Edward Chao Governmental Counseling consultant, Small and Me… Manager's Choice

"Risk Transfer" is often used in place of "Risk Sharing" in the mistaken belief

The term of 'risk sharing' is briefly defined as "sharing with another party the burden of loss or the benefit of gain, from a risk, and the measures to reduce a risk."

The term of 'risk transfer' is often used in place of risk sharing in the mistaken belief that you can transfer a risk to a third party through insurance or outsourcing. In practice if the insurance company or contractor go bankrupt or end up in court, the original risk is likely to still revert to the first party. As such in the terminology of practitioners and scholars alike, the purchase of an insurance contract is often described as a "transfer of risk." However, technically speaking, the buyer of the contract generally retains legal responsibility for the losses "transferred", meaning that insurance may be described more accurately as a post-event compensatory mechanism. For example, a personal injuries insurance policy does not transfer the risk of a car accident to the insurance company.

The risk still lies with the policy holder namely the person who has been in the accident. The insurance policy simply provides that if an accident (the event) occurs involving the policy holder then some compensation may be payable to the policy holder that is commensurate to the suffering/damage.

Some ways of managing risk fall into multiple categories. Risk retention pools are technically retaining the risk for the group, but spreading it over the whole group involves transfer among individual members of the group. This is different from traditional insurance, in that no premium is exchanged between members of the group up front, but instead losses are assessed to all members of the group.

Dr. Chao (Faculty teaching in Nan Hua university, Taiwan)
9-Feb.-2015

Comment (56) Unlike (53) Unfollow 7 months ago

James Andrae, Edward Chao, Nass Al Rayashi, +50 like this

James Andrae

This is spot on. In the 90s & (prior to GFC) companies "transferred" risks by buying or selling credit derivatives, only to discover that this strategy was only as good as the ability of the last holder to pay up on a claim. And so started the mini crash of developing countries especially Asia. The risks were at best transferred but created new ones in their wake. The credit worthiness of the counterparty. The best risk transferred is the one you don't have to begin with. It is all in the contract Ts & Cs. Get that right, accept what you have left and then look to optimise exposures.

Like (0) Reply privately Report spam 7 months ago

Edward Chao

Dear James
I agree with your comments. In fact,the buyer of the contract generally retains legal responsibility for the losses "transferred", meaning that insurance may be described more accurately as a post-event compensatory mechanism. The best risk transferred is the one you don't have to begin with, but you have to take continuous care on it.

Thanks for your comments.

Edward

Like (0) Delete 7 months ago

Guan Seng Khoo, PhD

That's why I prefer to use the term risk mitigation or response (which may not necessarily mean the risk can be totally eliminated) because in reality you can't really transfer risk (as risk is like energy) - it merely transforms into another form of risk, unless you are no longer the owner (or have the exposure anymore)!

Unlike (2) Reply privately Report spam 7 months ago

Edward Chao

Dear Guan Seng Khoo,
Perhaps, risk mitigation or response is a better term to explain the meaning of "Risk Transfer", thanks for your comments in this issue.

Sincerely,
Edward.

Like (1) Delete 7 months ago

Guan Seng Khoo, PhD

Gam sia, Gam sia! I'm Hokkien (by dialect). Keong Hee Huat Chye!

Like (0) Reply privately Report spam 7 months ago

Donald J. Riggin, CPCU, ARM

Folks, while I like philosophical discussions as much as the next guy, let's temper that with a dose of old fashioned horse sense. Guan Seng Khoo (above) said, "in reality you can't really transfer risk." I respectfully disagree. In reality, risk is transferred all the time. In theory, (as in quantum physics), risk may or may not be transferred. Or, it might be both transferred, and not transferred at the exact same time! (Was this one of Zeno's 4 paradoxes? Probably not.)

"Risk transfer" is the only reasonable and acceptable description of the insurance transaction. It means moving a risk of financial loss, of whatever quantity or quality, from one balance sheet to another balance sheet. Moreover, the transaction is memorialized in a contract commonly accepted by both parties - the insurance policy.

Yes, technically the transferred risk still lies with the policyholder, but in law that plays no part whatsoever. When counterparties (insurer and client) are engaged in a legal dispute, the notion that the client technically retains the risk is ignored for good reason. The payment of premiums (consideration) as prescribed by the contract issuer (insurance company) renders this technical argument moot for lack of applicability and materiality.

Of course the insurance company could go bankrupt; technically, the insurer is a credit risk to its customers, but the likelihood of that occurring is usually extremely low. And even with enormous amounts of counterparty/credit risk, the transaction is still one of risk transfer; the quality (or lack thereof) of the risk-taking party doesn't change that fact. It might be a bad risk transfer, but a risk transfer it remains. Remember, counterparty risk is a matter of credit risk management, that's all. If the risk transfer fails for one reason or another, the risk holder will deal with it.

