

Risk Management



CHOOSING INSURANCE

RISK MANAGEMENT

Choosing Insurance



Believing in "Murphy's Law": "Whatever can possibly go wrong will," is the first step in determining risk.

A person has four choices when dealing with risk:

1. Accept the risk.
2. Avoid the risk.
3. Reduce the risk.
4. Transfer the risk.

ACCEPTING THE RISK

Accepting the risk is of course the most economical course as it involves doing nothing. That is the way you usually accept risks with very long odds and against which you feel powerless at any rate, such as nuclear war or chances of a meteor striking you or your property.

AVOIDING THE RISK

You choose to avoid the risk when you sell a property at a discount with no guarantees ("AS IS"), or a broker decides to have no salesmen because he does not want to be responsible for their actions, or a family decides against keeping a dog because of the possible harm it may cause to other people or their property, or one decides to take public transportation rather than drive to work to avoid freeway accidents.

TRANSFERRING RISK

Transferring risk is the topic of our discussion. Transferring risk to a third party who agrees to take the risk from your shoulders in return for the payment of a certain sum of money, is what insurance is all about.

YOU AND YOUR POLICIES

Who reads an insurance policy? If I asked you what your limits of coverage are on your medical,

health, homeowners or auto insurance could you tell me? Most of you are familiar with your deductibles. (The amount you yourself must pay before the insurance company pitches in.) Do you know what your health insurance elimination period is? (The time between the actual occurrence of the injury and the insurer's coverage actually takes effect.) Do you know you are covered by your own uninsured motorists provision of your automobile policy if you are a victim of a hit and run accident?

If your attitude is, "I leave that all to my insurance agent- we're friends, he's a good guy and I trust him," you are not alone and pardon me for saying so but you are a fool!

INSURANCE IS YOUR RESPONSIBILITY

It is not my intent to cast dispersion on insurance salesmen. The great majority of them are conscientious, do a good job and are indeed your "friend," a "good guy" and "honest"; that is not the point. You are a fool if you do not thoroughly investigate something which can play such a major role in your life plans. As well meaning as your professional may be, he is being pressured from several sides by his need to rise within his company, the economic needs of his family, the needs of many other clients to keep track of as well as his desire to give you quality service. As good as he may be no one knows your particular situation like you do.

HOW DO YOU CHOOSE YOUR AGENT

Choosing an insurance agent is much like choosing your other professionals, such as accountants, doctors, and lawyers. Initial contacts usually come about through referrals from friends or business associates. Service, conscientiousness and promptness are what you are looking for in an agent. You will also want a person you can feel comfortable with and whose personality is compatible with yours. Since you will be turning to him in times of trouble and emergency, you want a reassuring person who you can trust and confide in. In your agent has a designation such as a CLU (Chartered Life Underwriter), CPCU (Chartered Property Casual Underwriter), or CFP (Certified Financial Planner) it shows a commitment to his profession and a better than average degree of knowledge in his field. Although there are of course many competent and knowledgeable agents without any of these designations it should be noted that these titles are not given lightly and may take years to achieve by passing examinations on insurance, taxes and other related fields.

WHAT RISKS TO INSURE AGAINST AND FOR HOW MUCH

All risks should not be insured against; it would be too costly. The risks that could potentially destroy your net worth are the ones to consider first.* It's not how often something occurs that one needs to be concerned about (for instance fender-benders to the automobile) but how large the damage could conceivably be (million dollar suit for personal injury payable to the other driver involved in the fender-bender).

A rule of thumb in determining whether to insure or retain the responsibility for paying potential losses in a given area, is to check out the relationship the potential claim bears to your family's current net worth. This would of course change over time. The larger your estate becomes the more important it is to have adequate liability coverage. Courts frequently award million dollar

damages to plaintiffs nowadays.

People with limited incomes must choose their insurance wisely in order to cover the premiums (cost of coverage). For example, they may not be able to afford insurance on their house, the other fellow's automobile as well as their own and have complete health care coverage also. Since very often such a family's net worth is attributable mainly to their home, they dare not skimp on fire coverage so they may choose to absorb some medical expenses or damages to their own automobile. However, they should always make sure damage to the other fellow's car will be adequately covered so his attorney will not come against their home and other assets.

SUMMARY

Risk can be handled by acceptance (use when either threatened damages or likelihood of occurrence is slight), avoidance (refrain from certain actions or control over certain things), reduction (cultivate careful habits), or transference (the insurance company assumes your liability for a price). It's your responsibility to analyze your priorities and determine the coverage you need and can afford. It is foolish to leave these decisions entirely to your agent's discretion. Insure against losses that could wipe out your net worth rather than against those events that occur frequently but whose cost you can absorb without risking everything.

Fill out the form following this chapter to determine your net worth. Use a separate notebook so you will have everything in one place as suggested in Section One. The recommended reading list follows the worksheet.

*** Your net worth consists of your assets, everything you own-- minus your liabilities which is all your debt.**

Worksheet

FORM TO DETERMINE NET WORTH AS OF (DATE)_____

ASSETS

Liquid Assets

Cash and Checking _____

Savings accounts _____

Money markets _____

Life insurance-cash value _____

U.S. savings bonds _____

Brokerage accounts _____

Other _____

Total Liquid Assets _____

Marketable Invested Assets

Common stocks _____

Mutual Funds _____

Corporate bonds _____

Municipal bonds _____

Certificates of deposit _____

Other _____

Total Marketable Invested Assets _____

Nonmarketable Invested Assets

Business interests _____

Investment real estate _____

Pension accounts _____

Thrift plan accounts _____

Preferred stocks _____

Other _____

Total Nonmarketable Invested Assets _____

Use Assets (use fair market value)

Residence _____

Vacation home _____

Automobile _____

Boat _____

Furs, jewelry _____

Furniture _____

Other personal property _____

Total Use Assets _____

LIABILITIES

Current Liabilities

Charge accounts/credit cards _____

Other outstanding bills _____

Short term loans _____

Outstanding taxes _____

Total Current Liabilities _____

Long Term Liabilities

Mortgage on residence _____

Mortgage on investment real estate _____

Auto loans _____

Other bank loans _____

Margin loans _____

Life insurance policy loans _____

Other _____

Total Long Term Liabilities _____

Family Net Worth

(subtract liabilities from assets) _____

Some Interesting Web Sites and Books

The Psychology of Risk Taking <http://www.risktaking.co.uk/>

Social Contexts and Responses to Risk <http://www.kent.ac.uk/scarr/>

Decision- Analysis Society <http://decision-analysis.society.informs.org/>

Defining Risk by Glyn A. Holton <http://www.riskexpertise.com/papers/risk.pdf>

Best's Insurance Ratings, by A.M. Best Co. <http://www3.ambest.com/ratings/advanced.asp>

Get Health, Home, Life and Auto Insurance Quotes and Helpful Information

<http://www.insurance.com/auto.aspx>

The Essentials of Risk Management by Dan Galai, Robert Mark, and Michel Crouhy

Principles of Risk Management and Insurance, by George Rejda