

Risk Financing: A Guide to Insurance Cash Flow, Volumes I and II.
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The apparent unpopularity of cash flow plans, evidenced in the study by Schmitt and Roth (1990) who surveyed risk managers of large U.S. corporations, suggests that there may be opportunities for risk managers who choose to invest in their human capital by studying cash flow mechanisms to handle the risks confronted by their firms. Risk managers know that losses occur despite effective loss control activities and the startling result of the Schmitt and Roth study may imply that these same risk managers, as a group, do not yet understand the role of the time value of money. Whether it is lack of knowledge by the practitioners or our misunderstanding as academics of the motivations underlying courses of action chosen by the corporate risk manager, the effect has been an insufficiency of education and new knowledge about the costs and benefits of cash flow plans to both the corporation and the employee who manages its risk.

The two volumes of *Risk Financing: A Guide to Insurance Cash Flow* represent a moderate movement toward improving the education of practicing risk managers who are interested in cash flow plans. It is a substantial loose-leaf reference source of risk financing programs available in practice, with a particular emphasis on cash flow plans. The writers have limited themselves to liability exposures although many of the general techniques and applications they discuss, i.e., loss forecasting and NPV analysis, can be applied to property exposures. Be forewarned, however, that the techniques they offer with respect to "Risk Quantification" do not get much more sophisticated than using a simple average of recent past losses to predict future losses. Nothing here on the order of the Cummins and Friefelder (1978-9) discussions of maximum probable yearly aggregate loss (MPL).

After the brief discussion about basic loss forecasting methods and present value analysis, the writers continue with Volume I by introducing insured plans, and including in separate subsections guaranteed cost, dividend, and retrospectively rated insured plans. Their presentation is important since in a competitive commercial insurance market insured plans cannot be described simply as entailing a contract whereby the insured pays a premium at the beginning of the policy period in exchange for the insurer paying all the losses throughout the policy period. Although these prospectively rated insured plans exist, the writers' array of alternative insured plans is important since the payment structures of these plans can reveal real cost differences to the discriminating risk manager. While the descriptions of all the insured plans are organized and presented well, a particularly useful feature of the subsections is that each ends with a discussion of the cash flow implications and the plan's advantages and disadvantages relative to the typical cash flow plan.

The middle third of Volume I focuses on cash flow plans that, in contrast to insured plans, involve less contractual transfer of risk and allow the firm to derive financial benefits from unpaid loss reserves or unpaid premium dollars at a cost associated with the risk of having higher than expected losses. The writers have organized cash flow subsections that discuss paid loss retros, compensation balance, pooling, self-insurance, and captive plans, again offering at the end of each subsection a plan's particular cash flow advantages and disadvantage. The material here is not that new and can be found in standard risk management textbooks. Perhaps because *Risk Financing: A Guide to Insurance Cash Flow* is marketed as *the* word on cash flow plans, the use of such plans will increase in the future.

The important sections that conclude Volume I discuss current tax and accounting ramifications of the different risk financing schemes and the section entitled, "Plan Evaluation" offers a decision paradigm to aid in the selection of the best cash flow plan. In this latter section the writers offer a plan comparison matrix to evaluate alternative plans that provides some organization to risk management decision-making with an emphasis on analyzing qualitative factors. The material covered in the tax and accounting sections is dynamic, subject to the winds of legislative seasons. Such is the case for nearly all the information in Volume II that is used primarily as an appendix with supplementary material on the risk retention acts of the 1980s, captive insurance laws, self-insurance statutes governing workers compensation and automobile liability, and financial accounting standards. However, such an emphasis enhances these volumes' power as an up-to-date reference for both practitioners and academics, and I suspect justifies their loose-leaf format. Certainly, the tax details offered throughout these volumes is contrary to standard risk management textbooks.

Risk Financing: A Guide to Insurance Cash Flow represents a beginning toward bridging the gap between practicing risk management decision-making and well-equipped risk managers who understand quantitatively the importance of cash inflow and outflow timing. However, until more conventional corporate risk management textbooks address the risk management function along the lines of Doherty (1985), evidence may suggest that corporate risk managers are not yet outfitted with the best decision-making tools.

References

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