Indifference, laziness, ignorance, naivety, carelessness, arrogance and casual dishonesty.

What do these behaviours have in common? They are all reasons why risk management can be undermined.

Consequently, it is increasingly failing to meet its fitness for purpose and this will begin to have serious implications for insurance brokers, as well as their clients.

Every insurance professional will recognise the cynics’ views of the purpose of risk management, namely to appease regulators, satisfy standards of quality assurance, enshrine operating systems and procedures and obtain premium discounts from insurers.

Yet, it was never intended as such and there is an urgent need for the industry to confront this cynicism.

The industry’s fears and frustrations in the seemingly interminable soft market are driving the realisation that managing risk really matters in the reduction of cost to the industry in losses and claims.

But there is also a common malaise towards risk management and this must be addressed.

So, what are the implications for brokers? Insurers may wish to incentivise the benefits of risk management as a means of reducing claims costs and proving to regulators they are exercising good standards of underwriting judgement and fair practice. And this is consistent with the principles-based rules of the Financial Services Authority (FSA).

But insureds will expect the risk management tools recommended to them, or required of them, to be fit for purpose. That is, to reduce the probability and chance of a loss or claim and to reduce the impact of the loss or claim that cannot be avoided.

Neville Miles, managing director of BIBA accredited broker, Lockton, comments: “If risk management fails to do what is intended because it is merely a tick box compliance procedure, then the insurance industry will have a serious credibility problem. Our recommendation now is to take this very seriously.”

And Richard Wynn, director of Howden UK, adds: “You can’t tick boxes for situations that you don’t know exist. Professionals need to take a long, hard look at the critical risk areas in their business – clients, cash, people and infrastructure – from the top down, in order to understand what risks they face and plan to manage them appropriately.”

Moreover, if brokers offer risk management services to their clients that do not meet the clients’ presumed benefits and targets, the brokers are exposed to a legal liability. Which, arguably, is a good reason for outsourcing it.

Consequently, as risk management becomes an increasingly important feature of modern insurance practice, brokers should become more familiar with its practical application and limitations, in its various forms.

There are more than 600,000 entries in Google for risk management in the UK listing. Insureds can be forgiven for being overwhelmed for choice and the natural place to come for advice will be their broker.

The ubiquitous tick box procedure designed to prove compliance has caused risk management to become detached from the human factor which is the essential prerequisite to making risk management work.

Removing human awareness of risk has deprived people of the intellectual recognition it is time to focus on the real meaning of risk management, stresses Roger Flaxman, or both brokers and their clients will lose out
Stop press…

BIBA is delighted to announce that Howden, a BIBA member specialising in broker PI, has been appointed to the BIBA Professional Indemnity panel.

Howden is highly experienced in providing market-leading PI protection to the industry and currently advises many UK insurance intermediaries on their PI needs. The appointment to the BIBA panel is testament to Howden’s experience, specialist knowledge and excellent service. With a reputation built on their broker knows all about risk and manages their own with skill and expertise.

Understanding the principles

What is important for the broker is to be able to understand the principles so that they can direct their client to an appropriate choice of specialist consultants. No more but no less.

Managing risk in professional service industry businesses such as broking – or indeed the main professional disciplines – is more difficult than managing risk in a business that manufactures or sells goods.

Much of the risk stems from individual skill, experience and judgement of the employees, each of whom have been engaged for their ability to work on their own to earn revenue for the business.

This makes the task of managing risk more complex because the behavioural characteristics mentioned in the opening of this article are dominant in service industry and professional businesses.

In April 2008, BIBA will publish its third brochure from its PI Initiative – A guide to a broker’s management of PI risk. It will explain the principal dynamics of professional risk and liability as currently applicable to our industry.

Richard Gledhill, associate director of Towergate, says: “This is a laudable attempt by BIBA to seek to make a difference in this field by approaching the issue from a new perspective which will, hopefully, enable brokers to tackle the problem.”

Elephant traps

In particular, the brochure will focus on the elephant traps for those firms who rely solely on FSA compliance as a total quality assurance and risk management programme – it is not.

Recent experience of claims made against brokers is showing how claimants’ lawyers are using the ICOBs to identify breaches that are causative of the alleged negligence.

This tactic requires the defending broker to prove there is no breach of FSA compliance and also to prove that the systems and procedures impliedly expected by reason of treating customers fairly and the practical application of Demands and Needs, beyond what is specifically required by the regulations, have been met in full.

BIBA will recommend brokers recognise the difference between managing risk and risk management.

Managing risk is a cultural embodiment of awareness of risk that is cascaded throughout the firm from the top and is a shared day-to-day responsibility of everyone, for their own part.

Risk management is a system and procedure based method of regulating the conduct of the processes that form the fundamental infrastructure of the business.

While an essential part of managing risk, the compliance systems and procedures account for only one quarter of the contribution to effective management of risk in a broker business.

The essential, but frequently missing, human ingredient to managing risk is effective communication.

Professional indemnity insurance lawyers recognise the overwhelming cause of PI claims is breakdown in communication. It can be overcome, but only with a deliberate and concerted effort to do so.

In General Sir Michael Jackson’s autobiography, Soldier, he uses a quote from wartime leader Major General “Windy” Gale who commanded the 6th Airborne Division. In this, Gale says: “One purpose of communication is to take a thought from one human being’s brain and transmit it to the brain of others with the minimum possibility of misunderstanding, confusion or ambiguity”.

This could not be a more apposite benchmark for the insurance broker as adviser intermediary between client and insurer.