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PULSE

ONTARIO RISK & INSURANCE MANAGEMENT SOCIETY · ORIMS

THE HEARTBEAT OF RISK MANAGEMENT, DECEMBER 2003

'Tis the season for Safety

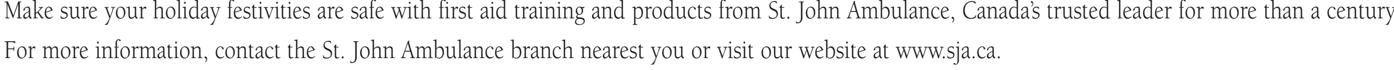
The following article is reprinted from the St John Ambulance Web-site at www.sja.ca

The tree is trimmed and the guest list complete. Presents are wrapped and delightful treats abound. Don't risk tragedy around the Christmas tree. At this special time of year, make extra room for safety in your schedule to ensure you enjoy an emergency-free holiday.

Here's a Christmas tree safety checklist from St. John Ambulance, Canada's leader in safety-oriented first aid training and products for more than 118 years.

Christmas tree safety checklist

- Don't get shocked. Lights and electric appliances must be handled with care. Don't put electric lights on metal or aluminum trees.
- Keep your real tree outside until you're ready to set it up. Cut the stalk on an angle to allow the tree to absorb water. Place it in a secure stand with a water reservoir.
- Feed real trees plenty of water. Add sugar to the water to provide more nutrients. An average 6-foot, 2 meter tree can consume more than one gallon – four liters – of water per day.
- Make sure the tree is secure in a safe location, away from heavily traveled areas or curious pets or small children.
- Use flame-resistant, non-combustible decorations.
- Replace burnt out bulbs on light strings immediately.
- Always turn lights off when leaving the room.
- Keep an all-purpose, dry chemical fire extinguisher nearby.



Make sure your holiday festivities are safe with first aid training and products from St. John Ambulance, Canada's trusted leader for more than a century. For more information, contact the St. John Ambulance branch nearest you or visit our website at www.sja.ca.

St. John Ambulance – *first in first aid, for you!*

PRESIDENT'S Message

I would like to speak to something that is still pretty fresh in everyone's minds. In the middle of October, over 600 risk managers from across Canada gathered together in Victoria to attend the RIMS Canada Conference. It really was an excellent opportunity for risk managers to expand our professional knowledge. I also thought it was fantastic to reconnect with old colleagues and make new friendships, as well.

The organizers in British Columbia excelled in holding a top-notch conference this year. Looking forward five years to 2008, we are pleased to announce that the RIMS Canada Conference will be held in Ontario once again. The Ontario venue has not been decided as of yet, but we have narrowed the location down to either Niagara Falls or Toronto.

I would like to invite my fellow risk managers in Ontario to get involved in the 2008 conference. This is an opportunity with incredible potential from the perspective of both career development and personal networking. There will be many different volunteer possibilities available, but for now, I am sending out a call to individuals interested in chairing the 2008 Conference. Please read the 'Call for Co-Chairs' for more details.

Thanks and have a wonderful holiday season!

Rupak Mazumdar
ORIMS President

Call for Co-Chairs for the 2008 RIMS Canada Conference

ORIMS is pleased to announce that the RIMS Canada Council has awarded the 2008 RIMS Canada Risk Management Conference to the Ontario Chapter. The ORIMS Board of Directors is seeking notification from risk managers who are interested in Co-Chairing this Conference.

All RIMS Conferences have two Co-Chairs, working as a team, in charge of organizing the conference. Given the importance of the team approach, all submissions must be offered by a team of two individuals. ORIMS would like a signed 'Letter of Interest' from each team (two individuals) outlining why they would like to chair the Conference and briefly indicating their abilities to meet the selection guidelines listed below. ORIMS reserves the right to hold a more formal submission process to decide between competing bids.

Selection Guidelines for Canadian RIMS Conference Co-Chairs:

1. Selected and governed by the ORIMS Board of Directors;
2. Report to the Chapter President and the National Conference Committee;
3. Employers must be active RIMS members;
4. If chosen, at least one Co-Chair must attend the 2004, 2005 & 2006 RIMS Canada Conferences and both must attend the 2007 conference.
5. Both must have their employer's understanding and commitment to the conference;
6. Preferably have previous conference experience
   - by having worked on a conference organizing committee, and/or
   - are respected and well connected to industry and peers, and/or
   - knowledgeable of conference organization in terms of space, design, etc.
7. Must possess and demonstrate excellent organizational, motivational and communication skills.
8. Must sign and commit to carry out the terms of the Conference Award Agreement.

Deadline for Notification: Wednesday, March 31, 2004

Co-Chairs will be announced at the ORIMS Annual General Meeting, May 2004.

Please send 'Letters of Interest' to:

Rupak Mazumdar, ORIMS President (2003-2004)
Technical Standards and Safety Authority
4th Floor, West Tower
3300 Bloor Street West
Toronto, ON M8X 2X4
E-mail: rmazumdar@tssa.org
Phone: 416.325.1833

Who What When Where & Why

Auditing of claims handled by Third Party Administrators: A primer for Risk Managers

by Jim Cameron, FCIP, CRM
President, Cameron & Associates
Insurance Consultants Limited

This article explains why an audit of your claims program is an important risk management function.

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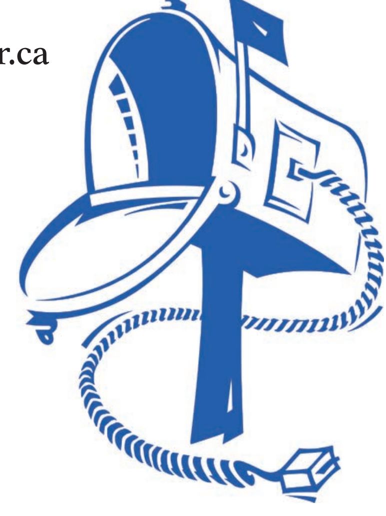

www.canadianunderwriter.ca

WHY

Why audit?

You have taken great pains to select a Third Party Administrator for your claims. You selected the TPA because you believed that they could do the best job of protecting your interests at the most reasonable cost. Why do you have to audit their work?

