RISK

WHAT IS RISK?

- **Risk**, as defined in insurance, is the possibility of a loss.
- The opposite of this definition is that risk is the possibility of no loss.
- Only risk is insurable, but not every risk.
- Only economic loss that can be compensated by the payment of money is insurable, and only if expected losses can be ascertained.
- The profitability of any insurance company depends on how well it can predict losses; thus, assessing risk requires the accurate calculation of the probability of losses.

CATEGORIES OF RISK?

- **There are 3 categories of Risk**:
  - Financial and Non-Financial Risks.
  - Pure and Speculative Risks.
  - Fundamental and Particular Risks.

1(a): FINANCIAL RISKS?

- Financial risks are the risks where the outcome of an event (i.e. event giving birth to a loss) can be measured in monetary terms.

- The losses can be assessed and a proper money value can be given to those losses.

- The common examples are:
  - Theft of a property which may be a motorcycle, motor car, machinery, items of household use or even cash.
  - Loss of profit of a business due to fire damaging the material property.
  - Personal injuries due to industrial, road or other accidents resulting in medical costs, Court awards etc.
  - Death of a breadwinner in a family leading to corresponding financial hardship.

- The losses can be replaced, reinstated or repaired or even a corresponding reasonable financial support (in case of death) can be thought about.

- All such losses are insurable under the category of Financial Risks/losses.

1(b): NON-FINANCIAL RISKS?

- Non-Financial risks are the risks the outcome of which cannot be measured in monetary terms.

- There may be a wrong choice or a wrong decision giving rise to possible discomfort or disliking or embarrassment but not being capable of valuation in money terms.

- The common examples are:
  - Choice of a car, its brand, color etc.
  - Selection of a restaurant menu,
  - Career selection, whether to be a doctor or engineer etc.
  - Choice of bride/bridegroom,
  - Choice of publicity etc.

- Since the outcome cannot be valued in terms of money, we shall call these non-financial risks as uninsurable.

2(a): PURE RISKS?

- **PURE RISKS:**
  - Pure risks are those risks where the outcome shall result into loss only or at best a break-even situation.
  - We cannot think about a gain-gain situation.
  - The result is always unfavorable, or maybe the same situation (as existed before the event) has remained without giving a birth to a profit (or loss).
  - Examples:
    - Cyclone damage possibility to the factory building,
    - Fire damage possibility to stock,
    - Machinery breakdown possibility to Machinery,
    - Theft possibility to removable items,
    - Personal accident possibility of factory workers etc.
  - These are identified as pure risks and as such insurable. Notice that these losses can also be measured in monetary terms.

2(b): SPECULATIVE RISKS?

- **SPECULATIVE RISKS:**
  - Are those risks where there is the possibility of gain or profit. At least the intent is to make a profit and no loss (although loss might ensue).
  - Examples:
    - Investing in shares
    - Pricing,
    - Marketing,
    - Forecasting,
    - Credit Sale etc.
  - the outcome of the trade or business is not the result of pure risks but indeed the result of economic factors, supply & demand, change of fashion, trade restriction or liberalization etc. and for convenience we call them trade risks.
  - These may be identified as speculative risks and usually are not insurable.

3(a): FUNDAMENTAL RISKS?

- **FUNDAMENTAL RISKS:**
  - are the risks mostly emanating from nature. These are the risks which arise from causes that are beyond the control of an individual or group of individuals.

  - The losses arising out of such causes may be catastrophic in dimension and felt by a huge number of populations, the society or by the state although an individual may be a part to that catastrophe.

  - Examples:
    - Flood & Cyclone, Subsidence & landslip,
    - Earthquake & volcanic eruption, Tsunami,
    - Convulsion of nature and other natural disasters,
    - Famine, Draught
    - war, terrorism, riots & other political activities which are neither created by nature nor by an individual but resulting in colossal losses.

3(b): PARTICULAR RISKS?

- **PARTICULAR RISKS:**
  - are risks which usually arise from actions of individuals or even group of individuals.
  - These may be identified as causes arising from personal (or group) behavior and effects (losses)
  - These are mostly man created because of their negligence, error in judgment, carelessness, and disregard for law or respect.
  - Examples:
    - Fire, Explosion,
    - Burglary, housebreaking, larceny, and theft,
    - Stranding, Sinking, Capsizing, Collision in case of a ship, including cargo loss,
    - Machinery breakdown and deterioration of stock due to machinery breakdown,
    - Motor accidents including death and bodily injuries, Industrial accidents,
    - The collapse of bridges, Derailments.
  - Particular risks are insurable risks and most of the insurances relate to these risks.

ELEMENTS OF AN INSURANCE RISK?

- **7 ELEMENTS OF AN INSURANCE RISK ARE:**
  - **Large numbers of exposure units:**
    - prime necessity for a risk to be insurable is that there must be a sufficiently large number of homogeneous exposures in order combine losses that are reasonably predictable.
  - **Define and measurable loss:**
    - the loss should be both determinable and measurable.
  - **Determinable probability distribution:**
    - The probability distribution of happening of an adverse event if determinable. If there is not determinable distribution, there is no question of issuing a cover by an insurance company.
  - **Calculable chance of loss:**
    - the chance of loss should be calculable.
  - **Fortuitous loss:**
    - The adverse event may or may not occur in future and once which the insurance company has not control. Naturally, if the event is non-random or the loss has occurred in the past, there is no question of insurance.
  - **Non-catastrophic loss:**
    - This means that a large proportion of exposure units should not incur losses at the same time.
  - **Premium should be economically feasible:**
    - the premium should be economically feasible. The insured must be able to pay the premium.

POOLING OF RISKS?

- In insurance, the term "risk pooling" refers to the spreading of financial risks evenly among a large number of contributors to the program.

- Insurance is the transference of risks from individuals or corporations who cannot bear a possible unplanned financial catastrophe to the capital markets, which can bear them easily.

- The capital markets, meanwhile, are generally happy to take on risk from individuals and corporations – in exchange for a premium they believe is sufficient to cover the risk.