account for granted. This tendency will be reduced by the realization that any "lock" will not be permanent. Furthermore, the tendency will be eliminated if the port adopts guidelines specifying the procedures for interim renewals. These guidelines should include:

- The port regards the services of the carrier and agent to be satisfactory.
- The port believes that the insurer has satisfactorily adjusted and paid claims.
- The company and agent have fulfilled all commitments made in their initial proposal.
- Renewal quotations are received on the subject insurance at least 60 days prior to expiration and do not contain any unjustified rate or premium increases.
- The decision to extend coverage beyond a total term of six years is agreed to by two other designated individuals in the port's organization.
- The insurance agent and carrier agree that the port reserves the right to seek competitive bids and will provide data on claims, claim reserves, and losses paid, in as complete a form as possible, within 30 days from the date of request.

Named Insured

A port is well advised to have the named insured wording for each of its policies phrased in as broad a fashion as possible, so that coverage will automatically apply to existing or new operations, ventures, boards, committees, acquisitions, etc.

Consolidation

Where possible, a port will generally find it advantageous to consolidate a single general line or type of insurance under one overall contract instead of dividing the insurance among several contracts and coverages. A single policy with one insurance company has many benefits:

- Allows for the efficient and effective administration of the insurance program in that there is only one renewal operation, one policy, one term, etc., thus affording greater ease in handling.
- Lessens the possibility of having an uninsured loss because of confusion as to which of several separate policies apply.
- Enables a port to marshal purchasing power that frequently results in securing concessions in premiums, policy conditions, or borderline claims.
- Creates a sufficient premium volume to cushion the effects of a bad loss trend that might be disastrous if separate smaller policies with several insurers are used.
- Greatly facilitates the uniform application of coverage, limits, and other broadening features.

Cancellation Provisions

The usual cancellation provisions of insurance policies permit the insurance company as little as five or ten days' notice before coverage cancellation. Typically, this is not sufficient time for a port to effectively replace coverage of a large and complex nature. For this reason, it is generally advisable to have standard policy cancellation provisions of all policies revised to provide at least 60 days and, preferably, 90 days written notice. Similarly, the coverage termination requirements should be extended, where possible, to cover non-renewal in addition to midterm cancellation. This will provide the time necessary to competitively remarket the port's program.

Anniversary or Expiration Dates

Anniversary or expiration dates of a port's insurance policies can be sometimes scattered throughout the calendar year. This can significantly complicate policy administration and in some instances result in coverage gaps. Ports should attempt to use common anniversary dates whenever possible.

In some situations, it is practical to place all policies on a common date. In other instances, it is preferable to place similar coverages, i.e., all property or all liability, on common anniversary dates.

When choosing common anniversary dates, it is generally advisable to avoid calendar year end or July 1 expiration dates, to avoid the congestion on many underwriters' desks at these times of the year. Underwriters' preoccupation with renewing other accounts may result in inadequate attention being given to the port's program. It is also advisable to avoid the end of the port's fiscal year, since preoccupation with other matters may prevent adequate attention being given to insurance coverage at that time.

Marketing the Port's Insurance Program

In a risk management context, "marketing" describes the process of submitting information to underwriters about the port's risk profile and negotiating to obtain quotations for insurance coverage and costs. The focus of the marketing effort should be to communicate the nature of the risk. There is a strong correlation between the quality of the submission presented on behalf of the port and the quality of the underwriters' proposals. Yet the Professional Insurance Wholesalers Association estimates that fewer than five percent of submissions to underwriters are of the highest quality.

The marketing process provides an opportunity for the port risk manager, the agent or broker, and the underwriter to act jointly to develop an optimal insurance program for the port.

The marketing and decision-making process should actively involve the port's risk management staff. Insurance is a business of utmost good faith. No one is better qualified than the risk or financial manager to describe the port's risk management culture, exposure profile, tolerance for risk, coverage needs, and organizational goals. Face-to-face discussions between the port, the underwriters, and the agent or broker can be very effective in devising a program that best meets the port's objectives. An underwriter is more likely to respond affirmatively to requests from a port risk manager known personally and with whom one has developed mutual trust and respect.

The risk manager must be diligent in learning the intricacies of the marketing process. This knowledge prepares the risk manager to most effectively support the efforts of the port's agent or broker and to approach direct markets without a broker, when this approach is favored.

Marketers of the port's account, whether the agent/broker or the risk manager, must demonstrate in-depth knowledge of the port's risks. Based on this information, the marketer must prepare high quality specifications that will be transmitted to selected underwriters to solicit quotations.