You should expect the best. However, you should inspect the process to make sure that your expectations are being met. A good TPA firm will welcome an independent claim audit. It gives them the opportunity to shine if they are doing a good job and to improve if they are not. As an adjunct to their own internal quality reviews, an audit can be most helpful in managing their people, and can help them retain your business by doing it better.

Having delegated the handling of your claims to a TPA or to the Insurer's claims staff, how can you ensure that you maintain control over your results? Are claims remaining open long after the claim is settled? Are your loss experience numbers reliable and credible? Are you paying too much or too little on settlements? An audit will tell you.

The quality of audits

A high quality audit will provide assurance that you, as a Risk Manager, are properly monitoring your Company's losses. It will provide a framework for improvements in process, investigation, analysis, settlement, loss control feedback, and all other aspects of the claims function. It will save you money either immediately or in the long term. For example, one audit we performed of an Insurer handling claims for 10 years within a Self Insured Retention discovered the Insurer's paid loss results overstated by a million dollars. The effect on the premiums paid over the decade due to such errors was, needless to say, significant.

WHEN

You should audit a third party administrator contract when:

1. You have recently changed vendors (within the past 12 months)
2. You have continued with the same vendor for a number of years.
3. You have doubts about the TPA's abilities to service your account.
4. You have no doubts about their abilities but seek reaffirmation of the arrangement.
5. You have doubts about the abilities of the Insurer to handle and service your account and properly track your losses.
6. You have a self insurance fund being administered.
7. You have unresolved questions on existing losses.
8. You have questions regarding the fee arrangement.
9. You intend to remarket the TPA or do an RFP
10. The nature, size or scope of your business is changing or evolving.

WHO

How to select?

In selecting an auditing firm to perform your claim audit, look for a firm that has specific expertise within your industry but also has enough general expertise with claims to be able to apply general trends to their analysis. Asking colleagues about their experience with claims audits can often be invaluable in selecting the right audit team.

Independent audit process

It is critical to the claims audit process that the audit team and their employer have no vested interests. Hiring an adjusting firm to audit another is simply not a good idea. Would you be comfortable letting your closest competitor evaluate your operations for a client? It is unreasonable to expect your appointed TPA to open up their files, books and records to their competitor. If they do, and suffer criticism, whether deserved or not, there is always a question whether disciplined objective auditing standards were applied. Even with such standards, there is a great deal of subjective input to the process that should not be allowed to be tainted. The results have to be truly independent of any perceived bias.

What is independent?

A claims auditor should be well versed in the line of business but should be able to freely express opinions on the quality of the work observed. If the auditor feels constrained by working relationships with those he is auditing this simply cannot happen. The auditor you select should have the reputation of fairness, honesty and reliability. The TPA you are auditing should have confidence in the abilities of the auditor and audit team you select. Ask them who they would recommend for their audit.

WHAT

What to select?

In some cases, such as a loss portfolio transfer or assumption of all existing liabilities, all the open files will require auditing. In most quality control audits, however, a sample size that is large enough to provide a representative cross section of the files should be chosen. While influenced greatly by the lines of business, the type of claims, the method of handling, and other factors, it is not uncommon to select 10% of the open files for audit purposes. A sample of this size should enable the auditor, in most cases, to draw general conclusions about file handling and the capabilities of the adjusters.

What to measure against?

The investigation, negotiation and settlement of claims can be problematic. It is often much easier to see opportunities lost with the benefit of hindsight. Not all outcomes turn out as anticipated or expected from anyone's view point. What an auditor will look for, however, is whether the TPA applied correct techniques available at the time to control the loss, monitored the investigation sufficiently, and made the best use of resources, including the TPA's time. Most TPAs have specific account instructions or general file handling guidelines that should be adhered to. Is there any evidence in the files that the TPA themselves monitored their own staff? It is surprising how often we find that adjusters did not adhere to their own guidelines and this resulted in leakage (paying more loss and expense than necessary).

Continued on Page 8

Using Defined Partnerships to Manage Risk

by Garry J. McDonell, Senior Vice President,
Aon Reed Stenhouse

As appeared in the September 2003 Issue of Canadian Underwriter

The complexity of today's business environment is largely a result of both the volume of change and the speed at which it occurs. Driven by shareholder expectations, the scrutiny of regulators and the demands of consumers, corporations are learning that managing risk is significantly different than it was even three years ago.

It's not surprising that we've had to examine, and in many cases change, the way we manage our business in this new environment. This includes a review of the role managing risk plays in the success of a corporation and acknowledging the need to develop and maintain a clear and robust corporate culture that supports the management of risk. The increased complexity of risk requires a more comprehensive and strategic business approach across the enterprise.

Traditionally, the relationship between a risk manager and a broker was simply that of a customer and a vendor. The broker was expected to be a procurer and distributor of insurance products. The value of the relationship was measured by the degree to which the broadest coverage could be obtained at the lowest cost. Given the mandate at the time this approach made some sense, but it doesn't begin to meet the risk management needs and expectations of corporations in today's environment. Brokers have evolved to also become risk consultants – in addition to providing valuable consulting expertise, they also have the unique ability to act on and execute their own recommendations.

To provide the competitive advantage corporations are seeking today, innovative risk managers understand that managing risk is more than simply protecting an asset. A comprehensive risk management program today seeks to protect and support the corporation's strategic plan and generally reduce the volatility in outcomes that have a negative impact on its goals. For example, if a corporation's plan is to maintain investment grade ratings, decisions with respect to insurance purchase, retentions and limits may be quite different than a corporation whose a goal is to reduce the cost of debt.

Strategic partnerships with broker/consultants provide an opportunity for the risk manager to bring a variety of expertise to their corporation, specifically tailored to the unique needs of corporations and their business or strategic plans.

Today's global broker/consultants maintain a full complement of resources locally, nationally and internationally to supplement the risk manager's internal resources and expertise. It is not unusual today for large broker/consultants, with a focus on managing risk, to have financial, legal, actuarial, engineering, research, information technology and in some instances, medical and psychological expertise to assist their clients.

