

# Building Blocks



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# Seven steps for property owners and managers to achieve robust risk management

With the prospect of higher premiums, it will be important for landlords to demonstrate that they are managing risks appropriately...

In the past, property owners may have been able to pay their premium and “sit there with their fingers crossed” and hope there are no claims. Those days are gone. Underwriters want landlords to demonstrate they have a progressive attitude towards managing risk.

Landlords cannot just rely on an insurer’s risk survey as the sole means of risk management. Insurers primarily undertake their surveys for their own purposes (reinsurance, estimated maximum loss calculations, checking sprinkler systems still qualify for reduced ratings, etc) and rarely make their full report available to the landlords.

Insurers issue a list of risk improvements but these will usually be limited in their usefulness in terms

of a comprehensive client driven risk management programme since they will more often than not be focussed purely on fire risks and will not usually provide comments on the management of other risks such as liability, engineering, business continuity and reputation.

Often their site visits are based on an annual timetable commencing at renewal and therefore they see each property at a similar time of year thus missing seasonal variations in the risk profile of properties.

Most insurers focus on the physical aspects of risk and, whilst significant, JLT feels it is also critically important to review wider risk management aspects such as procedures, systems, documentation, training, etc.

It is also imperative to demonstrate the effectiveness of the employed risk management programme. Insurers want to be able to see that the employed risk management framework is successful at addressing the identified risks. High frequency losses will be taken into consideration by the insurers when they are reviewing the landlord’s risk. If the landlord has employed risk management tools to address these losses, it is important to demonstrate to insurers the prevention methods that have been employed and how effective they are so that these high frequency losses will reduce.

“We are seeing companies investing heavily in risk management to differentiate their risk to insurers.”

Steve Broom, Risk Consultant at JLT.

For more information contact Steve Broom at JLT on (02) 9320 2700 or email [Steve.Broom@jlt.com.au](mailto:Steve.Broom@jlt.com.au)

## Health Check Alert

Does your insurance programme cover the specific risks your business is exposed to?

A number of property owners in Australia do not have policy wordings tailored specifically for their industry as many policies are designed towards the owner occupied risk.

## JLT Tip

Check your policy terms and conditions to ensure they really cover your individual insurance needs.

## JLT’s seven steps

JLT’s real estate practice has prepared seven steps for property owners and managers to achieve robust risk management...

1. Understand the need for risk management and the specific risks your company faces.
2. Formulate and implement a long-term risk management strategy that identifies the significant threats to your business, the solutions and a timetable for their implementation.
3. Take a proactive approach to risk management and the ability to manage risk on a day-to-day basis and not simply an ad hoc basis.
4. Invest in the training and education of staff on the core risk management issues in order to ensure the early identification of new risks.
5. Develop tools to improve the risk management capability of your company, including regular reviews.
6. Employ the necessary expertise to offer advice and guidance, whether it is internally or via a partnership with a specialist risk consultancy.
7. Ensure all risk management work and the resulting benefits are communicated to stakeholders including your insurance broker, insurers, managers, owners, occupiers and, where appropriate, secure their buy-in.

# What sort of insurance buyer are you?

There are generally three types of insurance buyer; Transactional, Progressive and Strategic. Each of these approaches has its merits and challenges and there is no simple answer to the question of which approach is best. At JLT we work closely with clients to choose the right strategy and to maximise any potential benefits such as minimising cost, enhancing protection or process improvements. Have you considered the advantages of understanding what type of buyer would be best suited to your organisation?

On the following page we have outlined some basic characteristics to allow you to identify your buying style including some of the advantages and disadvantages. It is important to understand that there is no obvious right or wrong. However there are some basic guidelines to consider. For example, the traditional approach is more common in smaller organisations with very basic risk profiles and minimal premium volume to leverage with insurers.

While most larger organisations aspire to be strategic in their approach, the majority are, in fact, progressive. There are many reasons for this ranging from the high levels of investment and commitment required to frustrations in the time it takes to implement truly strategic programmes.

JLT is able to undertake a detailed analysis of your organisation to assist you with the identification and pursuit of the right approach. Our analysis will consider the strategic, financial

and operational drivers of your business; the nature and complexity of your insurance risks; your current and desired approach to insurance purchase and whether this is the best approach for your organisation. It will also consider the merits and pitfalls of each approach and, where appropriate, provide a pathway to moving towards a preferred option.

Contact JLT today and find out if there are benefits to changing the way you purchase insurance.

