John Foord

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Improving risk management using asset valuations

Key messages:

- It is well known that inadequate insurance in the event of an insured event puts a company and their financiers at risk of material losses
- However uninsured losses may also create legal challenges for directors and senior managers and can delay settlements
- A regular review of asset values is therefore an important exercise to ensure that property damage cover is adequate and appropriate
- The use of modelling and on-desk analytics means that regular reviews are now much more cost effective and much less disruptive to day-to-day business operations
- In-house engineering teams, construction firms and brokers often have different skill sets and may not have the depth of knowledge to marry current costs with insurance requirements
- Regular independent valuations give insurers comfort that owners are sincere about risk management, often speeding up claims and settlements
- An insurance valuation exercise can often create additional benefits in terms of asset information for the engineering, finance or management teams

What's preventing you from conducting an insurance valuation?

“It’s not important enough to senior management”

In many jurisdictions because of enhanced corporate governance legislation, company directors may be held personally liable by stakeholders for any financial loss their company incurs as a result of a decision taken by the directors.

For example, in Australia a company director has a duty to that company and any breach of that duty may be considered to also be a breach of the Corporation Act 2001.

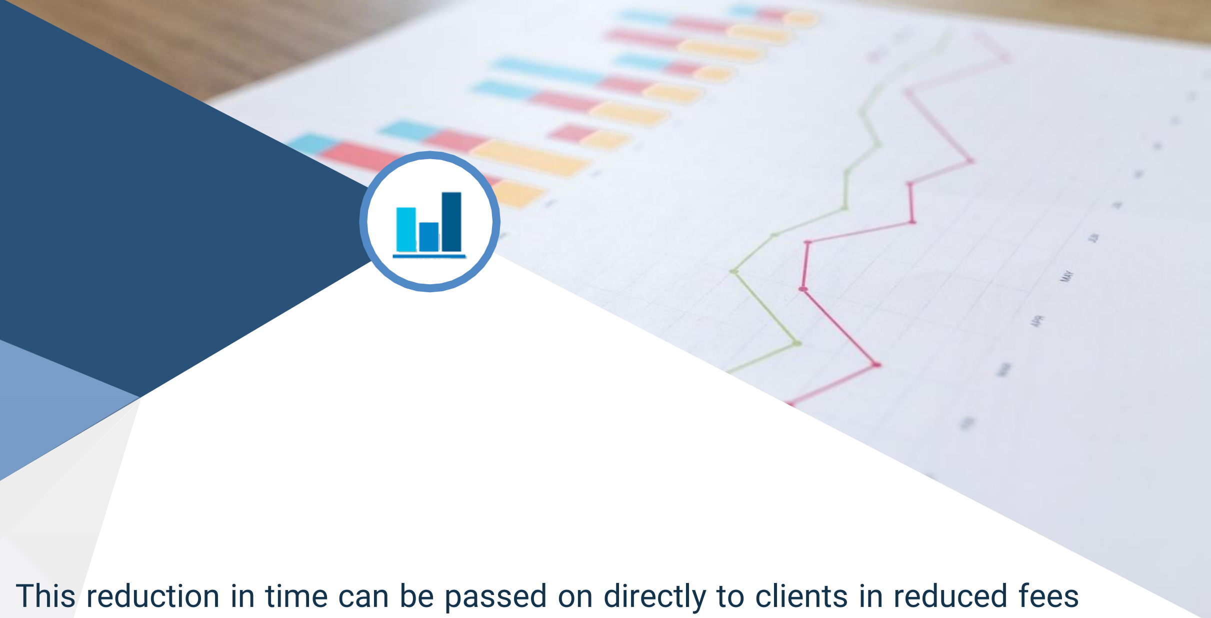
In the UK, a company director is formally a trustee of the property owned by that company and they may be held personally liable for any financial loss incurred to company property.

Knowingly or recklessly underinsuring the assets of the business, and the subsequent financial loss that results through a shortfall in an insurance claim, would be an obvious example of a breach of a director’s fiduciary duties.

Directors may be able to claim ‘relief’ from such obligations if it can be shown that they were acting in good faith based on professional advice, but that does not necessarily resolve the problem of the immediate and negative impact on a business after a loss of a financial settlement delay or shortfall.

“It will be too expensive”

One of the biggest benefits of advances in information technology is the massive reduction in the cost of previously time-consuming tasks. For the leading valuers, there are now a wealth of software tools and valuation modelling techniques that can be applied to significantly accelerate the analysis required to arrive at an accurate reinstatement costassessment.