The process of selecting underwriters to receive the port's specifications is a critical aspect of the marketing process, and is discussed in more detail in the Insurance Company Solvency Ratings section on page 2--24.

Generally, the marketer will hold preliminary discussions with several underwriters to gauge their degree of interest in the port's account and their ability to provide needed services. After identifying a subset of underwriters who offer the best potential for responding positively to the port's submission, the marketer will submit specifications to these underwriters and deliver an oral presentation in order to answer questions and "sell" the port risk. As mentioned earlier, the risk manager's participation in the oral presentation can be effective in communicating the essential character of the port.

After receiving quotations, the risk manager and the port's agent or broker will identify areas of concern and negotiate with the underwriters to finalize details of coverage.

Timing

A full-blown marketing effort can cost $100,000 or more. The largest cost element is the time spent by the risk manager, management, support personnel, and the agent or broker. Marketing should not be repeated every year, or even every other year. The underwriting marketplace does not look favorably on accounts that shop their program year after year.

Most ports market their accounts on a three to six year cycle. However, the risk manager and the port's agent or broker should continually keep a finger on the pulse of the marketplace, to identify trends, opportunities, changes, options or challenges that may impact the port's placement, and that may require immediate attention. In addition, the risk manager must regularly assess the adequacy of coverage limits, terms and conditions, and remediate as necessary to ensure ongoing effectiveness.

Market

Prudent selection of underwriters is critical to the success of the marketing process. Underwriters should be selected based on their ability to meet certain qualifications established by the port. Specific requirements will vary among ports, but some general guidelines include:

- Breadth of coverage offered.
- Ability to manuscript policy wording to cover the port's unique exposures.
- Position in the marketplace, i.e., primary insurance, excess and surplus.
- Access to or ability to provide reinsurance, as needed.
- Ability to work with a captive insurance company. (See Glossary, page A--2.)
- Flexibility in offering funding alternatives, such as guaranteed cost, retrospective or swing plans, finite risk programs, self-insured retentions or deductible plans.
- Willingness to work with a third-party administrator on an unbundled basis.
- Depth and scope of insurer's risk control, claims and other services.
- Preferences of the port's management or commissioners.
- Degree of financial and management strength.
- Solvency ratings.

Perhaps the most important criteria for selecting underwriters to participate in the port's insurance program are their reputation in the marketplace, their ability to provide essential services, and their financial stability. The insurer's most important role is to indemnify a port for losses that it has elected to transfer under the insurance contract. A less critical, but still important function is for the underwriter to provide risk control, claims, and other risk services.

Ports should view their risk management from a total cost of risk perspective. A low cost of risk transfer may be more than offset by increased claims costs. The optimal insurance program provides a portfolio of services, program design and pricing that minimizes the port's total cost of risk within the constraints of the port's risk tolerance. The portfolio for a port that desires guaranteed cost insurance coverage would differ markedly from that for a port with a $1 million annual aggregate retention.

Insurance Company Solvency Ratings

Perhaps the most critical factor in selecting an insurer is its financial soundness. Ports that fail to recognize this may wind up putting their faith in insurers that ultimately fail or abruptly cancel coverage. When the port's insurer becomes insolvent or cancels coverage unexpectedly, the risk manager is forced to find another insurer, often within a very limited time frame. A hurried marketing effort may lead to inadequate discovery with respect to the carrier's services and financial strength, inferior scope of coverage, and uncompetitive pricing.

Before purchasing any type of insurance policy, the risk manager should verify that the carrier the port is considering doing business with is legitimate, solvent, and reliable. The various state insurance departments are an excellent resource for information on whether a company is licensed to do business in a particular state. The port's agent and broker, and the risk manager's professional peers, can provide recommendations and referrals of their insurance companies.

The reports provided to the various insurance commissioners are possible means of evaluating insurers. However, these reports tend to be too complicated and time consuming for even the most experienced risk manager to evaluate. Perhaps the best method for determining the qualifications of a particular insurer is by using independent ratings services. Insurance companies are rated by five independent services: Standard & Poors, Weiss Research, A.M. Best Co., Duff & Phelps, and Moody's Investor Services. Each service provides ratings on a different letter scale.

See page 2--26 for brief descriptions of the factors used by the four major rating services to review insurance companies.