## Transactional

Those who view insurance as a list of risk transfer products, spend a minimal amount of time renewing those products and very little time analysing detail such as cost drivers, coverage improvements or broader risk issues.

- Purchases basic classes of insurance without many changes from the standard product
- Views insurance as a commodity or product rather than a risk transfer vehicle
- Meets with their broker once or twice a year during renewal
- Accepts market conditions
- Plans insurance buying around predefined budgets
- Views premiums as expenses
- Has minimal involvement in insurance process
- No formal approach to risk management
- Basic understanding of insurance concepts

## Progressive

Those who are more actively involved with a focus on improving tangible benefits like maximising the efficiency of their insurance spend, improving overall protection and minimising the impact of price drivers like deteriorating claims experience or poor asset protection. Progressive buyers are more likely to perform an annual review of insurable risks to minimise an unexpected and uninsured event.

- Purchases a diverse and sometimes complex mix of insurance products
- Views insurance as business enabler
- Exploits market conditions as they arise
- Actively involved in insurance purchase
- Meets with their broker several times a year
- Maintains a risk register
- Has risk controls in place
- Has a hazard minimisation strategy
- Safety culture ingrained within the organisation

## Strategic

Those who are more proactive in their approach. They are often quite sophisticated and advanced risk financiers with full time specialist resources and enterprise-wide risk management systems that drive and shape their insurance strategy. Strategic buyers tend to invest heavily in managing risk and insurance. Investment is not the key driver, however, the key driver is the alignment of critical business functions, goals and challenges with risk identification, mitigation and treatment (insurance or otherwise).

- Advanced risk financier
- Invests heavily in risk management and risk governance
- Takes an enterprise wide view of risk
- Views insurance as a risk financing option
- Performs analytics to calculate frequency and cost of risk
- Actively sells risk to its insurers
- High levels of self insurance

For more information contact Marcus Pearson at JLT on (02) 9290 8136 or email [Marcus.Pearson@jlt.com.au](mailto:Marcus.Pearson@jlt.com.au)

### Health Check Alert

Are you using the correct reinstatement value? Claims from recent events highlighted that a number of property owners had been declaring incorrect reinstatement valuations. This impacted the amount the insurers were able to payout.

### JLT Tip

Your reinstatement valuations should be updated every three years by a professional valuer to stay current.

### Transactional Buyer

**Advantages** include less time investment required, simple to understand and no risk management expenses.

**Disadvantages** include hidden uninsured risks as standard products purchased, higher premium levels, less confidence in risk transfer mechanisms and potentially poor corporate governance.

### Progressive Buyer

**Advantages** include lower cost of risk, improved coverage, better negotiating power with insurers and less "surprises".

**Disadvantages** include uninsurable risks not managed effectively, greater time commitment and some initial capital investment required.

### Strategic Buyer

**Advantages** minimises risk and cost of insurance and maximises business confidence in risk transfer mechanisms.

**Disadvantages** large investment required, time consuming, long-term payback and can be difficult to measure.

# An Underwriters Perspective...

Chubb Insurance's Property Practice Leader for NSW, Cara Barrow, tells us that they are looking closely at a landlord's approach to risk management when considering the risk.

Significant global losses over the past three years are making the expiring insurance and reinsurance premiums inadequate and general increases in insurance premiums are occurring, more so to portfolios with natural catastrophe exposed locations.

## With the doom and gloom, what can the Insureds do?

In order to obtain the most favourable terms from Chubb we would advise the Insureds to think about the key components of their risk, i.e.; Construction, Occupation, Protection and Exposure (COPE). An underwriter will take all of these into account when deciding whether to provide coverage for a risk and what level of cover they will provide. It is also important for an Insured to demonstrate that they have a proactive attitude to Risk Management and are committed to continual improvement. COPE, combined with risk management attitude, will ultimately impact the terms and conditions insurers apply.

Insureds need to work closely with their insurance brokers to ensure they provide them with the fullest possible understanding of all the risk management programmes they currently have in place. Underwriters also welcome the opportunity to hear directly from the Insureds themselves as no one knows their own risks better.

As a property underwriter we are interested in both the physical assets and the less tangible aspects of

the risk. To give the best terms and the broadest cover we need to be provided with full details of a buildings construction (i.e. materials used in floors, walls & roofs, age of building, etc). If they are available previous property surveys and status of risk recommendations can provide useful detailed information. For a property owner it is also important to know the occupation and nature of the building's tenants as this will impact the degree of risk at a location. The final piece of information that is needed is comprehensive details of the fire and theft protection that is in place.

