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DEPARTMENTAL INSURANCE AND RISK MANAGEMENT

Introduction

1. This circular reiterates the Crown's position on its departmental insurance and risk management regime, and outlines high-level expectations of departments when making insurance and risk management decisions. This is primarily in relation to business, legal, property and other asset risks.

Background

2. Treasury has recently reviewed the departmental insurance and risk management regime that has operated since 1990. The review has been conducted to determine how departments manage their risks and whether their insurance and risk management arrangements provide value for money. The review has involved two surveys of departments, options for enhancing the current regime and possible alternatives, and work with two large departments on property self-insurance arrangements.

3. The second insurance survey was conducted in the second half of 2003, with departments notified of the results by letter in February 2004. It was aimed primarily at up-dating the premiums and claims information that Treasury holds. The second survey confirmed that current practices are broadly acceptable. It highlighted that there is variation in insurance and risk management practices across departments, but that this largely reflects the varying business needs, risk profiles, and the assessment of self insurance by individual departments. A report on the second insurance survey is currently available on the Treasury website at www.treasury.govt.nz/cwirm.

4. Both the second survey and consultation with industry players (including departmental representatives) pointed to a need to restate the current regime, and outline high-level expectations of departments. This was last done by Treasury in the early 1990s.

Expectations of Departments

5. It is expected that departments will carry out some form of systematic risk management process covering:

- identification of the risks faced, or likely to be faced.
- quantification of the type and size of the risk (including consideration of prior losses and probability of loss).
- determination of a risk appetite (i.e., the amount of risk the department is prepared to accept).
- Deciding how the risks are to be managed or controlled, including whether to purchase insurance cover.

6. Each department is likely to approach this task differently to others, and will arrive at different conclusions based on their business profiles and risk exposures. Regardless of the process chosen, the critical element is that accountability for managing risk is established within the department, and that procedures are in place to maintain it as a high priority throughout agency operations. While governance of risk is important, the form this takes is less relevant than the results.

7. The full range of options for the treatment of risks should be canvassed before decisions are made. The options available can be defined as:

- Tolerate – an assessment of the costs to manage or mitigate a risk may outweigh the benefits to be gained, so a decision is made to accept the risk as it stands.
- Treat – internal systems or processes are put in place that reduce the risk to suitable levels (i.e. installing sprinkler systems).
- Transfer – an external party takes on the risk, most commonly by way of commercial insurance.
- Terminate – the activity being undertaken or contemplated is stopped due to the risks being too high.

8. Departments are not obliged to insure against all their risks. Rather, they are required to systematically assess all risk management options available to them, of which insurance is only one.

9. Decisions on the management of risks are likely to be made according to the probability and size of any loss, and the department's ability to absorb any potential

loss.[1] This is especially the case for decisions on self-insurance, where the department needs to be certain that it has the operational and financial ability to absorb any loss.

10. In the rare circumstance that a significant identified risk cannot be managed by a department (including by way of self insurance or commercial insurance), this should be quantified and reported to the responsible Minister and the Minister of Finance. This is likely to arise in situations where the insurance market is unwilling to take on the risk (for example, war time insurance of military assets), and where mitigation efforts are not deemed to be cost-effective or appropriate.

11. Options such as self-insurance by the department should be explored and costed before raising the issue with Ministers. This will include consideration of whether the department has the operational and financial capability to handle any loss, and the impact this would have upon producing outputs and achieving outcomes.

12. It is important that insurance and risk management arrangements are regularly reviewed. This ensures that relevant factors from the changing business environment are taken into account, and that best practice improvements are being implemented or adapted.

Current Departmental Insurance Regime

13. From 1989 onwards, the responsibility for risk management has been devolved to chief executives. This was introduced to achieve a number of objectives.

- Clearly identify the risks that departments faced.
- Clearly specify the insurance needs of departments.
- Ensure that the Crown knew what risks it was exposed to, and the potential impact of these risks on its fiscal position.

14. These objectives have been achieved through:

- Increased emphasis on minimisation or mitigation strategies, since the cost of any losses were more directly faced by departments.
- Improving the information held by departments on the level of risk exposure being faced, and losses being incurred.
- Allowing departments to insure in the commercial market, thereby sharing the risks faced by the Crown.

15. These aims remain a focus of the current departmental insurance and risk management regime, and therefore chief executives remain responsible for the identification and management of risks associated with the assets and operations of

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[1] The Australian and New Zealand Risk Management Standard (AS/NZS 4360:1999) can be a useful guide for departments when formalising or implementing their own approaches to managing their risks.

their departments. This covers risks such as business risk (e.g. service delivery, business continuity, capability (in terms of human resources as well as IT systems)), legal risks (e.g. legal liability), property and other asset risk (including disaster risk).

16. Departments may choose to obtain advice from commercial providers on insurance and risk management assessments and decisions. This may range from undertaking the full assessment process through to providing advice on options for management of specific identified risks and preparedness to respond to unidentified risks.

17. The Minister of Finance retains an interest in the insurance arrangements of departments – in terms of both the overall financial position of Government (including the likely fiscal cost to the Crown from its total exposure to risk) and the Government's ownership interests in departments.

18. Departments are encouraged to take opportunities for the sharing of best practice in relation to insurance and risk management. This may also involve the development of shared services schemes where practicable.

Risk Management of Crown Assets

19. The Crown owns other assets which are not recorded in departmental balance sheets (for example, Parliament buildings). The general policy for these Crown assets remains self-insurance.

20. Departments managing Crown assets (particularly assets with substantial and special value) should continue to review the risks faced by those assets and advise the responsible Minister(s) as to the most effective courses of action. In the case of buildings, for example, this may include increasing strengthening or mitigation strategies within buildings against catastrophic events such as earthquake or fire.

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