The term, risk transfer, has been used in US Tax Court and US Supreme Court cases to describe an important concept. Risk transfer and risk distribution, are the generally accepted circumstances required for an insurance transaction to exist. (Insurance is not defined in US law.)

Finally, 2 of the above posters said this: "the best risk transferred is the one you don't have to begin with." Huh? If you're right, every business in the world should cease operations, because that's the only way to not have a risk to begin with. I could go on…

Like (0) Reply privately Report spam 7 months ago

Edward Chao

According to businessdictionary website said that there have two definitions on "Risk Transfer"

* management strategy in which an insurable risk is shifted to another party (the insurer) by means of an insurance policy.

* shifting through non-insurance means, such as a warranty. See also transfer of risk rule.

(http://www.businessdictionary.com/definition/risk-transfer.html#ixzz3TkiQV3Mc)

"Risk Transfer" had been commonly accepted in the underlying tenet behind insurance transactions. The purpose of this action is to take a specific risk, which is detailed in the insurance contract, and pass it from one party who does not wish to have this risk (the insured) to a party who is willing to take on the risk for a fee, or premium (the insurer).

For example, whenever someone purchases home insurance, he or she is essentially paying an insurance company to take the risk involved with owning a home. In the event that something does happen to the house, such as property damage from a fire or natural disaster, the insurance company will be responsible for dealing with any resulting consequences.

Risk transfer is a risk management and control strategy that involves the contractual shifting of a pure risk from one party to another. One example is the purchase of an insurance policy, by which a specified risk of loss is passed from the policyholder to the insurer. Other examples include hold-harmless clauses, contractual requirements to provide insurance coverage for another party's benefit and reinsurance. When done effectively, risk transfer allocates risk equitably, placing responsibility for risk on designated parties consistent with their ability to control and insure against that risk. Liability should ideally rest with whichever party has the most control over the sources
of potential liability.

In addition, in today's financial marketplace, insurance instruments have grown more and more intricate and complex, but the transfer of risk is the one requirement that is always met in any insurance contract.

According your recognition, the term, 'risk transfer' has been used in US Tax Court and US Supreme Court cases to describe an important concept. Risk transfer and risk distribution, are the generally accepted circumstances required for an insurance transaction to exist. I fully understand and agree. In our normal life, risk transfer is occurred in transaction behavior, the transaction is still one of risk transfer; the quality (or lack thereof) of the risk-taking party doesn't change that fact. We can understand that 'risk transfer' can be viewed as the reduction of risk to a position by buying an insurance policy or taking an offsetting position. For example, a person may reduce the risk of loss due to medical expenses by buying health insurance. Likewise, a person may reduce the risk of loss to a long position by entering an equal but opposite short position.

I'm very appreciated with your professional viewpoints. Thanks for your comments about this issue,

Sincerely,
Edward

Like (1) Delete 7 months ago

Guan Seng Khoo, PhD

Thank you both. As long as all of us are comfortable with the "local" definition, without getting too detailed or preoccupied with the semantics, e.g., often CDSs create the illusion of risk "transfer", when in reality, risk transformation has its unintended consequences................, I'm happy to agree and disagree!

Like (1) Reply privately Report spam 7 months ago

Donald J. Riggin, CPCU, ARM

Indeed, an interesting discussion. At the end of the day it's just semantics, as Guan Seng Khoo has observed. I'm quite familiar with the non-insurance methods of transferring risk, but I think that risk transfer, regardless of technique, is just one thing: Moving negative financial outcomes from one party to another.

Think of the concept of risk having 2 separate and distinct properties, (1) potentially negative financial outcomes, and (2) one of the consequences of life: business activities, property ownership, driving a car, crossing the street, getting out of bed, and so on. All we can do is mitigate some of the negative financial consequences; insurance being the most prevalent risk transfer tool. The first property of risk is binary; the risk is either retained or transferred. Even the most onerous legal disputes between insurer and client as to whether or not a loss is compensable eventually settle if favor of one of the two litigants, (except Jaundyce v. Jaundyce).

Regarding the illusion of risk as mentioned above; it's an illusion because in reality some risk transfer schemes are just as likely to fail as to not fail, such as a CDS. But a CDS, just like an insurance policy, does indeed transfer the financial consequences of risk to a counterparty, but its value as a risk transfer tool is a matter of degree. Compared to the security available through a highly rated insurance company, a CDS's volatility and susceptibility to market risk greatly reduces its efficacy as a pure risk transfer tool. If the risk transferor isn't aware of this, well, that's his problem.