A broker/consultant's ability to assess constantly changing risk and manage the potential impact through customized solutions is essential to the partnership. This relationship seems to work best when both parties understand the other's role. As is often the case, these shifts are fluid, they happen quickly and there isn't time for duplicate efforts. If a risk manager and broker/consultant are investing time completing the same task such as reviewing policy wording, then the partnership is not operating efficiently and the corporation is not getting the maximum return on their investment in risk management.

A risk manager's chief skills today include project management, communication, finance and strategic planning. It is impossible to be an expert in all of these, but it is necessary to possess an good understanding of each discipline. It is the ability to understand and communicate risk to their organization, manage an array of resources directed to a specific task or outcome while developing and implementing and monitoring a plan that spans three to five years, that differentiates today's risk managers from the previous generation of corporate insurance buyers.

Similarly, today's broker/consultant must have the ability to shift focus and concentration depending on the ebb and flow of the client's business, as it adjusts strategy and direction to keep pace with the changing market. This may mean fulfilling different or more integrated roles with the risk manager. It is the combined strength of this partnership that ensures a thorough understanding of a client's business so that risk management becomes less a function within the business and more of a governing philosophy that supports the company's strategic direction.

Managing risk has become so integrated with running a business that operating without a formal risk management program is leaving the outcome of a company's business plan in jeopardy or to chance. In 1994 the Toronto Stock Exchange (TSX) adopted the Corporate Governance Committee's 14 recommendations as "best practices" guidelines. Every year, listed companies must both disclose and explain any deviations from these guidelines. One of the guidelines requires the Board of Directors to assume responsibility for the identification of the principal risks and the implementation of appropriate systems to manage those risks. Industry guidelines have been developed outlining the minimum standard for operating in today's business environment. Included in those guidelines is a general risk identification and control program. In spite of this, the Conference Board of Canada estimates that less than 40% of registered TSX companies comply fully with the guidelines. It is not difficult to foresee significant increased pressure on corporations to comply. Executing the risk management component of these guidelines will likely fall on the risk management team.

As a result of this, the risk manager/broker/consultant relationship must also change and each must share responsibility for the other's well being. In order for broker/consultants to become full partners, they must understand the client's big picture and what they're trying to achieve and they must give their full commitment and support of the above regardless of the product or service required. In turn, the risk manager must be prepared to share the ownership for managing this process and thus share the responsibility for the company's success with the broker/consultant.

If this partnership is working properly, the broker/consultant will become a "trusted advisor" with the same status and responsibility as the corporation's legal, financial and investment strategic partners. Taking risk is what business is all about. Anticipate it. Understand it. Measure it. Manage it. Exploit it. That's what a long-term commitment to a partnership between a risk manager and a broker/consultant brings to the table.

For more information, please contact Garry McDonell at Aon Reed Stenhouse: ph: 416-868-5925, E: garry.mcdonell@aon.ca

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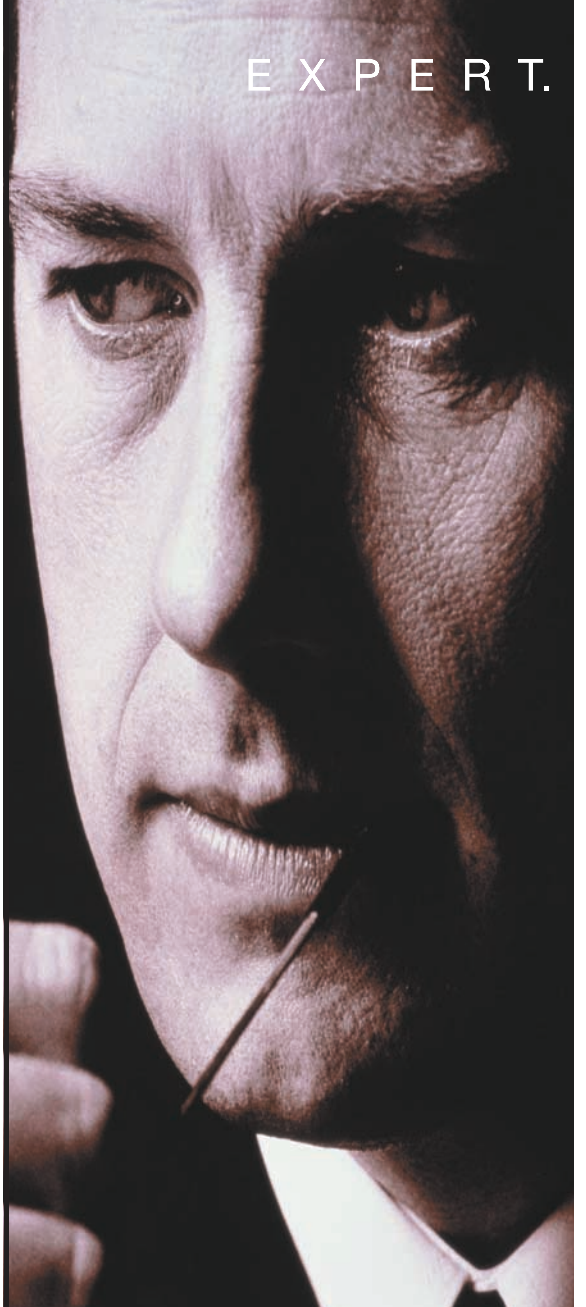

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What can you do to protect your property from wildfires?

By Gino Brunetti, P.Eng., Division Engineering Manager
FM Global Canadian Division

For Ontario RIMS, November 18, 2003

Anyone who followed the news last summer would likely recall the almost daily updates of forest fires across Canada, and in particular, the long battles fought to contain forest fires in the province of British Columbia. More recently, the brush fires in California communicated the seriousness of such disasters. In all cases, the fires illustrated the property devastation that can result.

Fires that attack the forests of Canada usually strike during periods of prolonged hot weather and low precipitation. These fires can blaze out of control for weeks or even months consuming and destroying vast areas of forest, as well as homes and businesses.

The most effective way to successfully eliminate or minimize damage, regardless of where your property is located, is to plan well ahead.

The most savvy organizations prepare well before the fire season. Long before the flame front reaches your property, radiant heat could set the buildings ablaze. Will the wind change direction? Will rains ever come? How will you save the property? Will there be enough firefighting resources?

