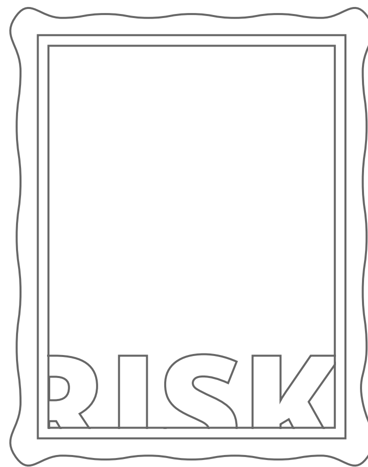
Risk Management

AN IMPORTANT PART OF YOUR FISCAL PICTURE



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Bonnie completed an impressive 25-year career in public service, holding risk management leadership positions in city, county, state and higher education arenas. Her last public sector role was that of risk manager for the County of Solano. Before that role, as a gubernatorial appointee, she developed a full-service risk management program for the Department of Corrections and Rehabilitation resulting in annual cost savings of over $20 million.

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A case for looking deeper

By now, most public agencies with defined benefit retirement systems have seen unprecedented increases in their annual costs. Even with recent retirement reform, most retirement cost trends suggest continuing large increases, anywhere from 25-50% and more over the next 15-20 years. As public agencies tackle this fiscal challenge, employees and their representatives are also asking for help with the heated real estate market and increased health benefit costs by demanding wage increases. While we may appreciate our current budgets, the future fiscal climate is stormy.

Many of your programs and services receive their fair share of scrutiny during budget times. However, one program that typically falls below the budget radar is the risk management program. An informal review of various city budgets and financial statements confirms there is no consistent and transparent way that public agencies account for the activities of their risk management program. Most senior managers can speak to departmental budget amounts and employee counts, but how many know what the annual risk management program expenses and accrued liabilities are? Given the total costs of risk-related activities, managers should know how much of their precious resources are tied up in these activities and how risks are being managed in your agency.

Our informal review found that cities with populations of 30,000-40,000 have annual expenses for risk management programs between $500,000 to $1 million, and cities with populations of 150,000-300,000 have annual expenses ranging between $5 million and $20 million. While all cities are unique in personality, they have one thing in common: the greatest costs and expenses are in the workers' compensation and general liability programs. And depending on your self-insured retentions and desired "confidence levels" for the future claims reserves, there might be another $2 million to $50 million tied up to ensure adequate funding of losses. Some agencies used some of these reserves to get by during the Great Recession. If this scenario applies to your agency, have those assets been replenished? Are you confident that the attention placed on the activities that generate these costs as well as the programs that can mitigate their impact are commensurate with the resources in play? Has your organization taken advantage of risk management solutions that result in cost savings so that other operational needs can be achieved?

While budgets typically reflect the direct costs of a risk management program, such as claims costs, insurance premiums and loss prevention and control activities, there are ripple effects that can surprise a smaller city. These ripple effects typically fall below the radar and are the indirect costs, such as overtime, backfilling a vacant position, poor morale, and extraneous benefit costs such as the Labor Code 4850 impacts. Do you know the effects of employee absences due to industrial or non-industrial injuries or illnesses? Do you know the number of lost days each year and are you confident that your current processes are designed to cope with these absences? These are but a few questions you should be asking yourself to ensure that your risk management program supports and aligns with your city's priorities.

Why is Sloan Sakai Yeung & Wong adding Risk Management to its Management Strategies Group (MSG) portfolio?

While Sloan Sakai is primarily known for its client-focused work in the labor and employment arena, the firm's leadership is constantly looking for ways to save you money and get ahead of issues where "upstream" investments will help to avoid costly legal actions. Adding risk management consultation to its consulting division, MSG, means that we can help you be more proactive, which translates into more program dollars for critical services and paying for other increasing costs. It means that you can stop spending money on things that have gone wrong and start investing in things that go right.

Given the pace, scope and severity of financial challenges local government faces now and in the future, there has never been a better time to integrate risk management into your strategic planning process. Doing so will allow you to make more informed decisions and likely save money—something we can all get behind.

MSG provides a seamless, integrated approach to problem-solving that provides our clients with the expertise of 27 lawyers and 13 consultants in human resources, financial management, performance improvement, change management, labor relations, departmental assessments and now, risk management.

What is risk management?

For us, "risk" is anything that can get in the way of an organization achieving its objectives. Not all risk is bad – after all, taking some risks leads to new opportunities. The secret lies in how those risks are managed. Traditional risk management programs typically focus heavily on insurable risks and any loss prevention and control activities.