Unlike (3) Reply privately Report spam 7 months ago

Guan Seng Khoo, PhD

Thanks Donald. I guess where I'm coming from is when the term is used outside of the insurance industry as in the typical COSO ERM or ISO 31K framework, where it's often used in the context of risk "reduction", which I don't believe in, or in banking, when instruments in the banking book are transformed into the trading book, e.g., via securitization.

But thanks again to everyone for sharing here. Have a marvellous week.

Like (1) Reply privately Report spam 7 months ago

Kathryn M Tominey

Just a thought, legalisms aside, if you lack capability to perform mission (product or service) essential work and outsource you are still accountable to clients and shareholders. Many CEOs & mgt teams are indifferent to this as long as they collect their annual bonus - based on very short term results.

You do remember why we had to bailout AIG don't you? Making book via naked CDSs without understanding underlying products which had ratings - arguably fradulent ratings - suggesting high quality.

Anyone putting that much effort into acquiring financial insurance is sending a message about how much they believe in their product.

Unlike (2) Reply privately Report spam 7 months ago

Guan Seng Khoo, PhD

Thanks, Kathryn, that's what I was alluding to in my CDS' comment, together with the roles played by monolines, e.g. AMBAC, etc.

Like (0) Reply privately Report spam 7 months ago

James Andrae

Donald, very solid legal points. I love a good philosophical discussion. It is as always a matter of semantics and perspective. Our experiences may be different, I don't believe it makes either of us more right or wrong. It does however open the mind to other perspectives which is always a good thing.

Insurance while a risk transfer mechanism actually creates other risks as you alluded. Credit, Legal, Cost, Timing. Kathryn above raised very important valid points. Perspectives, agendas, rorts, etc.

Risk Management should always try to minimise reliance on the legal process if things go wrong. (This is why I spend way too much time analysing contracts). While the process marches along, in the meantime a company may be seriously negatively affected, face bankruptcy at the extreme, share price fluctuations, credit downgrades etc. Bonuses not paid, people fired.
It always becomes a matter of size of the insurance claim, 100K not much of a problem, $100M is often open to "debate" in the court system. My experience is that CEOs and Boards don't like the court process and always look for heads to roll.

From a risk management perspective that's not good enough because of the domino effect on business' other activities that assume cash flows will be made whole in the proper time. Very few companies have a few "lazy" hundred million just hanging around. I repeat the best risk you have is the one you don't have and there are numerous examples from physical power plants to the financial markets.
In the financial markets, peculation aside, hedging can cause new and some unforseen linked risks. There is a famous issue now about a company being trading a commodity and having 40 - 50% of the liquidity in that market. They got it right, but could not get out of their trades. Greed. The best risk is the risk you don't have. Don't expect the market to accept losses when you are the major provider of liquidity. Stick to a lower threshold. If a company is that big that it needs 50% of the market liquidity then it need to review its operational risk management to account for the lack of reliance on the market hedges.

The GFC and Asian Crisis were in essence, liquidity and counterparty credit issues on the whole.

Power plants often have unexpected failures, these are insurable events. The major condition is the proper maintenance of the plant. One man's process is another man's negligence. We can understand that the insurance company will rightly want to verify everything before maybe paying. There are cases where a 1 week shutdown took 2 years and longer to pay. The claims are mostly for physical damage and financial loss. This could easily climb to $100M+ depending. Repairing a power plant may cost $5M the losses on a SWAP could be any amount perhaps a further $95M. No COB is keen on this sort of risk.
The best risk is the one you don't have. Solution don't over commit power plant transaction SWAPS such that if it failed apart from the burden of repairs you will also have the financial SWAP payments to make. There is nothing lost except for speculative revenue and that could go either way.
Building infrastructure creates volumes of possible risks to the owner. Power plants can be built by the power company or by an external engineering firm. This transfers most of the risks but some do remain. Two major risks are that the generator will not work to specifications, or be completed on time. The power company contract specifies Ts&Cs that if not met they simply don't accept the new generator. So the "lemon" risk as well as others are not theirs. The best risk is the one you don't have.
While your points are valid Market Risk Managers do not live in a post risk world but in a pre risk world.