If you begin asking such questions after you've seen the fire plume in the distance, it's too late. But if you strategize well before fire season, the odds are much more in your favor that you will be able to prevent major property damage.

Regardless of what you call them, wildfires, bushfires, wildland fires, brushfires, grassfires, or forest fires they all burn alike. Igniting suddenly, they are the only natural hazard most often caused by humans. Most fires flare up every year from careless acts. Long periods of drought fanned by high winds often set the stage. Dry vegetation adds fuel. And the spark? Maybe an arsonist strikes a match. Or a controlled fire jumps out of bounds. Sometimes heavy equipment or a discarded cigarette triggers it. A dry thunderstorm, radiant heat or lightning brought on by very humid weather ignites dry ground cover.

Flames follow an erratic path controlled by amount and type of fuel, contours of the land, and wind velocity and direction. High winds carry fire-spreading particles such as tiny pieces of grass, leaves, twigs and other vegetation under 0.25 in (6.4 mm) in diameter. Tree bark can tear off in a strong wind and travel as high as 100 yd (91.4 m) or as far as 1.9 mi (3.1 km). Even properties not directly in the line of a major fire front have burned down from just one or two small spot fires.

The other surprising feature about these types of fires is the speed. High winds can gust to hurricane forces and during a fire, gusts can become strong enough to smash windows and rip back roofing, fierce enough to drive burning tree branches or pieces of neighboring roofs through windows and walls.

Burning debris flying ahead of the fire front can fill the sky like fireworks. And embers plunging down on a roof-top or yard storage are certain to ignite many fires at once. Without outside sprinklers or hose streams, many fires burning everywhere are usually unstoppable.

Embers landing on plastic or fiberglass skylights can easily burn through them and ignite spot fires inside buildings. Sprinkler systems are designed to handle only one fire at a time, and fires starting in several places can quickly overtax a system. Emergency response often becomes a property's last chance for survival.

Radiant heat can ignite a building and furnishings near windows. Heat can shatter window glazing, allowing burning debris to blow through. Damage severity depends on how much and what type of fuel is available to burn and how much separation exists between the fire exposure and the buildings. Excessive yard storage, lack of on-site water supplies, and inadequate separation between buildings and storage or between buildings and forests or vegetation all play leading roles in severe losses.

FM Global property loss prevention engineers recommend the following seven qualities be examined to protect business property from these severe fires. If you are selecting a site for a new facility, it's easier to examine each in the following order:

1. Topography:

Locate new facilities on level or gently sloping terrain as opposed to a large slope, ridge, hilltop or gully. A building in the fire's path and at the top of a slope is in great danger. Gullies and ground slope can substantially modify wind direction, creating turbulence and erratic fire behavior. As the slope increases, radiant heat from the flame front heats the ground fuel more rapidly than it would on level ground. Anything in the fire's path will ignite faster because of the increasing speed and intensity of the fire. Radiant heat can be reduced up to four times by doubling the distance between the exposure and the exposed buildings.

2. Design:

Take a close look at anything that can affect the severity of fire damage. Design the shape of the building to reduce the number of corners or intersections (re-entrant corners) and changes in roof profile where burning debris can accumulate and ignite. Examples are wall-to-ground intersections and wall-to-eaves intersections. Fire-seal such areas to prevent windblown debris from collecting in them. Properly protect windows, doors, vents and other openings. Seal, enclose or otherwise protect underfloor spaces.

Avoid changes in roof profile where burning debris can accumulate. As much as possible, minimize changes in roof elevation, overhanging eaves, parapets, inset windows and doors and roof valleys. Avoid gaps where sparks can enter.

3. Construction:

Use noncombustible construction for new buildings and important structures such as cooling towers. Most facilities are made of noncombustible materials, but some items are combustible. Examples: plastic or fiberglass skylights, wall paneling and outside structures made of combustible materials, such as cooling towers. Cover openings to underfloor void spaces with steel-framed screens or close-weaved bronze spark screens. Do not use aluminum or glassfiber screens.

Cover vents in the walls or roofs with close-weaved bronze spark screens. Fit weep holes in brickwork with screens and fit chimneys with corrosion-proof metal screens.

Provide external doors with a minimum one-hour fire resistance rating. Construct doors to stop sparks from blowing through the gaps. Doors should not have glazing. Use protective wire screening instead.

Protect windows and frames with permanently fitted, one-hour-fire-rated shutters. Side-hung and steel roller shutter types are suitable. Make sure shutters are strong enough to withstand the impact of flying debris, high radiant heat and short-term flame contact.

Avoid skylights. If they are needed, construct them of wire glass and provide external noncombustible covers for them. Insulate steel covers with 2 in (51 mm) of mineral wool.

Do not use rainwater gutters on the roof. They collect leaf debris that can easily be ignited. Use ground level drains to collect and dispose of rainwater. If gutters are necessary, they and the fascia should be made of metal. Tightly seal any gaps leading into the building with fire-retardant materials that bear the FM Approved certification mark, indicating such materials meet the most rigorous property conservation standards..

4. Yard Storage:

Strong winds and yard storage are the two worst fire exposures. Many losses result from excessive amounts of yard storage and yard storage that is piled too high or located too close to buildings. Eliminating combustible yard storage should be your top priority. In any severe forest fire, yard storage will ignite and expose the facility. If yard storage is unavoidable, keep it to a minimum and keep storage heights as low as possible and locate storage a minimum of 50 ft (15.2 m) from any building. Use greater distances for certain bulk storage such as baled fiber, roll paper, baled waste paper, idle pallets, wood chips, pulpwood, logs, and flammable liquids. Also locate storage on the side of the facility opposite to the prevailing wind and separate yard storage into small blocks with at least 30 ft (9.1 m) separation between blocks. Never locate combustible yard storage under platforms. Finally, check flammable liquid storage for leakage.

5. Vegetation:

Fires start and burn rapidly in light fuels like bushes and grass, and these provide a path to trees. Once at the base of a tree, fire can move into low branches and climb to the crown.

Forest fires gain momentum by way of burning tree branches, leaves, twigs and bark traveling in the wind.