Figure 5
Insurance Company Ratings

General Ratings Categories	A.M. Best	Duff & Phelps	Moody's	Standard & Poor's
Superior	A++ A+	AAA	Aaa	AAA
Excellent	A A-	AA+ AA AA-	Aa1 Aa2 Aa2	AA+ AA AA-
Good	B++ B+	A+ A A-	A1 A2 A3	A+ A A-
Adequate (but could be vulnerable)	B B-	BBB+ BBB BBB-	Baa1 Baa2 Baa3	BBB+ BBB BBB-
Below Average	C++ C+	BB+ BB BB-	Ba1 Ba2 Ba3	BB+ BB BB-
Weak	C C-	B+ B B-	B1 B2 B3	B+ B B-
Substantial Risk	D E	CCC	Caa Ca C	CCC
Under Order of Liquidation	F	DD		R

Ports should consider doing business only with insurance companies with the following minimum ratings:

- Standard & Poor's: AA
- Moody's Investor Services: A-
- Weiss: B-
- A.M. Best Co.: A+
- Duff & Phelps: AA+

The port's agent or broker can provide rating information for companies being considered to participate in underwriting the port's insurance program. The risk manager can also look up the company in the reference library or by purchasing a rating through one of the following services.

Best's Insurance Reports may be available in the port's risk management reference library. Best also has a "900" number (900-424-0400) – for $2.50 a minute the risk manager can procure a rating by calling with a company's ID number. To get a company's ID number, call Best at 908-429-2200.

Weiss Research provides reports over the phone (800-289-9222). The costs are $15 for an over-the-phone rating, $25 for a short written report, and $45 for a longer written report.

Ratings from Duff & Phelps can be found in books called National Underwriter Profiles (800-543-0874). National Underwriter Profiles sells three books – health and accident insurance companies, life insurance companies, and property and casualty insurers.

Standard & Poor's ratings are also available in National Underwriter Profiles.

A.M. Best and other independent rating services do not rate many insurers. This may be because the insurer is not licensed in the United States, or because limited time has elapsed since its formation. The risk manager will have to evaluate unrated companies based on the size and quality of their trust funds, their tenure in the insurance market, their reputation, etc. The port's agent, broker, or consultant can be a valuable ally in the evaluation process.

In some instances, a port may safely deviate from a minimum rating from the independent rating services. Factors to consider when contemplating a deviation include:

- Nature of the Risk – For those exposures where losses become known and settled within a relatively short period of time, such as for property losses, a port need only be concerned with the immediate financial condition of the insurer. For those losses where claims may be slow to surface and can be slower to settle, such as in general liability where it may take ten years or longer to settle claims, a port must be more concerned with the long term stability and solvency of the insurer. Generally, this requires a port to be more conservative in selecting insurers.
- Size of Risk – The size of potential losses enters into the selection process as well. Obviously, the risk of an uncollectable loss such as insuring a $50 million grain elevator with a property insurer which has policyholder surplus of $1 million may be much greater than insuring with a carrier that has a surplus of $100 million.
- Insurer Affiliation for Reinsurance – Insurance companies may be reinsured by larger, more financially stable insurance companies. An evaluation of reinsurance arrangements may indicate the risks are not as severe as they may appear on the surface. A carrier may also be owned by another organization. A parent company may pay additional funds into the subsidiary should it experience financial difficulty. While it may not be legally required, the parent company may elect to do so in order to maintain its reputation. While much faith should not be placed in such a situation, a port may wish to consider this as part of its evaluation and selection process.

Time Needed For Marketing

Smaller ports may be able to conduct the marketing process in little more than a month. A major marketing effort for a larger port can require six months, or more. This includes:

- 6 weeks to prepare marketing specifications.
- 8 to 12 weeks to negotiate with underwriters.
- 2 to 8 weeks to market excess layers, depending on the structure and coverage desired.

These tasks can be completed in four months, but a broker can usually do a better job with more lead-time, particularly at year-end, when there is a high volume of renewals. The process may also require more time when the market is tight.

If the port is working with more than one broker, the risk manager should start informal discussions at least six months before expiration of the policy. To keep the process manageable, the port should work with no more than four brokers. When markets are assigned, each broker should be provided with the same backup information. An effective method of communicating this information is a loose-leaf notebook with tabbed sections covering locations, values, payroll, sales, vehicles, risk management personnel, safety programs, 5-year loss history, discussions of major losses, and financial statements.

Marketing Specifications

The port's broker and risk manager will generally collaborate in preparing the written specifications. This task is time-consuming and costly. However, quality specifications can be reused in the future with basic updating. When updating specifications, be diligent in avoiding carryover of previous errors.