Unlike (2) Reply privately Report spam 7 months ago

James Andrae

It took some companies over 7 years to get paid 6c on the dollar after Enron failed. Reliance on the legal system, while just, did not make the participants whole. Insurance failures were kept commercially private so we will never know if the losses were covered or not. The best risk you have is the one you don't have. When the CEO and CFO of a fortune 50 company resign suddenly. Smart risk managers closed out positions and watched the debacle with amusement and got bonus.
If entering into a trade with a counterparty is reliant on a CDS for risk mitigation, then the best risk is the one you don't have. 1 don't enter into the trade to begin with. 2 Don't pay any bonus until the expiry or closure of the contract. Implement #2 and a whole lot of needless exposures are removed because the traders now have some skin in the game.
You stated “If the risk transferor isn't aware of this, well, that's his problem”. In a perfect world with perfect knowledge maybe. The global financial system is based on the blind hope that the

other guy will “play by the rules” and be there to make you whole regardless of whether it is an insurance contract or swap. Blind hope because you can never see the true picture of the other counterparty, and, well, let’s leave the Credit Agency discussion to one side. It’s not only the illusion of risk but of transfer. The Transferors prior to the GFC had no idea who was really on the other end of the majority of the CDS deals. How was it their fault?
Market risk managers understand these limitations and on the whole tend to limit exposures as much as possible.
Of course you can't have no risks. You can even die in your bed sleeping.
But you should understand the domino factors in all risks and come back with the trade off scenarios and limit these whenever possible.
The point I think Edward is raising is to test whether risk managers understand that no risk is ever truly transferred or mitigated completely, so how do we live with that reality, post GFC.
I am certain that if the Central Banks and Finance Ministers had not stepped into the GFC, the global meltdown could have sent economies spiralling worse than the Great Depression. That was the risk they did not want to have.
They saved the world from calamity but also let some companies that could not be absorbed, fail.
This was the wake up call. Edward is asking if we have altered our thinking since.

Unlike (2) Reply privately Report spam 7 months ago

Edward Chao

Dear James,
I'm very appreciated and respect that you always point out the key concepts and useful viewpoints within your comments on a issue. I got some hints and implications from your comments. I also agree with Donald's comments which said above, 'the concept of risk having 2 separate and distinct properties, (1) potentially negative financial outcomes, and (2) one of the consequences of life: business activities, property ownership, driving a car, crossing the street, getting out of bed, and so on. All we can do is mitigate some of the negative financial consequences; insurance being the most prevalent risk transfer tool.'

I fully agree that your comments which said that "the best risk you have is the one you don't have and there are numerous examples from physical power plants to the financial markets." In addition, the global financial system is based on the blind hope that the other guy will “play by the rules” and be there to make you whole regardless of whether it is an insurance contract or swap.

In fact, the domino factors in all risks and come back with the trade off scenarios and limit these whenever possible. According to my recognition, risk transfer is a risk management and control strategy that involves the contractual shifting of a pure risk from one party to another. I sometimes discuss with the professional risk-control managers whether risk managers understand that no risk is ever truly transferred or mitigated completely but I find that some managers will ignore cultural and human factors which plays important roles in risk managements.

Thanks for Donald,Kathryn, Guan Seng Khoo, and your professional comments in this issue.

Thanks all of you with sincerity.

Sincerely,
Edward

Like (0) Delete 7 months ago

Kathryn M Tominey

Guan - don't "allude" use plain clear language to expose these frauds, ratings firms enablers and issuers too lazy to do their homework. The impact of naked CDSs unregulated, invisible thanks to Sen. Phil Gramm, Robert Rubin & Larry Summers leadership. At least Art Levine was man enough to admit, publically, that he was wrong to oppose Brooksley's efforts to just look at derivatives.

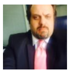
Buffett's latest letter really lays into the operators pushing transactions because fees are easy money.

Unlike (1) Reply privately Report spam 7 months ago

Guan Seng Khoo, PhD

Kathryn, I've written one whole document and blogged on the issues in some of my publications & presentations in conferences for Riskbooks, etc. Hence, I merely don't wish to be long-winded here, esp. for readers who are familiar with the GFC. But, thanks anyway for raising it more granularly.

Like (0) Reply privately Report spam 7 months ago



Syed Adeel Hussain,MBA

We as risk managers have to distinguish among Risk Controls, Risk Financing and Risk Retention Techniques. Risk Transfer is a Risk Financing Method, where you pay someone else to pay for your Unexpected Large Losses!

Unlike (1) Report spam 7 months ago

Edward Chao

Dear Syed Adeel Hussain,

Your comments provide simple concepts but useful in understanding.

I'm very appreciated.

Edward

Like (1) Delete 7 months ago

Abdulwadud Mohammed

Very insightful write up.

Insurance is embedded in risk management.

Real risk management is the prevention of loss. Insurance also practise risk management. Here, the company attempts to regulate the risk it underwrites as per probability of a claim crystallizing(no insurance company would underwrite a risk with 100% claim probability) or claims it pays upon crystallization.

Like the author said, in the event that an insurance company defaults on payment upon crystallization of claim, the liability remains with the insured.