This reduction in time can be passed on directly to clients in reduced fees or increased analysis in the final reports.

In addition, for many property damage insurance policies, insurers will set aside an “Engineering Fee” to allow for the preparation of asset valuations, risk assessments, etc. and are often willing to use part or all this engineering fee to help fund a regular formal valuation of the assets.

“Our broker can advise on the values”

Brokers are insurance specialists who can identify risks, the types of insurance policy and cover needed and where to find the most competitive premium rates for those risks.

However, while they may have experience in providing the correct insurance for a multitude of commercial and industrial environments, they may not have the same depth of knowledge of current replacement costs for those facilities. An independent valuation gives both brokers and owners comfort that the replacement costs are correct, and their interests are protected.

“Surely indexing up historical costs will be good enough”

Apart from the fact that asset registers are rarely 100% up to date, they usually exclude rented or other third-party assets which must be insured. Additionally, registers often include non-insurable and one-off assets, while lacking enough detail to permit accurate historic cost indexing.

It should also be noted that for facilities that may have been transferred as part of a M&A transaction, the “cost” of an asset in the books may be an allocation of the purchase/transaction price, not its original cost from the supplier. Equally sometimes acquisition dates may be based on when costs were recognized in the accounts not when the assets were purchased.

“We can do the valuation in house”

Nobody knows your assets better than those who work in your company. However, having an intimate knowledge of the plant or buildings does not automatically mean that anyone in your company knows their reinstatement cost for insurance purposes.

Too often in-house teams confuse worth with reinstatement cost and they base declared values on accounting book values or some other form of judgement on the value the assets bring to the business. As with indexing, the key is to be able to understand what is to be included or excluded from an insurance perspective and making sure this matches with the insurance policy terms.

Moreover, in these days of limited resources, local management or engineering teams may not have the spare time in addition to their usual work to prepare detailed assessments of replacement costs.

“My assets are new so I can use these costs”

Imagine you have just spent $2,000,000 on new warehouse facilities. The temptation would be to insure the facilities for $2,000,000. But, what about the cost of site clearance, if destroyed by fire, before you can construct a new building? Have costs varied since you tendered out the original construction? Would the suppliers still quote the same or did they underprice the original work? Valuers are trained to prepare reinstatement cost assessments that closely match to your insurance policy and well-established insurance assumptions.

“It doesn’t matter that much to the premium”

Due to the prevalence of underinsurance across the market, insurers and reinsurers are often skeptical of values declared by owners. The underwriters pricing the risk (and therefore setting the premiums) will look at not only the sums declared and the risk management of the facilities but will also take into consideration the overall management of the insurance renewal process.

As your insurance broker will confirm, an accurate assessment by a qualified, independent and experienced external valuer gives insurers and reinsurers additional comfort that the process is well managed, and this is often reflected in the final premiums offered.

"A professional insurance valuation exercise will be too disruptive"

Here at John Foord our aim is to be as unobtrusive as possible and to take up as little senior management time as possible, while still providing invaluable and beneficial information.

For the reinstatement cost assessment, only the following limited information would usually be required:

- Site layout and equipment layout plans
- High level technical specifications of the major equipment items
- A copy of the latest asset register
- Limited access to technical or engineering staff who are knowledgeable about the assets

"An insurance valuation exercise is only of limited value"

A professional insurance valuation requires a thorough investigation of a business's assets and can provide surprising additional value to business operations. In certain areas, this may not be dissimilar to an audit, giving you the opportunity to update your financial or engineering records on topics such as:

- Redundant or underutilized assets
- Condition surveys
- Estimated remaining life assessments
- Omissions or discrepancies in the fixed asset register, improving financial reporting
- Identify specific major equipment that has an extensive lead time for replacement (so helping in disaster recovery planning).

By way of example, in a recent case we identified for a client their significant reliance on a small number of equipment suppliers, so they would have a much longer lead time on their equipment after a loss than they had envisaged.

Conclusion

Some risk managers see an independent reinstatement cost assessment as a low priority issue that has minimal bearing on overall insurance coverage. After several years of losses in the insurance market, however, insurance companies are paying close attention to the sums insured and potentially rejecting full claims where under insurance is apparent. The use of modelling and on-desk analytics by an expert valuation firm with knowledge of the assets, insurance policy terms and practical post loss scenarios means that regular reviews are now cost effective and no longer disruptive to day-to-day business operations.

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