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Elements of Risk Management

Dear Reader:

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We hope this information will be useful to you; reference to it will assist you with many of the questions that will arise in your tenure with county government. However, the *Tennessee Code Annotated* and other relevant laws or regulations should always be consulted before any action is taken based upon the contents of this document.

Please feel free to contact us if you have questions or comments regarding this information or any other CTAS website material.

Sincerely,

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Elements of Risk Management

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The general responsibilities of a county risk manager include identifying and evaluating loss exposures, developing risk control programs, and deciding how best to fund risks. Risk management experts think of a full-scale risk management system as a system with four elements:

1. Risk identification
2. Risk evaluation
3. Risk control, and
4. Risk financing

Using the four-element approach is a step-by-step process. The risk manager first must Identify a Potential Loss before it can be evaluated.

Evaluation, the second step, is necessary to know how to control the expected loss. To evaluate a potential loss, the risk manager must know what the loss is, determine its severity, and calculate its probable frequency of occurrence.

The third element, Risk Control, is the one most often recognized by county officials. It is subdivided into "loss prevention" and "loss reduction." County officials will avoid much disappointment by admitting in advance and declaring in the policy statement that a risk manager rarely can completely prevent a loss in a given area. A sound risk management program of loss prevention can, however, decrease the frequency of loss in that area. When a loss does occur, the measures taken under the program will reduce the cost or severity of the loss.

The two-fold goal of the Risk Control element of a program is to-

- decrease the frequency of losses and
- reduce their severity once they occur.

Finally, to finance the loss in the proper manner -- after identifying it, evaluating it, and using such control measures as safety programs, inspections, and disaster training -- the risk manager must cover the risk with insurance or with a combination of insurance and risk retention methods.

Of the four elements of a risk management program, the policy-making role of county mayors and county commissioners is greatest in Risk Financing, which is simply arranging a method of paying for losses. No matter how successfully a manager handles loss exposures, the county will always need some type of risk financing program. No loss prevention program is 100% effective so when losses occur, they need to be paid. On the other hand, risk financing can only be effective if efforts have been made to identify, evaluate, and control losses.

The two major categories of risk financing are *retention* and *transfer*. All risk financing techniques are one or a combination of both. Risk retention includes-

- all self-insurance programs
- deductibles
- uninsured losses

and any other method in which the county assumes all or part of a loss.

Risk is transferred through a contract in which one organization agrees to pay for the losses of another organization in exchange for a premium. Insurance is the most common form of risk transfer. County executives and county commissioners must make the final determination of what forms of Risk Financing to use.

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