General Points

- Be concise and to the point. Include summaries and tables, but do not overlook the need for complete disclosure.
- Prepare specifications in such a way that the underwriter can read a little or a lot. In other words, make it brief so the underwriter does not get lost in detail. Use lots of headings and short paragraphs. Place all support material, charts, exhibits, etc. in an appendix. Highlight important points.
- Move from the general to the specific. For example, begin with total losses incurred by line, follow with a tabulation of individual losses and end with an analysis of large losses and measures taken to prevent a recurrence.
- For efficient formatting, write separate sections on organizational structure, financial statements, operations, properties, liability exposures, etc. This enables the port to substitute or delete certain sections for workers' compensation, property, liability, or other underwriters.
- Be consistent in oral presentation and written specifications.
- Have one or more colleagues proofread the specifications for errors, discrepancies, and clarity.

Agency Company Organization for Research & Development (ACORD) or Carrier Application Forms

ACORD and carrier application forms are not designed for large accounts and should be used only as a guide.

Format

Exposure Analysis

- Quantified underwriting data: revenues, payrolls, advertising expenditures, etc.
- Products which develop exposures.
- Incidental or umbrella exposures:
    - Care, custody and control
    - Professional liability
    - Federal acts
    - Watercraft and aircraft
- Contracts and leases under which the port assumes liability.
- Other perceived hazards.
- Manual premium calculations if available.

Assemble data in a binder marked with the port's name and logo. Begin with a short cover letter stating what it is, for whom and from whom – including the port's address, telephone and fax numbers. Describe briefly the coverage sought, special conditions and terms, major issues associated with the exposure, and the target date for the coverage inception. Use a table of contents and tabs for the various sections. A typical table of contents for the property/liability proposal follows below. Date all pages for easy reference when the specifications are revised.

Liability Underwriting Specifications

- Description of Operations.
- Overview of operations for the port and each division and branch. Include organizational chart, if appropriate.
- Financial statement.
- Annual report.
- Description of the Risk Management Department.
- Risk management policy statement, safety manual, and employee benefit booklet.
- Organization and structure.
- Functions provided – cost allocation, claims handling, loss prevention, etc.
- Contract Services.
- Loss Analysis.
- Description of claims handling: insurer, contract adjuster or in-house.

- Total incurred losses by line of coverage. Show the last five years, broken down by paid and reserves, bodily injury and property damage, auto and general. Also, break out products, malpractice, or any other special exposure.

- Description and analysis of all large (those over $10,000) losses, even if not yet paid.

- Loss stratification by line of coverage and in total. Exhibit should show losses at varying levels depending on size of risk, for example, losses from 0 to $10,000, $10,001 to $50,000, $50,001 to $100,000, and over $100,000.

- Loss forecasting and retention analysis. Trend future losses or use regression analysis to project probable future loss levels.

- Head sections with a summary, if appropriate.

- Insuring form desired (policy language, e.g., London, U.S., and universal)

- Specify Insurance Services Organization (ISO), ISO-modified, or manuscript form. This will help avoid misunderstandings and minimize the need for post-marketing negotiations. Provide as much specific detail as possible. Better still, specify the form number and edition date or attach sample copies.

- Manuscript forms may sometimes be more desirable than standard forms. However, insurance contracts are contracts of adhesion. This means that courts usually resolve ambiguities in favor of the party that did *not* prepare the wording.

- Risk managers are advised to convey their coverage needs to the broker or underwriter but leave the actual policy drafting up to them.

Property Underwriting Specifications

Certain basic information is essential regardless of whether the port is seeking property or liability coverage. If the port is seeking both from the same underwriter, repetition of the same data is unnecessary. If the port is approaching different underwriters, the same outline should be used as for liability specifications above in regard to:

- Description of Operations

- Description of Risk Management Department

- Change the Exposure Analysis to:

  - Basis of values: replacement, market or actual cash value, plus date of valuation.

  - Total values by location and by line of coverage. Give source and date of valuation.

- Details of construction and hours of occupancy.

- Maximum probable loss and the amount subject (maximum possible loss) by location.

- Individual fire protection reports, pictures and diagrams for large locations.

- Values for property in transit and unscheduled locations.

- Business interruption worksheets.

- Other time element value estimates.