Transferring or sharing risk should be combined with strong emphasis on prevention by embedding ERM in an organizational set up or adopting relevant credit support tools (a wide array is offered by Ace Depository) for banks, traders and financiers, in preventing actual loss.

Prevention of actual loss rather than seeking to be indemnified upon loss is better for any business moving forward.

Unlike (1) Report spam 7 months ago

Michael Allocco, PE, CSP

RISK TRANSFER...
It is possible to transfer (most) risk to a 2nd party, should the appropriate risk controls be applied:
• A specialized contractor (2nd party) may be used to conduct a specialized risk task or operation;
• Contractual risk controls can transfer most of the risk to the 2nd party;
• The 1st party assures that the 2nd party implements and enforces the appropriate risk controls;
• There may be some limited co-liability (co-negligence) in the chain depending on the risk controls contractually defined and enforced.

Unlike (1) Reply privately Report spam 7 months ago

Edward Chao

Michael, Thanks for your comments. You provide the necessary considerations concerning about the appropriate risk controls and transfer.

Edward.

Like (0) Delete 7 months ago

Michael Allocco, PE, CSP

Your welcome....

Like (0) Reply privately Report spam 7 months ago

Kathryn M Tominey

Guan - how diplomatic you are, an excellent quality in risk mgt right up to when a 2x4 is needed to focus their attention.

Oh, am I using correct convention for the part of your name to address you?

Like (0) Reply privately Report spam 7 months ago

Guan Seng Khoo, PhD

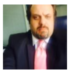
Well, Kathryn, I've always been guilty of making short commentaries on LinkedIn, and often inadvertently created "cross-communications across different frequencies" with other parties on other discussion threads. If I interpret you correctly - part of my Asian heritage, where tai ji is often practised - notice how Americans like boxing (more "push") vs the Japanese sumo (more "pull"). I practise a hybrid of push-pull with a bias towards "pulling"!!! Nice to make your acquaintance tho' as a fellow scientist - I was a computational chemist once upon a time!

Like (0) Reply privately Report spam 7 months ago

Stjepan Anic

Yes, it's really an apostrriori compensation mechanism rather than a pure risk transfer, and my experiance has thought me that repeated clearifications of various terms used in finance and risk management is often needed in order to maintain an understandable big-picture-view of the subject.

Unlike (1) Report spam 7 months ago



Syed Adeel Hussain,MBA

@Edward Thanks

Unlike (1) Report spam 7 months ago

Edward Chao

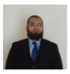
Very thankful to Stjepan Anic & Syed Adeel Hussain, this issue is concerning about my research in risk managements, therefore, I pay more attention on this issue.

In addition, I'm very appreciated with James Andrae, who is a risk management specialist. His comments provide me more strategic implications and thinking methodology. I fully agree that James' comments which said that "the best risk you have is the one you don't have and there are numerous examples from physical power plants to the financial markets." In addition, the global financial system is based on the blind hope that the other guy will “play by the rules” and be there to make you whole regardless of whether it is an insurance contract or swap.

Hoping you all can provide your comments and viewpoints into popular issues concerning about risk managements in risk managements online.

Thank you all.

Sincerely,
Edward
Like (1) Delete 7 months ago



Arslan Usmani CPPD MEnPrac MIEAU(RES,CES) MRMIA

Ed, risk sharing and transfer both are sometimes misleading. If a pipeline contractor misses the delivery on time and you lost your 1 day production, what you do, do we tranfer the risk to him (liquidated damage only) but is this enough to cover your production loss but what about your commitment and good will. If you share risk what percentage of time, resouce and cost you sharev in order to bring things to the agreed deadline.

Like (0) Reply privately Report spam 6 months ago

Edward Chao

Arslan,
Thanks for your comments and joining this discussion.

Edward.

Like (0) Delete 6 months ago

Edward Chao

In fact, some ways of managing risk fall into multiple categories.
Risk retention pools are technically retaining the risk for the group, but spreading it over the whole group involves transfer among individual members of the group.

In addition, I would like to site from James' comments which said "the best risk you have is the one you don't have and there are numerous examples from physical power plants to the financial markets."

Like (0) Delete 6 months ago

Mohd Amirul Nazri Ismail RMP® GPM-b™

Good financial standing of insurance companies is essential when addressing the risk transferring process. It can be a secondary risk when insurers are reported having difficulties in processing and settling claim. Some Banks are very particular on this when they assessed proposed project financing and had incorporated this in condition precedents (CP).

Unlike (1) Reply privately Report spam 6 months ago

Edward Chao

Dear Amirul Nazri,
Very thankful for your comments on this issue.

Kind regards.

Edward

Like (0) Delete 6 months ago

Jeff Elias, Ph.D.

