

## BENCHMARKING

Is traditional benchmarking really useful in the life sciences sector? This is a difficult question.

Usually, risk managers want to know if their chosen limits of liability and retention/deductible are consistent with that of their peers. They use benchmarking information as one method to support their decisions regarding what limits they purchase. Board members frequently ask how limits and retentions were determined. Since many life science company risk managers are also asking for benchmarking information, we want to take a good look at what benchmarking is and address the question – which seems even harder for the life sciences sector – is it useful?

## WHAT DATA ARE AVAILABLE?

The first issue we face is access to the information needed to conduct a legitimate benchmarking study. RIMS conducts a large survey that contains good information on cost of risk and other data points on all industries. This survey is divided into pre-defined industry sectors. All of life sciences is included with pharmaceuticals, which aggregates all life sciences sub-sectors into one large category. While different data are displayed by revenue size, there are no data distinctions for industry sub-categories (e.g., devices, contract research, contract manufacturing, research and development). This means that the data are interesting for the general industry segment but not specific enough for life science industry sub-sectors. The study's peer group is not homogeneous and can not yield accurate information for the typical life science company.

Some large insurance brokers claim to provide benchmarking information, but there are issues with this information as well. How many clients are in the comparison group? How many of those clients are truly in your industry sub-group? Brokers could come together and share information, but we hold client information to be confidential and not to be shared with others. This confidentiality is a justifiable barrier to sharing data.

Some life sciences companies have voluntarily come together to share data. This may be helpful, but we ask the same question (and issue a caution): Who do you want to be included in your peer group for comparison?



## YOUR PEER GROUP

Who is in your comparison group for proper benchmarking? If you are a device company, do you want to be included with therapeutic development and contract manufacturers? Probably not. If you are a class II device company, do you want to include class III devices in your data set? You can imagine that the limits of liability and retention may be very different for an orthopedic implant verses a monitoring device. Little benefit would be derived from blending these two groups for purposes of benchmarking. Additionally, public companies may have different buying habits from private companies.

To be accurate and useful, benchmarking peer group data needs to be large enough and homogeneous to be statistically credible. When you combine the desire to have a homogeneous peer group with the need to

have a data set large enough to achieve credibility, useful benchmarking information becomes very difficult to obtain.

## THE CALCULATION

Finally, if we could get a representative data set together, what would the data tell us? Life sciences companies tend to buy limits of liability based on perceived risk. Companies of the same size or industry category may purchase very different liability limits. If benchmarking data shows one peer group company buying \$100 million limits and another buying \$10 million limits, that information is not helpful in determining your appropriate limit. Why did one buy limits so much higher than the other? What risk factors influenced each company's decision?

Most benchmarking studies use a distribution chart that shows the percentage of a peer group buying limits in bands. For example, 30% of the comparison group buys \$5 to \$10 million, 40% buys \$11 to \$50 million, 20% buys \$51 to \$100 million and 10% buys more than \$100 million. It is difficult to see how this data is helpful in determining what limit of liability is appropriate for your specific risk profile.

Our conclusion is that traditional benchmarking is only useful as anecdotal evidence. However, we understand that a decision support system is needed to help in selecting the appropriate limit and retention.

## A BETTER ALTERNATIVE - CCOR<sup>SM</sup> (COMPREHENSIVE COST OF RISK)

Risk financing, like all major decisions involving expenditure of corporate capital, is coming under increasing scrutiny. Supporting decisions on structure, retention levels and limits with subjective judgments, benchmarking and other more qualitative information is increasingly falling short in this area. Willis has developed an approach to meet the new requirements of risk finance decision-making through a proprietary process we refer to as Comprehensive Cost of Risk (CCoR).

In some respects, CCoR analysis is the antithesis of benchmarking, as CCoR's focus is inward in terms of examining the specifics of your risk profile. The starting point is to quantify the risk in the absence of any insurance structure using state-of-the-art actuarial and risk modeling techniques. This produces an uninsured (unhedged) loss distribution curve. Once the uninsured curve is established, our quantitative specialists will overlay different combinations of premium, limit and retention to measure the "economic value" of each insurance program. Value is objectively determined by a metric that captures premium, expected loss and the cost of volatility retained on the risk. This calculation also takes into consideration your company's cost of capital.

Each insurance program that is modeled against the uninsured curve is measured against insurance program options. The program that delivers the highest value in terms of reducing the cost of risk represents the most efficient combination of premium, limit and retention for that risk.

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As with any meaningful business decision, we recommend a multi-pronged approach in your analysis to establish your optimal program structure. CCoR analysis should be combined with other relevant benchmarking data to support the most informed decision possible.

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