Equally important to the physical aspects of a risk is the Insured's attitude to risk management. A good initial indication of this can be seen by looking at compliance with the risk recommendations. The broker and Insured should keep a record of the status of old recommendations as it is important to be able to demonstrate that the Insured takes a consistent approach to risk management. We will reward an Insured if they learn from past experiences and prevent them happening again.

Whilst it is important to state all of the risk management functions undertaken by the Insured it is as important to be able to demonstrate effectiveness of risk management and this can generally be done by studying the claims experience along with the risk management framework timeline. This will soon tell us whether the risk management being employed is effective. Up to date business continuity plans (BCPs), which the Insured can show have been tested, are also a good indication of an insureds attitude towards risk management.

Unfortunately no matter how good your risk management is insurers may still have to impose certain terms and conditions for risks, especially those located in natural catastrophe zones. Properties in these locations, as you would expect, are bearing the greatest premium increases, application of sub-limits and increase in deductibles across the whole insurance market. However, the clients that can demonstrate they have employed effective risk management to mitigate and reduce their exposures are benefiting from lower increases and less onerous terms and conditions.

## Health Check Alert

Are your indemnity periods sufficient to reinstate your buildings?

Partial losses where the building needs to be rebuilt from ground up will take longer to reinstate than a totally destroyed property.

## JLT Tip

Sufficient time to restore premises following a loss must be allowed. This includes allowing for building approvals to be obtained before work can commence.

## Some examples?

### Loss:

#### Water Damage

With property owner's business, the number one offender we see is loss arising from water damage.

#### Fire Damage

Fires are frequently experienced at premises as a result of waste not being stored correctly.

#### Malicious Damage

Graffiti and petty arson can be problematic in Australia. The smallest actions can lead to expensive repairs.

### Prevention Method:

With older buildings we often see a maintenance schedule of pipe repair works which allows us to review the claims experience against the losses so the improvement works can visibly be seen to reduce the water damage losses. Some property owners install water sensors in high value areas so that the onsite building managers / night security get immediate notification of water discharged.

General housekeeping checks are extremely important to ensure that flammable items such as paints are not left near combustible items. It is important to have appropriate internal procedures about the storage of waste to be communicated to all members of staff.

The installation of CCTV and 24 hour security presence on site will often reduce the level of malicious damage significantly.

## Summary

We see a broad range of risk management cultures in Australia and Chubb favours the portfolios that have demonstrated positive risk management. We reward Insureds that have a strong grasp of risk management and are doing everything they can to prevent losses occurring. However, in order to be able to obtain the best possible terms the Insureds need to be able to demonstrate the effectiveness of the risk management employed.

JLT has a strong risk management offering and would be able to work with you to improve or create a risk management framework for you.

For more information contact Stephen Cooper on (02) 9290 8123 or email [Stephen.Cooper@jlt.com.au](mailto:Stephen.Cooper@jlt.com.au).

# Can you do more to protect yourself against subcontractors?

In today's competitive construction marketplace property developers need every advantage to limit risks and boost margins.

Under Construction Management contracts, the risk of a major subcontractor or supplier default sits with the property developer rather than the main contractor. That's why every property developer needs to take steps to manage its exposure to subcontractor default.

In Australia, property developers seek financial risk protection by requiring their subcontractors to provide performance bonds, typically 10% of the subcontract value. This means at least 90% of the subcontractor default risk is retained by the property developer. In practice, the financial consequence of the default could be much higher as the bond is applied to the value of the subcontract which may be disproportionate to the disruption caused.

## What is the solution?...

JLT is able to provide clients access to an innovative insurance product that is able to provide clients with an alternative to the low level protection traditionally provided by subcontractor bonds. This product, subject to the terms and conditions of the policy by the insurer, provides protection against major subcontractor or supplier default.

There are substantial retentions involved but the indemnity available in excess of this can be as much as \$35m per loss. It is important to understand that the default is not just restricted to insolvency. Performance, quality and programme issues are also covered. Some examples of losses that can be covered are shown at right.

Beyond providing the same protection, with the policy not reliant on a "damage" trigger, property developers can also receive the

added benefit of up to a six year period of post completion cover effectively providing a form of latent defects insurance.

JLT is one of the few insurance brokers to place this product outside North America and it is our involvement in these placements that provides us with a unique insight into the product, the underwriting process and how to tailor a programme to best suit your needs.