Although it's important to remove types of vegetation that ignite easily and release flying embers, some types can help minimize fire spread. Remove most but not all trees or shrubs around the property or plant them so there is no continuous canopy or line of vegetation from the brush to the buildings. Removing all trees within a clearance zone around the building is not recommended because they can slow wind speed and provide shelter from radiant heat and sparks depending on the type of trees, type of canopies, and the amount of moisture they contain.

Provide a minimum of 20 ft (6 m) between the tree canopy and power lines. Make sure all unnecessary combustible materials and flammable fuels are removed from these areas.

Trees with a more open canopy provide the best windbreak. Build a solid fence of preferably noncombustible material on the windward side of the trees to block low winds and stop ground fire spread.

Maintaining vegetation is a continuous task, but extremely important. Before and during fire season maintaining the zone of fuel-reduced vegetation involves removing dead leaves, bark and twigs that are held in the trees and shrubs and lie under them; removing all dried grass; keeping grass short and green; removing trees and pruning limbs that overhang buildings; pruning lower branches of trees.

6. Water Supplies:

Provide an adequate on-site water supply to meet automatic sprinkler and hose stream demands. The recommended water supply duration is usu-

ally two hours, the same as the internal sprinkler design. This could be much larger from four to five hours if combustible yard storage such as large stacks of idle pallets, baled waste paper or dry timber is to be protected. In addition, provide a water supply connection to outside tanks for the local fire service to feed fire trucks.

Size the gravity tank or pump and tank according to FM Global Property Loss Prevention Data Sheets for buildings and yard storage protection. Do not totally rely on an electrically driven pump to supply the water demand because a large fire may shut down electrical utilities. Provide either a stand-alone diesel fire pump or an electric pump with a diesel backup for each pump capable of supplying full sprinkler and hose demand.

Position hydrants around the building and on the roof so every wall and roof surface and yard storage area can be reached. Provide internal hose reels to reach every part of the interior building. Provide internal small hoses of a minimum 1.5 in (38.1 mm) diameter so that all internal walls, roofs and ceilings can be reached. These hoses should be supplied by on-site water supplies. Consider installing an open-head sprinkler system outside the building. This will protect the building walls, windows and roof, if adjacent vegetation presents a serious exposure that cannot be eliminated.

7. Emergency Response:

Training emergency response teams is essential. The public fire service might not get to your site when it needs protection because of demand for their services elsewhere. Personnel shortages can be expected in an extreme event but can also happen anytime more people need assistance than the firefighters can provide at one time.

Fully train and equip forest fire emergency response teams to take all the appropriate actions before, during and after the fire to properly protect the facility.

Consult the local fire service for help with the training. Together, develop a written prefire contingency plan. During the visit, review access and egress paths the fire service needs when it responds to protect your property; specific communication channels, and phone numbers for prior warning during the emergency; extent and severity of the wild fire exposure to your company; and prevention and mitigation measures you should take before the event.

Contractor Default Insurance (CDI) or Subguard©

AN ALTERNATIVE TO SURETY BONDS IN MANAGING CONTRACTOR PERFORMANCE RISK

Why CDI was developed

Traditionally, prime contractors have had only one risk management option available to them with which to address the risk of subcontractor/supplier default-bonding. In 1996, Contractor Default Insurance (CDI)[1] was developed in response to increasing problems that large prime contractors had in enforcing performance and payment bond claims against their subcontractors' sureties. The fact that sureties have an obligation to both the obligee, (the Prime Contractor) on the bond and their subcontractor/supplier clients conveys a responsibility which can influence how fast they can take action on a claim to mitigate both direct and indirect costs which result from a default. The surety's obligation to its client subcontractor/supplier necessitates that it conduct a due diligence investigation of the claim and support any defense that may be available. If the surety does not conduct itself in this manner, it stands to lose protection of its indemnity from the subcontractor/supplier. It may also be exposed to legal action, the cost of which can exceed the value of the penalty of the bond.

CDI addresses these concerns by delegating control of subcontractor/supplier selection and default resolution to the contractor. This is accomplished through the re-alignment of the traditional three-party agreement that exists when a bond is provided. Instead, the insurer enters into an insurance contract with the prime contractor, who is indemnified for any costs associated with subcontractor default (supplier default is also covered; for the purpose of this paper, reference to subcontractor is synonymous with reference to supplier). The subcontractor is not a party to the insurance contract, which means that no indemnity agreement exists between the subcontractor and the insurance company providing coverage. With this fundamental change in the structure of the coverage, the prime contractor controls subcontractor selection, subcontractor management, subcontractor default loss control and subcontractor default claims management without interference from the insurance company.

CDI Coverage

CDI provides coverage for the cost of completing the defaulted subcontractor/supplier under the subcontract or purchase order. CDI will cover the cost of correcting non-conforming or defective work, also known as "rip and tear". Professional and legal expenses associated with the default are a covered cost as are and costs, charges or expenses incurred in the investigation, adjustment, litigation and resolution of the default. This would include any such costs incurred by the project owner.

There is an indirect cost coverage component that covers those costs that are not directly related to the default, but otherwise would have not been incurred if not for the default. These include expenses such as project acceleration, liquidated damages, and extended overhead. Many of the indirect costs can be charged back to project owners under most standard construction contracts.

Coverage is afforded under CDI for as long as the prime contractor can legally default the subcontractor/supplier for up to ten years after substantial completion of the work. Consequently, warranty, extended warranty and guaranteed work are typically covered as long as the prime can legally default the subcontractor/supplier.

Contrary to some published materials about CDI, it is NOT written on a claims made basis. Consequently, when a subcontractor/supplier is enrolled under the program, coverage can not be lost through program cancellation or failure of the prime contractor to renew the programs.

Coverage is triggered by a formal notice of default from the prime contractor. Unlike a surety, the CDI insurance provider does not have the ability to question the legality of a default. This is the sole discretion of the prime contractor. If, however, a legally binding third party[2] determines that the default was not legal, there would be no coverage under CDI. Executing a formal notice of default does not mean that the prime has to terminate the defaulted subcontractor/supplier. Remedy to the default is entirely up to the prime contractor and many times the best remedy is assisting the subcontractor/supplier through the project.

When a project has been enrolled under the CDI program, all subcontractors/suppliers are covered unless selectively bonded.

