PERILS

- Any event or incident that cause a loss is called as 'Peril'.
- Peril is the cause of loss.
- Anything that causes loss is peril.
- Perils differ according to frequency and intensity.
- Examples – Fire, Flood, Landslide, Accident, lightning, earthquake.

Insurance

Does not protect the asset

Does not prevent loss due to peril

Peril cannot be avoided through insurance

Cannot compensate non-economic losses

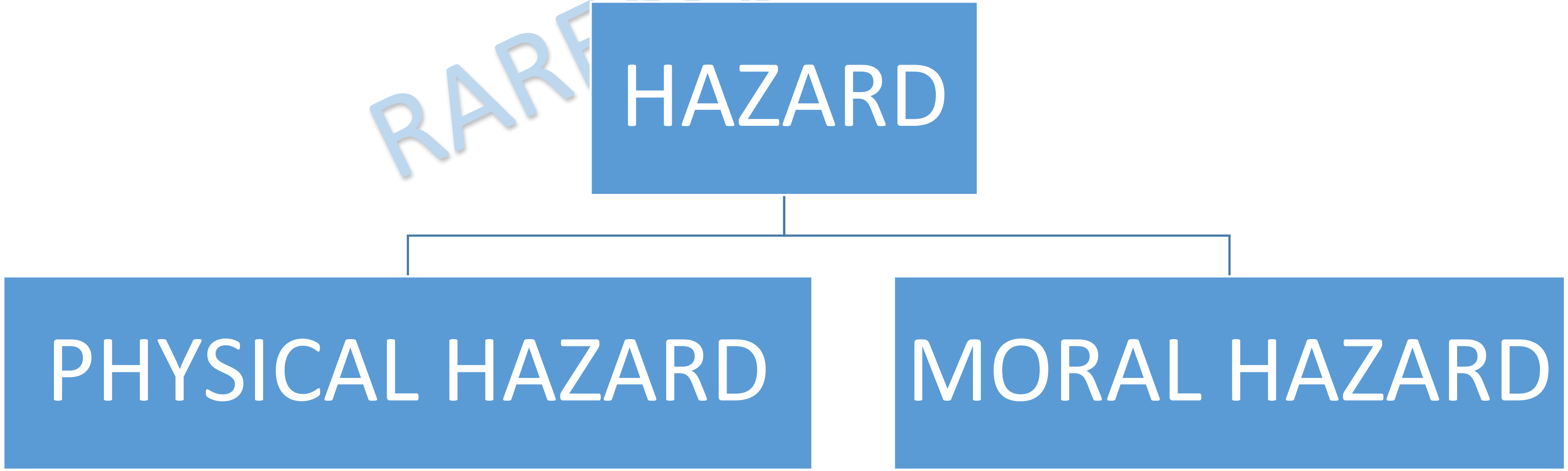
RISKS

- Risk is uncertainty of outcome.
- Risk exists where there is a chance that outcome will be different from expectations.

HAZARDS

- Hazard is a condition that increases the chances of loss.
- Hazard catalyses or accelerates or enhances the peril

TYPES OF HAZARDS



PHYSICAL HAZARD

- Physical Hazard refers to the qualities and characteristics of the subject matter of insurance.
- Physical hazards consists of physical conditions or physical attributes that affect the risk.
- Examples
  - Smoking (increase the likelihood of fire)
  - Loose wiring (may result in shocks or short circuits)
  - Buildings at seashore (tidal waves), river banks (floods)
  - Storing inflammable material (increase the chances of fire)
  - History of diseases (increases chances of ill-health or death)

Physical hazards can be managed through risk management tools, exclusions to the policy etc.

MORAL HAZARD

- Moral Hazard refers to the character of the person approaching the insurer for insurance.
- Moral hazards consists of malafide intentions, intention to make profit out of insurance etc.
- Acts of dishonesty are also called as Moral hazards
- Carelessness, negligence, fraudulent claims, inflated claims
- Examples
  - Suppressing existing diseases while approaching for life insurance
  - Non-disclosure of material facts at the time of proposal

  Moral Hazards, if detected, can be eliminated by rejecting the policy proposal / claim.