Special Underwriting Data

Many ports have unusual or, for the layman, hard-to-understand exposures. These must be carefully explained. Obscuring or overlooking material exposures may, at best, save some premium in the short run. However, it may cause long-run adverse consequences, such as cancellation, nonpayment of losses, litigation, or stiff re-pricing. Specifications should include a candid discussion of the following:

- Product liability

- Unusual liability

- Severity analysis

- Special perils

- Miscellaneous

Products Liability

An obvious product exposure left undefined creates uneasiness in the mind of the underwriter, which tends to increase when technical brochures of the product are reviewed. Consequently, to be on the safe side, the underwriter will charge more for the exposure than may be necessary. With adequate explanations, this can be avoided. Obtain the help of operational and technical personnel and assemble the following data, in layman's language:

- Products manufactured or distributed
- Ultimate user: original manufacturer or general public
- Current annual sales, both U.S. and non-U.S.
- Total units currently on market
- Discontinued units
- Number of years that product has been on market. Include brochures and catalog
- Normal life of product
- Principal customers, in percentages
- Risk control
- Safety methods
- Engineering R&D
- Quality assurance
- Instructions, warnings, labels
- Installation and maintenance
- Contractual aspects
- Defense
- Liability resulting from acquisitions and mergers

Unusual Exposures

Standard umbrella applications do not inquire into unusual or catastrophic exposures, such as concentration of people or valuable property, or fire and explosion hazards inherent in operations. Many applications do not deal with care, custody and control risks, Jones Act and other Federal exposures, professional liability, aircraft and watercraft, or protection and indemnity.

Frequently, the umbrella excludes these exposures, so the umbrella application does not address them. If the port requires any of these coverages, explain and quantify the exposures. Whenever possible, discuss mitigating factors that reduce the risk, such as fire protection systems or specific loss control measures.

Severity Analysis

Property underwriters are interested in the maximum probable loss (MPL) the port may experience. This would be the maximum loss at the port's largest location under most circumstances. Underwriters also want to know the amount subject (AS), which is the maximum possible loss if all protection facilities were to fail. The terminology used by engineers may differ. Be sure the fire protection engineer who determines these figures for the port defines the terms.

For the underwriter, these figures are important. They spotlight potential catastrophic loss exposures that may exceed an underwriter's net capacity. They also pin down anticipated severity by location rather than leaving the matter to the underwriter's guesswork.

Include current fire protection reports, diagrams, production flow charts, photographs of the facilities, and the latest and original inspection reports.

Special Perils

If the port requires special coverage for earthquake, flood, collapse, or windstorm, supply the underwriter with back-up information: concentration of values at each location, with a breakdown of values in basement and lower floors in regard to flood risks; geographical exposure to the peril; protection and safety measures existing or to be taken in regard to those perils.

Miscellaneous

- Spell out any significant transit exposures, subcontractors work, or bailment situations, and describe any hard-to-replace die patterns, molds and machinery parts. Equipment manufactured overseas may cause lengthy business interruption or extra expense.
- Specify any special considerations for placing high limits with facultative reinsurers (reinsurance of individual risks as contrasted to treaty reinsurance where the reinsurer accepts blocks of risks). Otherwise, loss of some insurance markets and higher premiums may result.
- Explain the existing program and, possibly, also the present premium. This is largely a matter of knowing the underwriter. Be consistent; if this information is provided to one underwriter, it should be provided to all.

- Offer the underwriter the opportunity to visit the port's facilities or talk to management.
- List additional available information, such as safety and quality control manuals, risk management handbooks, manufacturer's procedural manuals, or in-house directives regarding loss prevention and claims.

Marketing the Excess Layer

After the primary program has been arranged, excess coverage will fall into place more quickly.

The port can use the same specifications, but a different cover letter describing:

- The primary coverage and premium.
- The desired excess layer and suggested pricing.
- The desired time allowed for quoting and negotiating before implementation.

Ask the underwriter to first clear with the broker any steps to effect facultative reinsurance.

Begin with the first layer directly above the primary.

Allow two to six weeks depending on the market situation and the amount of excess desired. More time should be allowed when prices are high and capacity is low.

Needless to say, the job does not end here. Once the policies are received, they must be thoroughly checked for accuracy and coverage.

Other Considerations

Specifications should be accompanied by a cover letter to identify a desired time schedule for quoting.

With the above points in mind, the risk manager should be able to work with the port's broker to develop an effective marketing plan, carry it out, and monitor the results.

Information and Records

Most ports have some form of management information system in place to provide management with timely information. Management uses this information to monitor and evaluate the performance of the port against previously established goals and objectives and can implement changes in order to meet these goals and objectives.

