

Cut Insurance Cost

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As revenues decline and capital remains scarce, many businesses are finding that they have far too much fixed cost and leverage. Economic conditions are forcing them to scale back by paying down debt and making across-the-board expense cuts. While these actions force managers to make tough decisions, it is imperative that risk managers resist the impulse to cut the insurance budget.

Although it is tempting to think that insurance premiums are just another operating expense, it would be a huge mistake to focus exclusively on the cost of insurance without considering the benefit it provides. Insurance is another form of capital, and insurance premiums are the cost of maintaining this capital.

Businesses have a choice, they can either have financial capital on hand to deal with the consequence of loss events, or they can buy insurance and transfer the risk of loss to insurance companies. In comparison to the cost of maintaining extra capital, buying insurance is incredibly cheap. More importantly, there is no way that businesses can predict how much their cost of capital will increase after they have suffered a major loss event. For many businesses, capital may not be available at all.

In the present environment, most companies need access to more capital. Rather than asking risk managers to buy less insurance, senior management should demand that companies are fully insured. Recognizing that insurance is another form of capital implies that:

- The “Total Cost of Risk” should not be used to measure the performance of risk management because it does not measure the value of insurance or the cost of retaining risk;
- Buying insurance is a way of deleveraging and companies should seek to obtain as much value from this form of capital as they can get;
- The cost of holding capital for insurable events increases as the cost of capital increases, making insurance more valuable than ever in times of capital scarcity;
- Insurance is a more secure form of capital than relying on their credit ratings, operating strength, or lines of credit because insurers have to pay after a loss but banks do not have to lend;
- Companies may be able to restructure their insurance programs so that their insurance coverage increases while they pay less in insurance premiums.

For a methodology that describes how to get the most value from your insurance program, reference *Reassessing the Value of Insurance* and *Using Transurance to Maximize the Value of Insurance*.