In a nutshell, professional risk managers typically start by surveying the organization's "risk landscape" to get a better sense of the major risks and exposures faced by the organization. They use loss data (frequency and severity) to predict and mitigate future events with targeted interventions. They evaluate and recommend financial solutions, such as insurance or self-insurance, to protect the organization from the cost of catastrophic loss. They provide claims and litigation management expertise reflecting industry best practices. These individuals are typically collaborative, and usually enjoy getting to a "yes" solution so that you can get on with what you do. Managing risk is a tall order and it is impossible to do it right without collaboration of others in the organization.

Our firm has been in hundreds of client organizations. We notice that many public agencies have not created a dedicated risk management professional with the delegated authority to manage these programs. Often, the duties are assigned to staff that have other responsibilities; thus, the priorities of the day tend to squeeze out the adequate focus on risk best management practices. If this sounds familiar, an independent review of your risk management program might just be what's needed to reset your practices and policies.

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What should typically be in a risk management program?

In a traditional risk management program, the basic tenets are insurance of all types and all things prevention and loss control-related. However, the risk management program can vary in complexity from organization to organization. That can be a good thing and a bad thing because while it leaves a lot of room for customization, the lack of standardization may lead to variability in program outcomes making it very difficult to benchmark against others. Risk management professionals know, however, that there are industry best practices that can reap excellent program results. By measuring performance of the program over time with appropriately selected metrics, you can review the positive and negative impacts and then consider improvements.

Are there best management practices that can reduce your costs of risk?

Always! We recommend you focus on prevention because at the end of the day, the best claim is no claim at all. Beyond that, understand that things happen despite our best efforts, so the idea is to reduce the impact to our organizations as much as possible and anticipate by having methods in place to manage them.

- ✓ Review your self-insured and insured financial strategies to ensure you are capitalizing on the best possible solution for your entity
- ✓ Implement a return-to-work program with modified or transitional assignments
- ✓ Ensure that your claims administrator is actively managing claims with tight medical and legal oversight
- ✓ Monitor claims trends and consider interventions to reduce negative trends on a timely basis
- ✓ Audit your health and safety program to ensure it is up-to-date with its policies, procedures, training and emergency response plans
- ✓ Create high level oversight committees for any major program, such as health, safety, wellness and workers' compensation
- ✓ Consider using technology to track disability-related leaves and ADA accommodations
- ✓ Create incentive/award programs for departments that reward best practices
- ✓ Develop contract insurance requirement guidelines
- ✓ Involve employees in solutions that will help them stay healthier, such as wellness programs
- ✓ Conduct regular reviews of your highest cost programs to ensure that third-party administrators are actively managing your claims and closing them as soon as possible
- ✓ Conduct quarterly review with departments that experience high volume claims and/or employee absences (discretionary or not)
- ✓ Use your affiliation with a risk pooling agency to take advantage of all training and services
- ✓ Inventory your property to ensure that you have adequate insurance coverage
- ✓ Focus on the ongoing educational needs of your risk management staff to keep their skills and knowledge current
- ✓ Allocate risk costs to departmental budgets based on claims experience/losses

What are commonly used metrics that drive costs?

Using the workers' compensation program as an example, your risk manager can provide you with more detailed metrics and help you understand what factors are driving program expenses and whether you can institute changes to reduce or stabilize them.

Here are some common workers' compensation metrics to consider in a program report:

1. The claims count (frequency) and total reported loss (severity) detail—all claims, closed claims, open claims and closure rates, broken out by type of claim (medical, lost time, and allocated loss adjustment expense); first aid, medical only, and future medical.
2. The lost-time (indemnity) claim severities broken out between total reported, paid losses, and reserves.
3. The top 10 claims by total reported loss, including the name of the injured worker, the total reported loss, the total amount that has been paid, and the outstanding reserve. Knowing whether the claim is open or closed is also important with this component. This will help with identifying the most expensive claims and any trends associated with them.
4. A stratification of claims by severity ($0-100, $100-$1,000), type of claim (medical, lost time, and allocated loss adjustment expense). This provides a view of the distribution of claims and where a risk management program might need specific focus.
5. A strong indicator of whether a risk management program is effective or successful is the percentage of lost-time claims that are in litigation versus all lost-time claims.
6. A view of claims distributed by the tenure of the injured worker (0-1 year, 1-2 years, 2-5 years, 5-10 years), broken out by total loss, medical only, and lost time. This is valuable to help understand where to focus training efforts or where more supervision of newer employees is needed.
7. A view of the claims stratified by age.
8. The day of the week that the claim occurs, broken out by the total number of claims each day and the dollar amount of total reported losses, medical-only losses, and lost-time losses. This can help identify any trends, such as an increase in injuries in specific time periods or days.
9. The top five injury types (strain, contusion, burn, etc.), and injured body parts (lower back area, fingers, knees, etc.). This information can be directly related to loss control and safety practices and can be very helpful to a risk manager in identifying any trends.
10. "Lag time"—the time it takes to report a claim—is a true behavioral indicator and is captured as the number of days in which a claim is reported by either the employee or employer (1-3 days, 4-6 days). It is critical that your risk professionals quickly begin working on a claim to mitigate its impact to your agency.
11. The return-to-work metrics. These metrics help determine if the return-to-work practices are effective in retaining employees and reducing severity loss costs.
12. Case closure rates. Open cases mean open reserves and your money is tied up. How many are setting by Compromise and Release versus Stipulated Awards; how actively is a case managed by the administrator.