To achieve the port's risk management objectives, a similar information system should be implemented. A well designed risk management information system (RMIS) can aid the port in better identifying risk management and insurance costs, identifying adverse trends, claims or other expenses, allocating insurance and risk management costs, and compiling useful loss prevention data.

Many types of information systems can be established. They range from simple programs where the insurer or broker provides claim's reports to more sophisticated programs that import information from a number of sources into a central database. The best system for a port will depend on its individual needs. Items that may be incorporated into a risk management system may include:

- Historical Loss Experience – The port should maintain information on past loss experience. Reliance on brokers, insurers, etc., can result in incomplete records when outside sources are changed. Loss records should be maintained long enough to allow for trends to be spotted. For feasibility studies of alternative funding methods, five to ten years of loss experience is generally required. Loss data should be maintained in such a manner that loss development and claims payment patterns can be analyzed and evaluated.
- Premiums and Deductibles – Records of premiums, deductibles, rating plans and bases, etc., are beneficial. Information on major changes in methods of operation, growth, etc., are also important in determining changes in exposures.
- Cost Allocation System – Programs can be designed to automatically allocate such items as premiums or self-insurance costs, etc., to appropriate operating departments.
- Claims Frequency and Severity Analysis – Accumulating loss information by the nature of the injury, part of body injured, or location

where the injury occurred can be used to direct loss prevention and safety activities.

- Insurance Certificates – A file that collects, services, and brings to the attention of the risk manager expiring certificates of insurance can be valuable to ports with large numbers of contractors, lessees, or other service providers.

Insurance Document Preservation

Many ports and other organizations do not, as a practice, retain expired insurance policies. Litigation involving asbestosis, pollution, and other claims arising out of injuries that may take years to manifest themselves has increased the awareness of the need to maintain information on expired policies. Every port should establish a formal policy for the preservation of expired insurance policies.

Expired policies insuring physical damage, such as fire policies or vehicle physical damage policies, need only be kept long enough to insure that all losses have been discovered and settled. Generally, one to two years beyond policy expiration is a sufficient retention period for these policies.

Liability policies typically require a much longer retention. Since the statute of limitations for minors generally does not begin until the minor reaches the age of majority, a general rule of thumb for retaining "occurrence" policies is the total obtained by adding the years until the age of majority plus the statute of limitation years plus one year. This typically produces a retention period in the range of 21 to 25 years.

Relying on the memories of brokers and insurers can be risky and result in both potential litigation with insurers and uninsured losses. Therefore, ports should establish formal retention guidelines for expired policies. As valuable records, ports would be wise to store policy information in a fireproof vault and make duplicate copies to be stored at a separate location. To aid in the storage of old policies, it is often helpful to microfilm policies rather than retain hard copies.

CLAIMS ADMINISTRATION

The largest single component of insurance premiums is the cost and expense of claims. Because of the impact of claims on the cost of insurance, it is essential to efficiently handle and control claims to keep insurance premiums to the lowest level possible. Subrogation comes into play for all claims, including property damage, liability, and workers' compensation.

The objectives of a properly administered claims plan are to insure that:

- All claims are promptly and appropriately reported to the insurer and individual within the port responsible for claims.
- All claims are adequately investigated and sufficient facts recorded and preserved to permit the port to determine liability, settle claims or render a defense.
- Reserves for claims are established and maintained.
- Claims' experience and costs are properly recorded and preserved for analysis and evaluation by the insured port.

Because of the impact of claims on overall insurance costs, it is extremely important for ports to take an active interest in claims' administration. Many ports that have insured programs rely solely on the insurer for claims' administration. While claims adjusting should be left to those with experience, a port can perform, in coordination with its insurer or adjuster, many activities which will improve claims' administration and over the long-term enable the port to reduce its cost.

Claims' administration varies by type of insurance and among insurance companies. It will also vary from port to port. It is impossible to detail within the confines of this *Guidebook* the procedures that should be used by each port. There are, however, general principles in claims' administration that should be a part of any program.