Why CDI is being purchased

- ***Timely Completion of the Project.*** CDI affords the prime contractor the ability to address a default without delay. Additionally, the prime contractor retains control of the schedule under CDI where as under a bond it is likely that the surety will dictate the schedule as they are required to resolve the default in the most economical manner.
- ***Default remedy is in the best interest of the project.*** The fiduciary responsibility that the surety has to the subcontractor/supplier is such that they are legally required to remedy the default in the most economical manner. This may not be the best solution for the project. In that coverage for a default remedy under CDI is managed by the prime contractor, the motivation to "cut corners" in finding a remedy to the default is removed.
- ***Subcontractor/supplier selection.*** Recent events have impacted the bond capacity of many otherwise quality subcontractors/suppliers. Under CDI, the prime contractor is not limited to selecting subcontractors/suppliers who are able to provide a bond. Subcontractors/suppliers are tending toward projects that use CDI as it is less likely to effect their bonding capacity.
- ***CDI covers 100% of the subcontractors/suppliers on the project.*** In most cases, the greatest risk of a prime contractor defaulting is born from the default of a subcontractor/supplier. In that CDI programs cover 100% of the subcontractors/suppliers, the risk of a prime default is reduced. As a result, project owners may elect not to bond the prime. This can save the project up to 0.6%.
- ***Coverage.*** Coverage under CDI is such that in the event of a default, CDI will cover many costs that have to be negotiated with the surety and/or otherwise can be charged back to the project owner or to contingency.
- ***Insurance Limits Available.*** Coverage under a bond is typically going to be limited to the penal value of the bond (i.e. the amount of the subcontract). The default policy limit under CDI applies to each default. These limits are typically well in excess of most subcontracts.
- ***Warranties, Long Term Warranties and Guarantees.*** Are covered under CDI as long as the subcontractor/supplier can be legally defaulted.
- ***Direct Cost.*** The cost of CDI projects is generally less than the cost of bonding subcontractors/suppliers. Especially considering that CDI covers 100% of the subcontractors/suppliers and CDI does not make additional charges for extended warranties, dual obligee riders, or multi-year projects.
- ***Indirect Cost Benefits.*** Many sureties require subcontractors to bond their tier subcontractors and suppliers as a condition of providing a bond. In that CDI does not require subcontractors to bond their tiers, the subcontractor's competitive bid will likely be lower.
- ***Improves performance of the Prime Contractor.*** CDI gives the prime contractor operational advantages that primes who bond their subcontractors/suppliers do not have.

CDI Performance to date

Zurich NA is the primary underwriter of CDI, and currently the only insurance company offering the product. They have underwritten close to 100 programs with premiums that would place them in among the top 7 sureties worldwide. There have been over 250 claims; several have been very significant. All claims to date have been resolved without litigation. Overall CDI loss results have been significantly better than Surety results since CDI was introduced[3]. This lends credibility to those who believe that prime contractors have significant resources available to them to underwrite this exposure. Zurich has not cancelled any programs.

Dave DeSoto is a Director from Aon's Minneapolis' office and is the leading authorities on CDI. For further information on this product, please contact your local Aon Reed Stenhouse Inc., Construction Services Division

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[1] *Contractor Default Insurance has also been described as Subcontractor Default Insurance, or Subguard®. Subguard® is Zurich North America's CDI program.*

[2] *Such as through a counter claim filed by the subcontractor.*

[3] *Loss results on CDI obtained from Zurich. Surety loss results obtained from surety association websites and surety company publications and reported financial reports.*

Bill 198: The Threshold and the A/B-Tort Transmogrification

By Ross Macdonald, B.A., A.I.I.C., RGM Claims Services Inc.

Stop me if you've heard this one. Once upon a time the cost of automobile insurance in the province of Ontario was spinning out of control. Double digit rate hikes were annual events, and many people simply stopped paying their auto insurance premiums because they couldn't afford the prices. The government stepped in and promised to put an end to the problem by eliminating claims for minor injuries, because everyone knew it was the lawyers who were causing insurance costs to skyrocket by inflating the cost of previous 'nuisance-value' claims. In exchange for losing the right to sue for minor injuries, claimants would access no-fault benefits directly from their own insurers without having to fight about it. The government's new legislation delivered on all the promises, and Ontario auto insurance problems were solved.

Whoever said 'the more things change, the more things stay the same' must have been thinking about Ontario auto insurance. In the old days the injury threshold was a simple "crash equaled cash" equation. But ever since Ontario's first no-fault scheme, the 'Ontario Motorist Protection Plan', the threshold bar has moved up and down like a thermometer during a Chinook in Calgary. Half the changes came about with new statutes; the balance came through interpretations from Ontario's courts.

There is doubt amongst some claims people and claimant legal representatives that the latest round of changes will bring peace to Ontario's automobile insurance market.

What do these changes mean?

Under Ontario Regulation 381/03 the definitions of what constitutes a permanent serious impairment of an important physical, mental or psychological function have been retooled. In a nutshell, if the claimant is employed, the claimant has a threshold injury if the impairment prevents the claimant from doing the essential tasks of his/her usual job, despite reasonable efforts to accommodate the impairment, and the impairment must have been continuous since the accident with no reasonable prospect for recovery.

If the claimant is a student, the claimant has a threshold injury if the impairment prevents the claimant from engaging in the essential tasks of his/her studies, despite reasonable efforts to accommodate the impairment, and the impairment must have been continuous since the accident with no reasonable prospect for recovery.

For the balance of claimants (i.e. caregivers, children, and 'non-earner' claimants under the Statutory Accident Benefits Schedule) the threshold means a substantial inability to look after themselves because of an inability to engage in normal life activities. The impairments must be continuous since the accident with no reasonable prospect for improvement.

If you are a member of the Ontario Trial Lawyer's Association (OTLA) these changes are discriminatory. From the OTLA's perspective "The new criteria [about who qualifies to sue] favours those who have jobs or are enrolled in training programs… To bar people from suing for damages because they didn't have jobs before they were hurt is discrimination, plain and simple. What does being employed have to do with whether you experience pain or suffering or are disfigured in a car crash?"