I'd like to add that risk sharing can be very profitable for the group or association who are involved. 1st you need a good assessment audit as to the types of risks, organizations,the and firms' liquidity to qualify them to join the "association" risk pool. Using appropriate tools for assessment of the "potential" risks, can generate a cost savings, and structured properly as an "off-shore captive insurance association" (taking advantage of money hurdle rates) with streamlined, accurate and timely reporting, with effective claims management, training, and safety programs) could repatriate income back to the association in the form of reduced future premiums. As a note, off-shore domiciles have different "banking, LOC, liquidity, etc. requirements. These types of arrangements can also work for effective costefficient re-insurance markets, as well. Dr. Jeff Elias, Ph.D. HR & RM Consultant.

Unlike (1) Reply privately Report spam 6 months ago

Edward Chao

Dear Jeff Elias,Ph.D.

I fully agree with your viewpoints that you have mentioned 'Using appropriate tools for assessment of the "potential" risks, can generate a cost savings, and structured properly as an "off-shore captive insurance association" (taking advantage of money hurdle rates) with streamlined, accurate and timely reporting, with effective claims management, training, and safety programs) could repatriate income back to the association in the form of reduced future premiums.'

Thanks for providing your comments.

Kind regards.

Edward

Like (0) Delete 6 months ago

Edward Chao

According to my past studies,insurance is a both well-known and popular form of risk transfer to take into consideration, where coverage of a risk is obtained from an insurer in exchange for ongoing premiums paid to the insurer. Risk transfer can occur informally within family and community networks where there are reciprocal expectations of mutual aid by means of gifts or credit, as well as formally where governments, insurers, multi-lateral banks and other large risk-bearing entities establish mechanisms to help cope with losses in major events. Such mechanisms include insurance and re-insurance contracts, catastrophe bonds, contingent credit facilities and reserve funds, where the costs are covered by premiums, investor contributions, interest rates and past savings, respectively.

Edward

Like (0) Delete 6 months ago

Marcelo Severino de Oliveira

In short, we need to beware, always an eye on possible risks before it happened.
Because if all the losses are passed to insurers, there would be many insurers.

Unlike (1) Reply privately Report spam 6 months ago

Edward Chao

Marcelo Severino Oliveira,
Thanks for your comments.

Edward

Like (0) Delete 6 months ago

David Wilson

We cannot be 'blind' to the need for our decision-making (and resultant actions) to be based upon information that is NOW accessible to us. 'Ignorance', due to a lack of the correct tools or techniques is understandable but, to ignore tools and techniques that enable informed decision-making, is beyond 'ineptitude'...an emerging GRC issue!

'Causal Relationships': operational interdependencies and interactions within and among organisations are the sources of emerging risk and opportunity but, if unidentified, can be amplified, cascade and spread far beyond the points of origin...and 'feedback' as threats: unrealised - as increased uncertainty or volatility; realised - as correlations in data (reflexive -

after the event).

Unidentified and unmanaged risk does not dissipate, nor does the probability of occurrence, scale, duration or cost reduce...

Like (1) Reply privately Report spam 6 months ago

Edward Chao

David, your viewpoints are acceptable in understanding 'Causal Relationships', whereas, if unidentified could be amplified, cascade and spread far beyond the points of origin. perhaps, if providing some examples you have ever met will be better to understand.

Thanks for your comments.

Kind regards.

Edward.

Like (1) Delete 6 months ago

Ned Robins

Fascinating discussion. The exchanges between Edward and Donald display two TOTALLY different philosophical points of view, with Edward focussing on "achieving things" and Donald on "paying for calamities". I must support Edward's point of view completely. When one takes out insurance one is NOT transferring ANY of the actual risk. Neither the probability nor the cost of the potential calamity is reduced by one single iota. Yes, the ownership of the cost of the calamity has been transferred, but doing this is COMPLETELY MISSING THE POINT of risk management!! If ever you have to make an insurance claim, the risk has OCCURRED. It is now TOO LATE TO MANAGE THE RISK. It is no longer a risk, but has become a fact. You did not transfer the RISK, you simply transferred the ownership of the RECOVERY STRATEGY implemented AFTER the risk ceased to exist!!

Take Edward's example - house insurance...... You do not insure your house because you want to rebuild it. You insure your house because you like it AS IT IS and you do not want it to get damaged. If you have a house fire, yes you are very happy that you took out that insurance policy to pay the costs, but you are NOT actually happy!! Damnit - you have just had a house fire! Your life is totally disrupted. You have nowhere to live, all your things are burned and it will take ages to replace them. You would have been much better off spending the insurance money on fire precautions.

Personally I think it is very sad when people measure life by how much money they make. Money should be seen as a means to some worth-while end, not an end in itself. Risk management should be a means to increase the probabilty of achieving something really worth doing.