Workers' Compensation

State statutes or regulations generally require that all workers' compensation claims be reported within a specified time period. Delays in reporting can subject ports to fines and penalties. It is important, therefore, that claims be reported promptly. The steps that might be included in a claims' procedure are:

- The supervisor of the injured employee should complete reports of injury. Generally, the report should note the nature of the injury, time, location, cause, witnesses, and other relevant facts pertaining to the claim. If the validity of the claim is questioned, it should be indicated in a cover letter to the injury report.
- A thorough investigation should be made of all claims. There is a need to investigate all accidents to aid in preventing future losses.
- It is often helpful to contact the injured employee as soon after the accident as possible. During the contact, the employee might be reassured that his or her job will be there upon return to work. In addition, entitled statutory benefits should be explained. This contact should continued through the recuperation period.
- All valid claims should be paid promptly. Claims that are not valid should be defended vigorously.
- The injured party should be returned to health and productive employment.
- Programs designed to return employees to jobs as early as possible such as "light duty" or "alternative duty" programs should be established and injured employees mandated to participate.
- The port should continuously monitor all claims. Failure to monitor and control claims can result in excess medical treatment, litigation, or malingering employees.
- All claims should be administered in accordance with state/federal laws and adjusted with consideration given to industry practices.
- Identification and control of safety/health hazards is essential.

General Liability and Automobile Claims

General elements should include:

- Prompt reporting of all claims. Insurance policies typically include a provision that states "written notice shall be given by or for the insureds to the insurer and any of its authorized agents as soon as possible." Failure to report as required may void insurance coverage.
- Claims should be promptly and thoroughly investigated. It is extremely important to immediately identify witnesses, including names and addresses. Oftentimes, in the confusion following an accident, this vital information is forgotten, making investigation difficult, if not impossible. A port is well advised to assist the insurer in any way possible with the investigation. The port can be particularly valuable in providing technical knowledge or assistance for the unique aspects of its operations or activities. Sufficient information should be obtained in initial and subsequent investigations so that a decision can be made as to whether the claim should be denied, compromised, or litigated.
- All claims should be monitored on a continuous basis. Claims should be settled as promptly as possible. Payments should be made on settled claims as soon after settlement as possible.
- Reserves for claims should be maintained at accurate levels.
- Claims' experience and cost should be recorded and preserved in sufficient detail to allow for analysis and evaluation of historical experience.

Property Damage

- Claims should be promptly reported to the individual responsible for the risk management program within the port. If the damage is expected to exceed the policy deductible, the insurer should be notified immediately.
- Measures should be taken to preserve all undamaged property susceptible to loss because of the property damage.
- Fire protective equipment should be restored as quickly as possible.
- Emergency repairs should begin immediately. Do not wait for the insurance adjuster to arrive. This is especially true if a time element loss will

result from the property damage. It is important to preserve and protect property from further damage.

- Damaged property should be isolated in one location and preserved for the insurance company to inspect.
- All bills for materials, labor, etc., for clean up and repairs should be accumulated. Often it is advantageous to establish a separate budget account to which all charges for repairs are charged.
- The claim, along with support documentation, should be prepared by an individual familiar with the port's insurance and presented to the insurer. For larger claims, a port can negotiate interim payments and present the claim as repairs are completed. For smaller losses, claims are generally reimbursed after completion of the repairs. For large or complicated claims, a port might wish to retain an independent adjuster or consultant to assist with the preparation of the claim and subsequent negotiations.

Risk Management Audits

Ports are advised to conduct regular, independent audits of their risk management programs, to assess processes, policies and procedures, and to gauge ongoing effectiveness. In the course of the audit, the port and its broker or consultant should evaluate and explore:

- The port's risk profile
- The insurance program
- Adequacy of limits
- Risk retention levels and potential benefits of alternative risk financing approaches
- Internal risk control, security, and claims handling activities
- Services provided by agent, brokers, third party claims' administrators, consultants, and other independent service providers
- The port's risk management policy
- Risk administration, information management, cost of risk allocation, risk management structure and staffing, and other internal risk management functions

Benefits of a Risk Management Audit

An objective review by an independent third-party can provide a perspective on the port's risk management operations that simply cannot be attained by port staff. An experienced professional broker or consultant can recommend and assess alternative approaches and provide port management with an objective appraisal of the effectiveness of the current program.

The Risk Management Auditor

Experience, knowledge, judgement, and objectivity are the four most important qualities that an auditor should possess. It is imperative that the auditor have no financial interest in the outcome of any recommendation.

Historically ports have employed independent consultants to conduct their risk management audits. However, many large brokerage firms also have qualified professionals, not involved in sales, who can provide an objective perspective on the port's risk management function. Brokers who focus more on consultative approaches to meeting their clients' needs are expanding their auditing capabilities.

The process for selecting and engaging an outside consultant is described in detail above.