On the other hand, here is an observation from a noted Toronto law firm: "Bill 198 expands the rights of innocent accident victims to sue for health care expenses… In the context of a tort claim, the definition of catastrophic is no longer operative. This is an important and welcomed change to the current legislative scheme."

Meanwhile, there is a whole generation of adjusters and examiners who have had no experience investigating auto tort claims. What this means is a significant percentage of claims become 'sleepers' – files that have not been investigated because there is a shortage of knowledgeable staff.

When the restriction on accident benefits cash settlements is thrown into the equation, we have a very volatile mixture indeed. No settlements today means a/b files have to stay open to get over the one-year hump. At the end of that year, many of these files have undergone a breathtaking facelift. The a/b adjuster had lost interest in the file seven months earlier, and so what was once a myofascial injury of no significance has become a chronic pain file. The unopposed medical information used to construct this noteworthy a/b file starts spilling into the injury side, and all of a sudden the insurer is staring down the throat of a complicated tort file.

The $30,000 deductible on non-pecuniary damages and $15,000 deductible on FLA claims will eliminate some claims. On the other hand, the imposition of deductibles tends to inflate assessed values and force the claimant representatives to work that much harder to "adduce evidence… that explains (a) the nature of the impairment; (b) the permanence of the impairment; (c) the specific function that is impaired; and (d) the importance of the specific function to the person" (O. Reg. 381/03 Court Proceedings for Automobile Accidents that Occur on or After November 1, 1996).

If anything, proving the threshold after October 1, 2003 is going to be easier. The claimant has to make an accident benefits claim. If the claimant is employed – and if we follow the OTLA train of argument, the successful tort claimant will likely be employed – then he will already have had to satisfy the threshold for an income benefit (IRB) entitlement under the accident benefits policy by suffering "a substantial inability to perform the essential tasks of that employment…" While the strictest test comes at two years post-accident, if the income benefit claim continues beyond a year, then the claimant will be well on the road to demonstrating the kind of evidence needed to satisfy the injury threshold test. This is because injury impairments are much more likely to be permanent if they endure beyond one year.

If the IRB threshold sounds familiar that is because it is very similar to the injury threshold definition for employed people listed earlier in this article.

In other words, it looks as if tort claims are transforming into a/b claims, and vice-versa. If you satisfy the test under one theshold, then after one year of so goes by you'll likely satisfy the test under the other.

Perhaps Ontario's auto market will enjoy peace and tranquility for awhile. On the other hand, it looks more like a calm before the storm, because when Bill 198 car accidents have their first birthday in October 2004, the tort claimants will stop hibernating.

Ross Macdonald and his partner, David Rienzo, own and operate RGM Claims Services Inc., an all-lines independent adjusting firm based in Mississauga, Ontario. Mr. Macdonald lives in Oakville, Ontario with his wife Alison and their three daughters.

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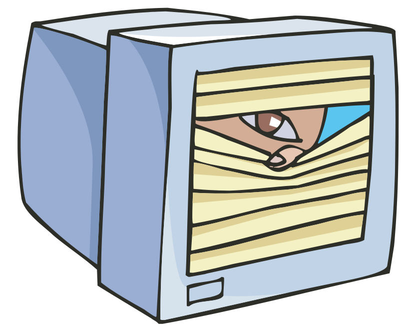

PRIVACY 101: *A Risk Management Issue?*

On January 1, 2004 the Personal Information Protection and Electronic Documents Act (PIPEDA) comes into force and any organization engaged in commercial activity that collects, uses, or discloses personal information, must be in full compliance. The Act applies to everyone involved, be they Canadian or foreign. No personal information can be collected, used or disclosed without the person's **prior** knowledge and consent.

What is Personal Information?

Personal Information is information about an "identifiable individual". This includes name, age, weight, height, medical records, income, purchase and spending habits, race, ethnic origin and colour, blood type, marital status, education, opinions, loan and credit records. This list may even include the individual's home address and telephone number.

It does not include the name, job title, business address or office telephone number of an employee of an organization, that is, **it does not include what is on a business card.**

Who is Affected?

Anyone who has information in sources such as the following is affected:

- Customer relationship management databases
- Direct or secondary marketing lists
- Fundraising or membership lists
- Individual credit or financial information
- Surveillance systems
- E-commerce
- Lists collected on a website

The legislation is retroactive, meaning that the owner of information already on file must renew any permission to keep and use it.

Why Care?

As we all know, a sound privacy policy can remove barriers to on-line shopping.[1] Accurate information about customers and clients earns goodwill and trust. Inaccurate or deceptively collected information can lead to negative publicity and liability charges. Even if the situation is unintentional, accidental or unforeseen, the media and the public will not care.

What's Involved?

Organizations must comply with 10 principles:

- Designate someone who is accountable for compliance
- Identify how the information will be used
- Get consent for the use
- Collect only what is necessary for the purpose stated
- Limit use, disclosure and retention of the information
- Ensure the information is accurate
- Safeguard the information
- Make information about privacy policies and practices available
- Give those involved access to the information
- Allow those affected to challenge and correct the information

What Happens if I Don't Comply?

Public complaints may be made to the Privacy Commissioner of Canada, who investigates and resolves them. If necessary, the Commissioner may go to the Federal Court which has the power to order correction of practices and award damages of $10,000 to $100,000.

Are There Exceptions?

Unless a province has legislation that effectively regulates personal information which is "substantially similar" to the Federal act, PIPEDA will apply. Currently, only Quebec has such legislation. B.C. and Alberta are working on it.

In addition, information is exempt if it is collected, used or disclosed for:

- Personal or domestic purposes
- Journalistic, artistic or literary purposes
- Purposes of breach of agreement or debt collection
- Statistical, scholarly study or research
- Purposes in interest of the individual; e.g. a Christmas card list
- Regulating illegal activities
- National security or intelligence gathering

Where Can I Get More Information?

Check the following web sites:

- Strategis.gc.ca
- www.fasken.com

[1] *AICPA. "Privacy – Minding Your Own Business."*

McLARENS CANADA

Michael C. Holden, B.E.S., F.C.I.P.

