



# A SELECTED READING

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## **Risk Management: Avoiding and Reducing Municipal Tort Liability**

### **What is Risk Management?**

Risk management is the identification, analysis and evaluation of potential losses in order to develop methods to reduce or eliminate them. Risks are identified and then steps are taken to avoid them. This may be as simple as continuing to operate as usual or as complicated as restructuring or abolishing an entire department. Employing risk management principles will not always prevent a city or town from being sued or from suffering some other loss, but the resulting financial burdens can often be reduced.

### **Risk Identification**

The first step in the risk management process is to identify all potential losses facing a municipality. Risk identification is an ongoing process that changes with each new situation.

Risk identification, or exposure identification, requires the development of an inventory of all municipal operations, knowledge of the potential liabilities that may be imposed by either statute or common law and knowledge of the worth of all municipal assets and sources of revenue. This step must include an evaluation of all potential events that might adversely affect the finances of a municipality. Contracts should be reviewed thoroughly prior to being signed to ensure the municipality is obtaining the best deal possible. In some cases, risks can be transferred to the contracting party.

Potential losses of income and extra expenses that a municipality might incur are two areas often overlooked in risk identification. These risks must be considered even though they tend to be speculative.

Other areas where risk management principles should be applied include vehicle usage, maintenance of property and facilities, public use of facilities, use of independent contractors and consultants, personnel questions and personal injury and property injury exposure. All municipal activities should be evaluated, and facilities inspected.

Court decisions and legislation affecting municipalities must be reviewed. Insurance and risk management publications should be studied for the latest information on loss avoidance. Attending courses on risk management may also prove beneficial.

The importance of the human element cannot be overemphasized when identifying risks. Ask employees and supervisors for their input, as they are usually in the best position to identify risks. It is also important to communicate with people in other municipalities who are involved in risk management. They may have faced and solved a similar problem in the past.

Obviously, a great amount of guesswork is involved in risk identification and some potential losses may be overlooked. However, by making a conscientious effort, the most common losses can be reduced or perhaps totally avoided.

### **Analysis**

The next step is to calculate the potential severity and frequency of losses facing the municipality in each of the identified risk areas. A review of the past experience of the municipality, as well as statistical information and probability analysis, is necessary. Obviously, the impact of a particular risk on a municipality is difficult to determine. The use of statistics and probability analysis involves guesswork. To determine where a municipality should concentrate its risk management efforts, the risk analysis should be performed carefully. Some risks may involve such a small amount or probability of loss that the municipality will decide to absorb any losses which occur. Or the potential loss may be so large and difficult to avoid that insurance might be the only recourse.

### **Risk Control**

Once the risk areas are identified and analyzed, the next step is to eliminate, reduce or transfer the risk. This process is called risk control. Steps toward risk control are taken prior to suffering a loss, with the primary goal being loss prevention. However, when a loss cannot be prevented, risk control principles may help reduce the financial liability suffered by a municipality.

Elimination of a risk is the most desirable goal. If a municipality discovers a way to eliminate a risk, there is no need to worry about its future effect or to insure against it. But risks cannot always be eliminated. For instance, abolishing the police force will eliminate all loss exposure in that area but in most cases, that action is not desirable. After an analysis, a municipality may decide to stop performing some activities or transfer the risk to a private operator.

If a risk cannot be eliminated, the next choice is to attempt to reduce the risk. Risk reduction primarily involves safety. Some common techniques for reducing risks include adoption of policies for and proper training of personnel, particularly for the police and fire protection services, and proper inspection and maintenance of equipment and facilities. Segregation of equipment may also help avoid the loss of all equipment at one time during a disaster such as a fire at a storage site.

If the risk cannot be eliminated or reduced, two final options are available. First, if the risk is not large, a municipality may decide the best option is to retain the risk and fund it itself. The municipality must be aware of its financial condition, its cash flow and the availability of additional funds before deciding to assume a risk.

Retaining the risk is the appropriate action in many cases. Studies have shown that municipalities retain far fewer risks than they are financially able to. By deciding to retain a risk rather than purchasing insurance, a municipality may save money in the long run. Again, this decision can only be made after the financial condition of the municipality has been analyzed in detail. Second, a municipality may be able to transfer the risk to another party. This does not always mean obtaining insurance. The most common form of risk transference is probably the “hold-harmless agreement,” in which a supplier or contractor agrees in the contract to assume risks for which the municipality would normally be responsible. Of course, the added cost to the supplier or contractor of obtaining insurance or otherwise guarding against loss may be passed on to the municipality. In such cases, a municipality must calculate costs to determine if transferring the risk in this manner is the best option.

In some instances, insurance remains the ultimate solution to a risk management problem. A municipality may want to retain some of the risk of an activity and transfer another part to an insurance carrier.

### **Developing a Risk Management Program**

On a practical level, the first step in developing a municipal risk management plan is to define the scope of the program. This definition should be in writing and should set out the objectives or reasons for establishing the program.

Second, it is important to delineate the responsibilities of all persons involved in the risk management function. All persons engaged in identifying and analyzing the risk and implementing the risk management program should be included in this step. Cooperation is one of the keys to successful risk management.

Third, a municipality must develop a formal risk retention policy. Once the retention limits are established after a thorough survey of the financial strength of the community, the working policy should be drawn up as a formal policy and approved by the city council. A municipality or board may want to form a safety committee which will be responsible for conducting a mandatory safety program for employees. This committee should recommend safety policies to be carried out by administrative personnel and should review all accidents and claims against the municipality. Most accidents and claims usually result from the performance of only a few activities. Concentrated efforts can be devoted to the correction of procedures in these areas, thereby minimizing possible losses. The second principal duty of the committee should be the inspection of municipal procedures and installations, concentrating the search on possible defects which might cause injury and liability. Finally, the committee should confer with insurance carriers and their representatives for the cost of insurance coverage in areas where liability dangers are greatest. Beyond this point, professional input and guidance become necessary. A professional consultant is best suited to help a municipality determine what steps should be taken to protect itself.

### **Assistance through League Affiliated Programs**

The Municipal Workers Compensation Fund was created by the League to provide workers compensation insurance coverage for municipalities and their agencies. For more information, contact Richard Buttenshaw, P.O. Box 1270, Montgomery, AL 36102, or phone 334-262-2566. Web: <http://www.almwcf.org/>.

The Alabama Municipal Insurance Corporation has been formed to provide liability insurance coverage for municipalities and their agencies. For more information, contact Steve Wells, President, 110 North Ripley St., Montgomery, AL 36104, or phone 334-386-3863, or 1-866-239-AMIC (2642). Web: <http://www.amicentral.org/>. Jointly, in connection with the League, these two entities operate a Loss Control program that has successfully helped municipalities in Alabama save millions of dollars by successfully managing their risks. You can learn more about the Loss Control program at <http://www.losscontrol.org/>.

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