ZURICH

Municipal

# A wider lens

## The risks of short-term decision making

# Introduction

## "May you live in interesting times". Anyone working in the public sector today will note the irony of this 'blessing'.

As the 18th Global Risks Report highlighted, the first years of this decade have heralded a particularly disruptive period in human history. The return to a "new normal" following the COVID-19 pandemic was quickly disrupted by the outbreak of war in Europe, ushering in a fresh series of crises in food and energy – problems that decades of progress had sought to solve.

Current crises are taking all available resources and capacity meaning risks arising over the medium to longer term can look like they're being neglected. And of course, this comes on top of over a decade of austerity and budget cuts which has led to reduced spending in almost every area with housing, planning, environment, and highways particularly impacted.

As a result, risk management and finance teams are left constantly putting out small blazes, leaving little time, resource, and money to create strategies for preventing issues from igniting in the first place. In addition, inadequate risk assessment and management can have huge consequences in other areas. For example, overcrowded, damp, mouldy homes costs the NHS £1.4 billion per year.

A study published by the Building Research Establishment (BRE) consultancy suggests that **every £1 spent on warming up the homes of vulnerable households yields £4 in health benefits.** However, the link between decent quality social housing and reduced health spending is seldom acknowledged beyond the impacted sectors.

Effective, long-term risk analysis and management can have far-reaching positive impacts, not only for public sector bodies, but society as a whole. For example, local government long-term investment in creating and maintaining pothole-free cycleways and footpaths mitigates the risk of public liability and personal injury claims. However, it can also help lower dementia cases (physical exercise is proven to reduce the risk of developing this crippling disease), providing an opportunity to free up care budgets in the future, reduce the burden on the NHS, and increase the chances of people being able to enjoy cognitively healthy longevity.

## Defining total cost of risk

The term 'total cost of risk' can mean something different to different organisations. What is measured to build the picture of costs can differ from model to model.

As with all things risk, understanding and consideration is evolving and shifting depending on risk management philosophy and leadership. The term can be more associated with accountancy than risk management but it is an important concept and mindset for those involved in insurance and risk management decisions.

Throughout our series, **A wider lens: The risks of short-term decision making**, we aim to return to the fundamentals of risk analysis and management, by examining how an organisation understands its risk profile and the different elements that make up that overall picture along with the total long-term cost benefit of eliminating or at least mitigating those risks.

To achieve this, we will be deep diving into the following matters:

- **Understanding your whole risk profile** – considering the risks which may be under insured, or even over insured
- **Why it is better to prevent rather than respond to a crisis**
- **The importance of risk management and resilience** - including the need to examine and plan for long-term risks
- **How experts can provide valuable advice to help you create a solid, proactive risk management strategy**

Our overarching message is that to ensure sustainability of spend, resources, and reputation, risk and insurance managers must focus on evaluating the long-term impact of decisions that provide short-term relief. To achieve this, organisation stakeholders need to appreciate the value of investing funds on long-term risk management and how this links to future savings and better overall performance.

## What is the total cost of risk?

The total cost of risk is an equation which captures the total cost of self-retained losses, risk management administration expenses and insurance premiums. When considering your cost of risk, the focus can be directed towards the risk transfer or insurance cost, when this is only the tip of the iceberg.

It is therefore important that decisions are made that consider all of the different elements which make up the overall risk picture, and how much they cost you in the short, medium and long-term.

A total cost of risk calculation should include:

1. Risk Financing or Transfer Costs – this includes all insurance premiums, broker commission/fees and captive contributions

2. Loss Costs (both Direct and Indirect) – this encompasses direct loss costs such as deductibles and claims that are anticipated and funded inside the risk management plan, the cost of administering claims by third part administrators, uninsured or self-insured losses, and indirect costs such as additional unfunded business expenses that arise from a claim

3. Administrative Costs – including additional fees or expenses paid for claims management, risk control and other project costs such as data analytics

4. Taxes & Fees – including IPT and VAT

## Short-term gains exchanged for long-term pain

The current economic situation has everyone looking for savings and efficiencies but considering the wider risk profile of your organisation and implementing effective risk frameworks is no luxury – it is necessary to reduce costs in the longer term. Perceived quick wins in the short-term can have detrimental impacts in future.