LAW OF LARGE NUMBERS

- Insurance is known as Law of Large Numbers
- Premium collected from large number of group members can be paid for the financial loss suffered by small number of affected members.
- A large and uncertain loss to few members of homogenous group is compensated by paying a small amount called premium.
- Risk is spread among large group of members.
- Law of Large Numbers helps insurance companies in charging premium before occurrence of the risk.
- Stable premium for insurance company
- Avoid credit risks to insurer

ADVERSE SELECTION

- Adverse Selection is a situation where sellers do not have information which buyer are having or vice versa.
- Existing risks not factored in at the time of sale of policy.
- Deliberately hiding material facts
- People at higher risk of death are buying life insurance
- Insurance company charges average premium and end up paying maximum claims
- Reasons for Adverse Selection are asymmetries in information and difficulties in selection of customers.
- Due diligence in underwriting decisions, proposal forms, assessment of proposal will help in reducing Adverse Selection.

ADVERSE SELECTION - CONSEQUENCES

- Higher overall price for policies
- Incentivise high risk customers at the same time disincentivise low risk customers
- Delay in underwriting decisions

- Examples – Persons with smoking habits, pre-existing diseases, high risk category jobs, material characteristics etc.
- Adverse Selection is high in Health Insurance

Adverse Selection is different from Moral Hazard.

HOW ?

INSURABLE RISK

- Insurable Risk is a risk that meets the criteria, conforms to and fulfilling the norms and specifications of the insurance policy.
- Insurable risks have previous statistics which form the basis for charging of premium.
- These risks can be measured and forecasted.
- Prospect of loss only.

ELEMENTS OF INSURABLE RISKS

- The loss must be random / by chance (Fortuitous Loss)
- The loss must be definite & measurable (Define & Measurable loss)
- The loss must be predictable.
- The loss can not be catastrophic (Non Catastrophic Loss)
- The loss exposures must be large.
- Determinable Probability Distribution
- Economically feasible premium

TYPES OF RISKS & THEIR INSURABILITY

TYPE OF RISK	INSURABLE RISK	NON INSURABLE RISK
CATASTROPHIC RISK		
IMPORTANT RISK OR SPECIFIC RISKS		
FINANCIAL RISKS		
NON-FINANCIAL RISKS		
DYNAMIC RISKS		
STATIC RISKS		
PURE RISKS		
SPECULATIVE RISKS		
FUNDAMENTAL RISKS		
PARTICULAR RISKS		

EXAMPLES OF INSURABLE RISKS

- Accidental damage of motor vehicles
- Fire accidents in warehouses, factories
- Floods in shops

EXAMPLES OF NON-INSURABLE RISKS

- Acts of God
- Earthquakes, Hurricanes
- Launching new product
- Fall in Demand
- Gambling, Investments, Share market
- Change in lifestyles, fashions
- Change in Regulations / Laws

INSURABLE OR NON-INSURABLE RISKS

HOW THE FOLLOWING RISKS WILL BE INSURED ?

LIFE INSURANCE

HEALTH INSURANCE

PERSONAL ACCIDENT INSURANCE

EARTHQUAKES, FLOODS

LIABILITY INSURANCE

SELF-INSURANCE

- Individual or company acting as Insurance company to cover its own risks.
- Predict the probability and severity of loss
- Estimate the possible loss with accuracy
- Set up a fund for future possible losses

SELF-INSURANCE - PROS

- Avoid payment of Premium
- Amount in established fund can be invested
- Investment Returns
- Option to liquidate the fund / investments when purpose is met / no longer required
- Customisation of Insurance needs as per own requirement

SELF-INSURANCE - CONS

- Exposure to catastrophic risks
- Inaccurate estimations / projections / provisions
- Tax implications
- Insufficient fund value at the time of need
- Expertise in handling various issues
- Possibility of diversion of funds at times