Unlike (1) Reply privately Report spam 1 month ago

Edward Chao

Dear Ned Robins,
Very thankful to your comments about the issue "Risk Transfer" is often used in place of "Risk Sharing" in the mistaken belief'. I fully agree with your practical points concerning about "achieving things" and "paying for calamities".

The term of 'risk transfer' is often used in place of risk sharing in the mistaken belief that you can transfer a risk to a third party through insurance or outsourcing. In fact, when one takes out insurance one is not transferring any of the actual risk.

Commonly, I have met some investors and/or house owners who usually think their life could be measured by how much money they make and wealth represents their social status and success. Therefore, I have the same viewpoints with you that money should be seen as a means to some worth-while end, not an end in itself. Risk management should be a means to increase the probability of achieving something really worth doing.

Finally, I'm very appreciated with your viewpoints, and thankful to your comments.

Kind regards.

Edward.

Like (0) Delete 1 month ago

Michael J. Shand

A perfect example of risk sharing would typically be found in the baseline assumptions of a contract where force majeure risks are managed by individual parties.

For example, if a contractor is performing work at a clients facility, the client states and the contractor agrees in contract, that unforeseeable loss incurred due to a force majeure event shall be owned by each respective party. The catch is 'unforeseeable'. If a loss is incurred due to a secondary event that should have beyond a reasonable doubt been reasonably practicable for the client to have avoided, then the contractor may have grounds to lay claim.

An example of Risk Transfer would the outsourcing of a scope of work. For example, a contractor may recognize that a particular scope has way too much risk for employee turn over thus an increased likelihood due to project slip.
He may then, once allowable, outsource the scope, enter a penalty for avoidable delays that would amount to liquidated damages exposure.

The transfer of Risk isn't as clear cut as the sharing of risk as unquantifiable exposures such as reputation impacts and further scope award remains exposed.

Unlike (1) Reply privately Report spam 1 month ago

Donald Whittaker

Someone should tell the marketing teams at the insurance companies. And, anyone on Wall St. using the TLA ART.

Unlike (1) Report spam 1 month ago

Donald Whittaker

the issue is are you transferring the risk or the financial consequence. this is another schoolmarm thread about.semantics that looks at treatment terms in a vacuum.

Unlike (1) Report spam 1 month ago

Michael Allocco, PE, CSP

SAFETY-RELATED RISK TRANSFER...

A specific safety-related risk can be transferred to a subcontractor with special capabilities to mitigate the risk; when the original risk holder does not have the abilities to handle the risk. It should be indicated in the agreement that the 2nd party applies best practices in risk mitigation; and assumes all responsibility associated with the risk. Further, the specific hazards, risks and mitigations should be stipulated.

Unlike (1) Reply privately Report spam 1 month ago

Thu Ly, CRMA

Could not agree more.

Unlike (1) Report spam 1 month ago

Mohammed Abid

Congrats

Like (0) Report spam 14 days ago

Edward Chao

Dear all,

Today, I want to share some points concerning about enterprise risk management with all.

In enterprise risk management whose risk can be defined as a possible event or circumstance that can have negative influences on the enterprise in question. Its impact can be on the very existence, the resources (human and capital), the products and services, or the customers of the enterprise, as well as external impacts on society, markets, or the environment. In a financial institution, enterprise risk management is normally thought of as the combination of credit risk, interest rate risk or asset liability management, liquidity risk, market risk, and operational risk.
In the more general case, every probable risk can have a pre-formulated plan to deal with its possible consequences (to ensure contingency if the risk becomes a liability).
From the information above and the average cost per employee over time, or cost accrual ratio, a project manager can estimate:

the cost associated with the risk if it arises, estimated by multiplying employee costs per unit time by the estimated time lost (cost impact, C where C = cost accrual ratio * S).

* the probable increase in time associated with a risk (schedule variance due to risk, Rs where Rs = P * S):

Sorting on this value puts the highest risks to the schedule first. This is intended to cause the greatest risks to the project to be attempted first so that risk is minimized as quickly as possible. This is slightly misleading as schedule variances with a large P and small S and vice versa are not equivalent. (The risk of the RMS Titanic sinking vs. the passengers' meals being served at slightly the wrong time).

* the probable increase in cost associated with a risk (cost variance due to risk, Rc where Rc = P*C = P*CAR*S = P*S*CAR)

sorting on this value puts the highest risks to the budget first.
see concerns about schedule variance as this is a function of it, as illustrated in the equation above.

Conclusion:

Risk in a project or process can be due either to Special Cause Variation or Common Cause Variation and requires appropriate treatment.

That is to re-iterate the concern about extremal cases not being equivalent in the list immediately above.