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Looking at this data will provide insights into where training or communication improvements are needed. Managing the frequency and severity of claims is a key driver in the execution of a successful risk management program. It relates directly to the bottom line, affecting the cost of insurance as well as indirect costs, which can be far greater than the direct costs.

Not concerned about indirect costs?

Well, you should be. While direct costs are sometimes the first thing we notice, soft or indirect costs can be even more significant and can paralyze an organization. Examples of indirect costs are:

- Lost work days
- Overtime costs to backfill for injured employees, especially in a 24/7 operation
- Cost of hiring and training replacement staff
- Loss of morale
- Loss of productivity
- Attrition
- Business interruption
- Reputation

In general, and based upon conservative actuarial estimates over the years, indirect costs in relation to direct costs is a **1:1 ratio**, meaning there is **$1** of indirect cost for every **$1** of direct cost. Estimates for some risks can range as high as a **3:1 ratio**. These ratios translate into huge expenses that many organizations are not tracking, thus not managing for results.

Still not convinced? Okay, then let's think about extended absences due to injury or illness, such as Labor Code section 4850 leave applicable to safety positions. This statutory benefit provides a safety employee with up to one year of full wages, tax-free, for each workers' compensation claim filed if the individual cannot perform the essential functions of the job. In addition, that individual receives Temporary Disability after one year of 4850. When this occurs, it's not just the employee suffering the injury who feels the pain and can't work; the organization feels it, too, and especially so when the workforce is lean. The lost work days, lower productivity and position backfilling (if it's even possible) mount up quickly. How can you manage these absences? Can you develop programs that incentivize safety that averts injury? There are best practices available to you, such as Managed Provider Networks (MPN's) and Health Care Organizations (HCO's), both of which manage medical costs. But there's one that our firm specializes in, called "Carve-Out's", which control both medical and legal costs, and can also include incentives when there are cost savings. If you're interested in hearing more about this, you can always call us to learn more.

You don't know what you don't know!

Regardless of your years of experience and education, and due the pressing needs placed on your agency, it's quite likely that your management team doesn't have a complete handle on some of your organization's processes that have resulted in liability losses. Our experience is that risk management processes that support operations tend to be less visible and sometimes fly under the radar. For example, we had a client that was unknowingly operating without self-insurance reserves, along with a $1 million deductible on certain types of claims. This kind of scenario is a high-risk gamble if things go wrong and could cause massive budget cuts to fund a catastrophic claim.

Commissioning an independent look at these processes is not about finding fault, but rather it could provide you a fresh perspective along with a road map for saving money. Most senior managers prioritize their inquiries based on total dollar impact, whether it's a governing body priority or getting attention in the community or organization. We would suggest to you that the risk management dollar impact may be bigger than you think, and it deserves your attention.

Opportunity is knocking at your door

Risk management is a tool that provides an opportunity to protect the public's trust and resources. Given the cost pressures from pensions, benefits and compensation, we believe there are potential savings in the cost of risk that can be redirected towards these other cost categories. We have experts in our firm that can help you positively transform your risk management program, simply review your current systems and see if there is room for improvement, or even provide occasional guidance on risk issues as they arise. Give us a call. Our team of experts are here to help.

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Management Strategies offers innovative and cost-effective solutions for our clients' most complex problems. Our team of non-attorney consultants have deep expertise in management consulting, labor relations, human resources management, public finance and issues related to public safety management. Our consultants work independently or in coordination with Sloan Sakai Yeung & Wong's legal team to assess and solve the needs of managers and executives.

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