A. Stewart Ponton, CIP, CLA, Chairman of the Board of McLarens Canada, a division of Ponton Coleshill Edwards & Associates Insurance Adjusters Limited, is pleased to announce the appointment of Michael C. Holden, B.E.S., F.C.I.P., to President and Chief Executive Officer effective October 1st, 2003.

Mr. Holden formerly held the position of Managing Director of McLarens Canada, where he was actively involved in all aspects of the corporate structure. He has held senior positions in the past in the insurer and brokerage communities in both national and international forums.

McLarens Canada continues to enjoy successful growth in their claims handling, risk management and niche products, servicing national and international clients from an expanding network of branches strategically located across Canada.

McLarens Canada is part of the McLarens International Group providing claim services worldwide.

Avoiding the Reactive Risk Trap™

by Owen Smith

It is remarkable how well society is able to pull together in order to deal with unexpected emergencies and disasters that fall upon us. Clear examples of our ability to cope with such situations include the aftermath of the World Trade Center disaster, the recovery from the power blackout, the reaction to the Walkerton water crisis and the recent Aylmer meat fiasco.

Risk Managers, in particular, usually have comprehensive and highly effective Emergency Response Procedures in place and are well equipped to recover from setbacks and emerging problems. However, what is often missing is the same sense of urgency, planning and competence when it comes to ***recognizing*** the risk and ***preventing*** it.

The same Risk Managers can be found lacking in taking proactive steps to recognize and efficiently deal with a risk with the same type of up front response.

Risk Managers tend to focus on acting with maximum efficiency and effectiveness when the risk goes wrong, but their attention also needs to be placed on preventing the risk from occurring. In order for Risk Managers to avoid this barrier, risk control systems should include a component requiring a proactive and red tape cutting emergency response.

The secret of success in these instances lies in using powerful focusing methods to identify factors which may lead to emergencies or critical problems, and providing the same type of response, which is customarily used for dealing with full-blown emergencies. Red tape is cut and the word gets to the top immediately and without bureaucratic derailments.

If all risk management systems included this component, the following scenarios could and should have occurred:

The highest decision makers in the United States would have been notified of the suspicions of the intelligence network in regard to 9/11 and would have been accountable to act on them;

The Government of Ontario would have been required to have steps in place to recognize and act upon the concerns of water and meat experts and informed parties;

Electric Power officials in both the United States and Canada would have been held accountable to receive and act upon the concerns expressed in study documents and reports, which warned of just the type of problems which occurred with the blackout.

The key to making a proactive system such as this effective is accountability, the same type of responsibility, which is imposed and willingly accepted in our traditional emergency response procedures. In the courts, the accountability is clearly and forcefully recognized and imposed and that any system, which is ready for trial, must include it.

The bottom line is Risk Managers need to have systematic empowerment and accountability in place.

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Have your attempts to implement ERM been unsuccessful? Does senior management still perceive your role to be purely one of insurance procurement? This interactive session will identify the key skills necessary to lead and influence change within your organization.

"Legal Update Panel"

Wednesday March 24th, 8:30a.m.-11:00 a.m.

Hear the latest news on legal issues and trends with Cassels Brock LLP.

For further details see the ORIMS web site or contact:
Carrie Green, Director of Programs/Education
cgreen@curie.org

Who What When Where & Why

Continued from Page 2

Extracting value from the process

An audit is not inexpensive. You should be able to demonstrate to your management that the claims audit produced something of value. Where recommendations for improving the handling are made and implemented, productivity or quality improvements should be visible in the long term. If there are no improvements necessary, at least you have the assurance that your gut feeling that all is well is a correct one. Peace of mind is well worth the price of an audit.

WHERE

The audit should be conducted on the premises of the TPA, preferably and if practical, at more than one branch office. What the auditors observe during such a visit can be as important as the files they audit.

Setting goals

It is important to set goals before you ask for quotes for an audit. What do you hope to achieve? Are you seeking reassurance that the TPA deal you made was right? Do you have some trust issues? Do you have some quality issues? Do you have any other specific concerns? If you do not communicate your concerns to the auditors, they may not approach the audit in the appropriate manner. Some may argue that any preconceived notions might taint the audit: for example, if you are looking for an excuse to sever a relationship, the audit might provide ammunition. A professional auditor, however, should be able to distinguish your perceptions and concerns from the empirical evidence gathered during the audit process and come up with their own conclusions. They may support your views, be neutral to your views or be totally opposite to your views, but their conclusions should be supportable.

If, however, you do not share any of your concerns or potential desired outcomes with the audit team or at least the lead auditor, you may find that the audit will not specifically address the issues that you wanted dealt with. An audit cannot be all inclusive and any specific areas that you wish commented on should be stated to the auditor. If not, the audit is doomed to fall short of your expectations.

Verification of the goals

A properly conducted audit will draw conclusions that should be supported by anecdotal evidence in the files. You should have explained to you how the auditors drew certain conclusions, good and bad, about your claims. At the conclusion of the audit, the auditor should have achieved the goals set out at the beginning.

Follow up

It is important to follow up a claims audit with either another audit or at least some spot checking of individual files. Have the auditor's recommendations been implemented? If so, has there been any improvement? Depending on the complexity of the program, and the number of claims, a follow up at 6 to 12 month intervals reinforces the audit and allows you to keep control of your claims.

Conclusion

If you recognize the need for a claims audit, carefully select the auditing firm, monitor and follow through with their recommendations. Your claims experience can and will improve over time. You will also be able to demonstrate that you have properly managed this important function of a sound risk management practice.

Jim Cameron and his team have conducted over 200 claims and regulatory audits for insurers, reinsurers, and risk managers. He can be reached at james@cameronassociates.com or visit the web site at cameronassociates.com.

Editorial Policy

The PULSE is a publication of the Ontario Risk and Insurance Management Society and is published periodically throughout the calendar year.

The opinions expressed are those of the writers and the volunteer members of the PULSE Editorial Committee. Articles submitted to the PULSE for publication are subject to the approval of the PULSE Editorial Committee. Approval of such articles is based upon newsworthiness, and perceived benefit to the readership. All decisions of the PULSE Editorial Committee are final and are not subject to appeal. Individuals submitting articles to the PULSE hereby acknowledge their acceptance of the PULSE Editorial Policy.

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