Edward

Like (0) Delete 14 days ago

Michael Allocco, PE, CSP

WHAT RETURN ON INVESTMENT (ROI)…?

There is a major problem with cost analysis and risk analysis. It is very hard to prove both quantitatively and qualitatively the adverse outcomes averted as a result of validated and verified risk controls.

Like (0) Reply privately Report spam 13 days ago

Edward Chao

II fact, in this new business universe requires much more than listening to customer feedback. The accepted information hierarchy – including established newspapers and media outlets – has rapidly given way to a multidimensional information matrix where no single voice dominates. Information and opinions of all kinds are easier to access – yet more difficult to evaluate and control.

In response to these issues and trends, companies are making a deliberate effort to improve their strategic risk management capabilities and performance. Traditional approaches for managing risk tend to focus on monitoring leading financial indicators as well as the evolving regulatory environment. However, because they are generally grounded in audited financial statements, the resulting risk strategies and hedges are largely driven by prior performance and past negative events – and do not necessarily serve to detect future strategic risks or predict future performance. As such, they are more focused on protecting value than creating it.

Edward

Like (0) Delete 11 days ago

Edward Chao

In the previous discussion, RM specialist, James Andrae have ever pointed out that the best risk is the one you don't have. Solution don't over commit power plant transaction SWAPS such that if it failed apart from the burden of repairs you will also have the financial SWAP payments to make. There is nothing lost except for speculative revenue and that could go either way.

Building infrastructure creates volumes of possible risks to the owner. Power plants can be built by the power company or by an external engineering firm. This transfers most of the risks but some do remain. Two major risks are that the generator will not work to specifications, or be completed on time. The power company contract specifies Ts&Cs that if not met they simply don't accept the new generator. So the "lemon" risk as well as others are not theirs. The best risk is the one you don't have.

The concept of risk had two separate and distinct properties,
(1) potentially negative financial outcomes, and (2) one of the consequences of life: business activities, property ownership, driving a car, crossing the street, getting out of bed, and so on. All we can do is mitigate some of the negative financial consequences; insurance being the most prevalent risk transfer tool.

The global financial system is based on the blind hope that the other guy will “play by the rules” and be there to make you whole regardless of whether it is an insurance contract or swap. To make a conclusion, my viewpoints as mentioned above perhaps are valid Market Risk Managers do not live in a post risk world but in a pre risk world.

Like (0) Delete 8 days ago

Guan Seng Khoo, PhD

Edward, Yes, ex-ante instead of ex-post. That's the reason I stay away from discussions where participants use terminologies or labels like positive risk and negative risks, without considering that when the risk event manifests, the outcome can be positive, negative or status quo!!!!

Like (0) Reply privately Report spam 8 days ago

Edward Chao

Hi, Guan Seng Khoo,
I remembered that you had posted your comments six months ago. The main contents which said that I've always been guilty of making short commentaries on LinkedIn, and often inadvertently created "cross-communications across different frequencies" with other parties on other discussion threads.
I respect your comments and I agree with your viewpoints to some percentage. Don't mind the other participants' viewpoints, you can just provide your comments to share via this platform.

Thanks for your comments again and welcome to participate continuously.

Kind regards.

Edward

Like (0) Delete 7 days ago

Edward Chao

According to my past experiences, risk sharing can be very profitable for the group or association who are involved. 1st you need a good assessment audit as to the types of risks, organizations,the and firms' liquidity to qualify them to join the "association" risk pool.

I would like to cite the main viewpoints from Dr. Jeff Elias (Sr. Executive Consultant/President at ECG.). Dr.Jeff Elias pointed out that 'using appropriate tools for assessment of the "potential" risks, can generate a cost savings, and structured properly as an "off-shore captive insurance association" (taking advantage of money hurdle rates) with streamlined, accurate and timely reporting, with effective claims management, training, and safety programs) could repatriate income back to the association in the form of reduced future premiums.'
A good example of risk sharing would typically be found in the baseline assumptions of a contract where force majeure risks are managed by individual parties and stimulate the brain-storming discussions inside the organization.

Very thankful to the comments came from all participants in this issue again and welcome to participate continuously.

Kind regards.

Edward

Like (0) Delete 7 days ago

Michael Allocco, PE, CSP

SAFETY-RELATED RISK PREDICTION....
It is quite possible to predict future performance that equates to system design. Here is when inclusive system hazard analysis and risk assessment comes into play. We do have verious methods in system assurance that require simulation, testing, and modeling that are very effective toward prediction. We can even exclude weak stocastic processes and be very effective applying qualitative decision methods. Given that the inclusive system is understood, (system of systems and families of systems).

Like (0) Reply privately Report spam 4 days ago