Scope of the Audit

A risk management audit generally encompasses:

- Risk management policy.
- Risk management staffing and procedures.
- Types of risks faced, their relative importance, and the degree to which they are transferred or managed.
- Opportunities for risk control enhancements.
- Effectiveness of risk management information systems.

- Loss projections based on analysis of loss/claim payouts (i.e., frequency patterns, severity calculations, loss stratification, payment triangles, and other statistical methods).
- Tolerance for risk and retention capacity.
- Alternative risk financing approaches.
- Insurance problems, such as gaps or overlaps in coverage, restrictive named insured wording, inappropriate limits or retentions, onerous policy conditions, questionable carrier solvency, and unclear policy wording.
- Risk management and insurance records retention program.
- Claims and litigation management.
- Disaster planning.
- Broker or agent performance, method and amount of compensation.

Timing

Conditions at the port that may trigger an audit include:

- A major change in operations
- No audit has been done for five years or more
- New developments in markets, regulation, laws, or specific events
- Management concerns about the effectiveness of the risk management function
- New management wants an independent evaluation
- Insurance has been placed with the same carrier for more than six years, or with the same broker more than ten years
- An alternative risk financing approach offers potential benefits

Information Required

The comprehensiveness and quality of the information used to conduct the risk management audit will determine the quality of the audit itself. The information provided to the auditor should include:

- The port's annual budget (including the Risk Management Department's budget) and annual report.
- Organization chart and reporting responsibilities.
- The port's risk management manual.
- Other internal documents relating to insurance, claims, or risk.
- Contracts with risk management service providers.
- Representative leases and other contracts, and any unusual contracts.
- Bond indentures with insurance or risk aspects.
- Property schedule, including replacement costs.
- Detailed loss runs by year, and summary by division.
- Relevant exposure history, i.e., revenues, vehicles, payroll, building square footage.
- Copies of insurance policies and related documents, including retro agreements, business income worksheets, etc.
- Copies of current and recent past premium audits.
- If workers' compensation insurance is involved, payroll by workers' compensation classification.

Audit Process

The auditor meets with appropriate port personnel to define the scope of the proposal, become acquainted with current conditions, and identify the right people to contact and locations to inspect. Whenever possible, the auditor should interview the Port Director or other senior officers for views on the port's status and plans and to lay the groundwork for later acceptance of the audit report. The audit team should:

- Inspect major properties and interview key personnel to become familiar with the flow of materials and the risks inherent in every step. This process also helps in identifying any off-premises exposures.

- Determine loss potentials, including maximum possible losses.
- Review a representative sample of contracts and leases (including bond indentures) to determine whether the port's contract review procedures are adequate. If not, the port may be enduring unwarranted assumptions of liability, unmet requirements for insurance, unrealistic requirements of others, contracts that should have insurance requirements but do not, etc.
- Examine loss runs to identify trends and loss problems and to assess the quality of the port's communication of loss information.
- Review the port's risk management manual and related directives to evaluate the field's compliance with accepted practices.
- Conduct an in-depth interview with the port's insurance brokers or agents, to understand their program design and marketing approach, service plans, and strategy for future servicing and marketing.
- Thoroughly review the port's insurance policies.
- Interview port personnel to learn about risk-related issues and exposures that management may not be aware of. In addition to the risk manager, the team should talk with the following:
    - Chief Financial Officer, to discuss topics such as the port's risk tolerance, retention capacity, bond indentures, and reserves
    - Claims or workers' compensation manager, to address claims practices, use of loss runs, identification of hazards, and claims problems
    - Controller, to consider the nature of reserves, cost accounting, and cost of risk allocation
    - Legal counsel, to address standard contracts, contractual problems, important litigation, and claims techniques
    - Engineers, to discuss the use of safe design criteria, and current engineering activities
    - Fleet manager, to review driver selection practices, accident procedures, subrogation techniques, and car rental practices
    - Manager of internal audit, to discuss the nature of security and other audits
    - Human resources manager, to consider hiring and firing practices, and employment practices exposures
    - Purchasing manager, to address terms of shipping and clauses in purchase orders
    - Safety manager, to review the port's safety standards and manuals, procedures, and tie-in to workers' compensation
    - Security manager, to consider the nature of security problems and scope of activity

The lead auditor may conduct an exit interview with the Port Director to discuss findings, and the team prepares a report for the port that addresses:

- Audit rationale and process
- Summary of the primary conclusions
- Recommendations
- Detailed discussion of all findings