



RISK MANAGEMENT FOR ENTERPRISES AND INDIVIDUALS

Chapter 11

Property Risk Management



Learning Objectives

- In this chapter, we elaborate on the following:
 - How insurable property is classified.
 - The ways in which valuation, deductibles, and coinsurance clauses influence property coverage and premiums.
 - The increased frequency and severity of e-commerce property risks.
 - Five major categories of e-commerce property risks.



Learning Objectives

- In this chapter, we elaborate on the following:
 - Loss-control steps that can reduce e-commerce property risks.
 - Availability of insurance as a means of transferring e-commerce property risks.
 - Global risk exposures in the international competitive landscape.
 - Risk control measures for reducing common global risks.
 - Insurance options for global risk exposures.



Property Risks

- Property can be classified in a number of ways, including its mobility, use value, and ownership.
 - **Physical property:** Consists of real or personal property.
 - **Real property:** Permanent structures (realty) that if removed would alter the functioning of the property.
 - **Personal property:** Physical property that is mobile (not permanently attached to something else).



Property Risks

➤ General Property Coverage

- The first **standard fire policy (SFP)** came into effect during the late 1800s and came to be described as the generally accepted manner of underwriting for property loss due to fire.
- Most recently, the SFP has been replaced by homeowners policies for residential property owners, and the commercial package policy (CPP).



Property Risks

- Types of Property Coverage and Determination of Payments
 - Valuation Clause
 - Property insurers often offer coverage on a replacement cost new (RCN) basis.
 - **Replacement cost new** is the value of the lost or destroyed property if it were bought new or rebuilt on the day of the loss.



Property Risks

➤ Deductibles

- Purpose is to reduce costs for the insurer, thus making lower premiums possible.
- The most common forms being:
 - **Straight deductible:** Requires payment for all losses less than a specified dollar amount.
 - **Franchise deductible:** Pays the entire amount in full once the amount of loss equals the deductible.
 - **Disappearing deductible:** One whose amount decreases as the amount of the loss increases.
- Help maintain reasonable premiums because they eliminate administrative expenses of the low-value, common losses.



Property Risks

➤ Coinsurance Clause

➤ Has two main provisions:

- Requires one to carry an amount of insurance equal to a specified percentage of the value of property in order to be paid the full amount of loss incurred
- Stipulates a proportional payment of loss for failure to carry sufficient insurance.

➤ The coinsurance limit is calculated as follows:

$$\frac{\text{Amount of insurance carried}}{\text{Amount you agreed to carry}} \times \text{Loss}$$



E-Commerce Property Risks

- Business risk exposures due to the use of computers, the Internet, and the Web.
- Are grouped into five broad categories:
 - Hardware and software thefts (information asset losses and corruption due to hackers, vandalism, and viruses)
 - Technological changes
 - Regulatory and legal changes
 - Internet-based telephony crimes



E-Commerce Property Risks

➤ Trademark Infringements

- **Domain name hijacking** occurs when an individual or a business reserves a domain name that uses the trademark of a competitor.
- Seeking compensation for the use of a registered domain name from the rightful trademark holder is known as **cybersquatting**.
- **Web site hijacking** occurs when a Web site operator knowingly deceives the user by redirecting the user to a site the user did not intend to view.



E-Commerce Property Risks

- Businesses can take loss-control steps to reduce the e-commerce property and business interruption risks by using the following:
 - Security products and processes; System audits
 - Antivirus protection
 - Backup systems and redundancies
 - Data protection and security
 - Passwords
 - Digital signatures and Encryption
 - Firewalls and Virtual private network (VPN)



E-Commerce Property Risks

- E-Commerce Property Insurance
 - Some insurers now offer customized e-commerce insurance policies that expand the areas of coverage available for e-commerce property risk.
 - ISO has an e-commerce endorsement that modifies insurance provided under commercial property coverage.



Global Property Exposures

- **Global risk:** The unique problems that arise when companies cross national borders.
- The main categories of global risk exposure are:
 - Destabilized international political environment
 - Heightened terrorism risk; Legal risk due to changes in local laws
 - Lack-of-data risk; Currency inconvertibility risk; Cultural barriers risks
- **Political risk:** Unanticipated political events that disrupt the earning or profit-making ability of an enterprise.



Table 11.2 - Ten Ways to Tune up Management of Political Risks

1. Look closely at foreign operations—current or planned—and identify all possible political risks.
2. Examine the locale of each foreign operation and stratify them along a risk continuum, according to susceptibility of political risks.
3. Explore “public” political risk insurance coverage through facilities such as MIGA and OPIC.
4. Allow plenty of lead time for procuring insurance for political risk coverage.
5. Seek multiyear policies or coverage for as long a time frame as possible. Keep tightlipped about the existence of any political risk coverage you obtain.
6. Engage an insurance broker who is specialized in procuring political risk coverage.
7. Invest in infrastructure in host countries and cultivate a strong track record of being a good corporate citizen.
8. Fine-tune security and anti-hijacking procedures to address the potential loss from kidnapping, ransom, extortion, or terrorism.
9. Make sure that retention of any political risks is accompanied by realistic funding mechanisms.
10. Strive to bring the same thoroughness to political risk management as the organization brings to more mainstream risks such as fire, flood, earthquake, and workers’ compensation.

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Global Property Exposures

➤ Legal Risk

- **Nonadmitted coverage:** Contracts issued by a company not authorized to write insurance in the country where a risk exposure is located.
- **Admitted insurance:** Contracts written by companies authorized to write insurance in the country where a risk exposure is located.
- Coverage is also affected by the codification of the legal system in the other countries.



Summary

- Insurable property is classified as real or personal, and affects the property's exposure to risks and basis for valuation.
- E-commerce property risks are categorized into hardware and software thefts, technological, regulatory and legal changes, trademark infringements, and Internet-based telephony crimes.
- The steps in global risk management include processes to reduce risk and develop loss-control policies, along with obtaining the appropriate insurance.