

Total Cost of Risk

Measuring the overall costs of your risk management program

Measurement of Total Cost of Risk is the primary methodology for measuring the overall costs of your risk management program. While management typically counts its financing costs (premiums) only, you should factor in the related costs to arrive at the real total. Each of the factors contributes to the total cost and any reductions in any of the factors will result in an overall reduction in the total cost.

The factors include:



Risk Financing	The total financing cost (usually premium) for your program.
Direct Loss Costs	The total incurred cost from you loss runs, plus the retained losses you pay (if any).
Indirect Loss Costs	The most subjective of the factors, usually the most difficult to quantify (see the Hidden Costs of Claims for more information). Includes overtime, equipment repairs, retraining time.
Administrative Expenses	Typically includes both internal and external costs, such as service fees, staff salaries to manage the program and claims. Can also be an area of some subjectivity, although an allocation of personnel salaries attributed to the program may result in quantifying this factor. For example, any salaries or percentages of you can allocate to the program should be included. Any transfer of duties to another party (such as the broker, whom you are already paying) will reduce these costs.
Taxes	Includes surplus lines taxes, cost of Letters of Credit (LOC) and other fees to facilitate the program. These may not apply in some cases.

Reductions in any of these factors will result in a reduction to the total costs. For example, if you can transfer duties and responsibilities handled internally to the broker or carrier, who is already being paid via the premium (or fee), you then reduce your administrative costs, and achieve a reduction in total costs. If you reduce losses by employing loss control and prevention techniques, you achieve a reduction in the Direct Loss Costs and automatically to the Indirect Cost of Losses. Again, the overall effect is a reduction in the Total Cost of Risk.

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