Across risk and insurance in the UK public sector there are examples of organisations deprioritising risk management activities and resource, with some doing this at the same time as choosing to take higher deductibles. This may provide small initial savings in terms of costs and annual premiums however if a comprehensive, long-term risk assessment has not been conducted on the area being insured, the organisation could easily end up spending more on claims under the increased deductible in the future.

Managers in finance and risk departments tend to focus on reducing overinsurance, however neglecting to look at the long-term risk picture can often result in underinsurance, which can lead to negative economic and social outcomes for an organisation and the people it serves.

Without full appreciation of the total cost of risk, organisation risk saving on procurement today, only to pay out more – financially and non-financially – over the whole life of the contract and beyond.

> “Short cuts make long delays”
>
> - J.R.R. Tolkien

Of course, it is easy to call for an increase in long-term risk assessments and planning when you are not actually responsible for departmental budgets and increasing demands to cut costs to improve the balance sheet.

The UK public sector is dependent on many different sources for funding and how it is distributed. A paper on public spending by the independent think-tank The Smith Institute highlighted the impacts of cuts made since 2010 and of the short-term nature of most public sector funding. However, there are ways to maximise your organisation’s response to future as well as present threats.

Rather than focusing primarily on cost, it is the quality of insurance and the wider proposition that accompanies it which safeguards public money and protects communities interests in the long-term.

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## Solutions

**Assess the total cost of risk, focusing on resilience maximises cost savings.**

The total cost of risk is much more than the annual insurance premium; it must also incorporate the tangible and intangible costs of risk mitigation and response.

**Optimise risk mitigation and transfer strategies**

To effectively reduce the total cost of risk, decisions have to be based on assessing what risks to retain or transfer (risk appetite), risk retention strategies, risk management and how to transfer risk. Working with an insurance specialist helps you optimise your insurance spend to ensure you are only spending where it is required. Any money saved can be put into eliminating or mitigating long-term risks identified during the risk assessment phase.

**Work with your suppliers and experts**

Specialist sector insurers have in-house risk experts who can collaborate with your team to evaluate medium- and long-term risk and provide support to mitigate or respond to your exposure.

**Take advantage of a comprehensive risk management approach included in your insurance cover**

Evaluate the impact of the whole proposition, not just the price. An example of this is the Safer Schools proposition for schools insured with Zurich Municipal, which includes safeguarding training for school staff, that can in turn save money that can be redirected towards mitigating other risk issues.

## Concluding comments

A total cost of risk mindset can bring huge value to risk management and finance professionals who everyday have to demonstrate that public funds are being utilised responsibly.

Two particular areas to focus on are “what is the total cost of focusing on short-term risk” and “what is the total cost of not investing in risk management”? Decisions taken today will have wide ranging impacts on tomorrow.

As Abraham Lincoln famously quipped “Give me six hours to chop down a tree and I will spend the first four sharpening the axe.”

To deal effectively with the challenges to come, public and voluntary sector organisations must resist focusing exclusively on short-term cost savings and invest in long-term risk analysis, planning, and mitigation.



At Zurich Municipal, we help protect the things that really matter to you. Since 1993 we’ve insured charities, voluntary organisations, housing associations, and the education and public sectors, helping you to better understand and reduce the risks you face.

Our insurance supports society in ways you might not think. From preventing problems before they occur with our in-house risk experts, to protecting the physical and mental health of your team and communities through access to nurses, counsellors and therapists, so you can protect the future in more ways than one.

If you have any questions or if you would like to talk to one of our team, please contact us:

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