

By Erik Rasmussen

Direct writers of group insurance could gain competitive advantages from better understanding the risks of disasters where they can cause the most harm.

Concentration of Risk

Many group life, medical and disability insurers weren't directly affected by Sept. 11, 2001, so why should they be worried about it?

The short answer is, because a similar scenario could happen again. Today it's clear that the threat of terrorism or a natural disaster has to be considered when assessing risk. Unfortunately, the catastrophe coverage that once served as a safety net for protecting and managing net retentions is now scarce and expensive. With fewer options available for managing exposures, the need to better understand the potential for concentrated risk is critical.

There are four steps group insurers can take to put themselves in a stronger position to assess and manage the impact of disasters.

- **Define Risk Tolerance.** Whether by gut feel or by formula, an insurer needs to have an idea of how much exposure it will accept in a particular geographic area. Individual business units may determine this, but since exposures may potentially accumulate over multiple business units, this may be a decision for corporate leadership.

- **Collect and Maintain Data.** Next a company needs to determine what information it needs to collect and then organize in a database that allows employees to determine clients' exposures by geographic distribution, ZIP code by ZIP code, building by building. This is especially important for high-rise office buildings or sprawling complexes that house multiple clients. Simply having an administrative or billing address on file is not an accurate indication of actual business locations and dispersions of insureds.

Insurers may think that such exposures are too difficult to assess because people are mobile, but this is not a valid excuse. The fact is most people are in their place of employment during the workday. Tools that estimate the dispersion of people when they leave work are in development.

- **Mapping.** Having a visual map showing exposures by location and their proximity to each other or to specific landmarks can be a powerful tool for those needing to help senior management or others understand and visualize total risk exposures. Mapping employee location data also can be a proactive way to help reconcile differences that may exist between business units and the corporate area as to what constitutes a tolerable risk.

- **Risk Modeling.** Risk-modeling software helps a company use exposure data to develop a clearer picture of the potential impact of a disaster. Disaster modeling is new to the life and health industry but common in the property/casualty area since 1992, when Hurricane

Andrew resulted in historic losses.

Group life, medical or disability insurers can use modeling to analyze the impact on their business from an event such as a San Francisco earthquake, a nuclear power plant explosion on the East Coast, or even the effects of a theater fire in a small community where most people may be covered by the same health maintenance organization.

Having a visual map showing exposures by location and their proximity to each other or to specific landmarks can be a powerful tool for those needing to ... understand and visualize total risk exposures.

There's a fifth step for insurers unconvinced that concentration-of-risk data is important: conduct a "what-if" exercise. What if a terrorist attack or natural disaster happens tomorrow? The day after tomorrow, could you provide headquarters an early estimate of losses? Could you demonstrate you have done an adequate job of understanding the risks you assumed before the event?

Finally, good concentration-of-risk data can help insurers strike the best reinsurance deal. Similarly, lack of information might soon make a deal untenable because reinsurers may be unwilling or unable to approve transactions with unknown concentrations.

Things will never be the same as they were before Sept. 11, 2001. Already we've seen that greater awareness of risk has spawned the creation of more risk-management positions within companies and a risk-management section within the Society of Actuaries. Insurers need to put more risk-management principles into place, particularly when it comes to gathering and managing employee location data. There are no set rules yet on data vs. no data, but the trend is evolving. Concentration-of-risk data will eventually be part of the pricing formula for reinsurers, and insurers who can provide concentration-of-risk data will have competitive advantages in pricing their own coverage and securing reinsurance. BR



Erik Rasmussen is vice president, Risk Management, for ING Re's Group Life, Accident and Health Reinsurance operation, based in Minneapolis. He can be reached at insight@bestreview.com.