If your annual or single project subcontract expenditure is in excess of \$150m, we may be able to provide you with a cost efficient, comprehensive subcontractor or supplier default protection alternative.

**Claim scenario - It is discovered that the dry lining contractors workmanship does not comply with the relevant building regulations and will therefore need to be replaced.**

Conventional insurance solutions are unlikely to provide the coverage required to protect against this loss.

There will be no coverage available under a Contract Works policy as this policy will generally require damage in order for the policy to be triggered.

There will also be no coverage under a Professional Indemnity policy unless a professional error has occurred.

JLT is able to arrange an insurance product that, subject to the terms and conditions of the policy, indemnifies the Insured for the cost to strip out and replace noncompliant dry lining, the cost to rework any finishing trades affected by the strip out, the cost to accelerate any impacted trades to minimise programme delay, the cost of any additional management time or legal expenses incurred as a consequence of the default and also the cost of liquidated damages directly related to the default.

## Direct Losses

The cost to supplement subcontractors' work to stay on schedule

The cost to complete any unfulfilled subcontractor or supplier obligations, including costs to terminate and replace a defaulting subcontractor

The cost of rectification of defective or non-conforming work or materials

The cost to pay for unpaid suppliers or second tier subcontractors

The cost of legal expenses associated with a defaulted subcontractor

## Indirect Losses

Cost to accelerate other trades affected by a defaulted subcontractor

Cost of extended overheads incurred as a result of a defaulted subcontractor

Cost of liquidated damages directly related to the defaulted subcontractor

For more information contact Iain Drennan on (02) 9290 8163 or email [Iain.Drennan@jlta.com.au](mailto:Iain.Drennan@jlta.com.au).

# Insurance Costs Rising – Need A Different Approach?

With the increasing cost of insurance it has become more common to consider alternative ways to manage risk. JLT has been operating **discretionary trusts** in Australia since 1986...

A discretionary trust is an innovative, cost effective protection vehicle, unique to JLT, and is in essence an alternative risk retention vehicle. The discretionary trust is designed to build a fund to retain the high frequency / low value losses and then purchase insurance to protect members of the trust against any losses that occur in excess of this initial layer.

By retaining these working or predictable losses it reduces the amount of “dollar swapping” with insurers enabling the trust to manage these predicted losses in a tax friendly environment. This will lead to an overall reduced

premium spend with insurers in the traditional market.

An overlaying insurance policy protects the trust fund in the event of a catastrophic loss or funds held in trust being exhausted. This allows the trustees to choose their level of risk retention according to their risk appetite.

Whilst the discretionary trust allows for a more effective means of managing losses, it is also able to generate profits by returning underwriting surplus and interest earned on funds held in trust to the members’ benefit. Good claims performance will generate a surplus.

## Placement structures

As an example, a discretionary trust would still allow your property insurance programmes to be placed with conventional insurance markets. This placement sits in excess of a discretionary trust that manages your programmes’ working losses covered under your property programme. The discretionary trusts would have a capped exposure with a maximum annual aggregate being applied. Once this is exhausted the conventional insurance drops down to replace the trust. This placement sits above the various selected self insured deductibles or excesses.

# What can you put into a discretionary trust?

In addition to more familiar covers usually seen in conventional insurance programmes, the discretionary trust can be designed to potentially address any types of exposure, often beyond the scope of what is normally available from the traditional insurance market.

## Benefits...

1. Can reduce your insurance premiums and the overall risk transfer spend
2. Allows you to control the level of participation in self risk retention
3. Allows you to participate in the underwriting profit of the trust
4. Provides a tax efficient environment
5. Allows discretionary claims settlements
6. Allows blended solutions with conventional insurance
7. Provides insurance like solutions for risks that are not insurable, whether they be cost prohibitive or general market exclusions

## Other advantages to you?

JLT’s Discretionary Trusts have been developed in consultation with APRA, ASIC and the ATO. The trusts provide discretionary claims decisions, competitive terms, flexible structure and are supported by a dedicated and responsive JLT team.

For more information contact Craig Harms on (08) 8100 3008 or email [Craig.Harms@jlt.com.au](mailto:Craig.Harms@jlt.com.au)

## Health Check Alert

Is your premium being spent efficiently and effectively?

Insurance premiums increase dramatically for high frequency low severity losses leading to “dollar swapping” with insurers.

## JLT Tip

The ability to voluntarily amend your deductible levels and remove minor losses from the Insurers’ claims listing can ensure your premium is being used to protect your business, and balance sheet, from crippling losses.

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