RISKS

- Risk is uncertainty of outcome.
- Risk exists where there is a chance that outcome will be different from expectations.
- Risk might involve the loss, theft, damage or injury
- The frequency and severity of risk determine the premium amount

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TYPES OF RISKS

INSURABLE	NON-INSURABLE
• SPECIFIC/IMPORTANT	• CATASTROPHIC
• FINANCIAL	• NON-FINANCIAL
• DYNAMIC	• STATIC
• PURE	• SPECULATIVE
• PARTICULAR	• FUNDAMENTAL

TYPES OF PURE RISKS

PERSONAL

- Directly affect individual capability to earn income
- It involves reduction of earning income, extra income, depletion of financial assets

PROPERTY

- Risks to the persons in possession of the property being damaged or lost or stolen

LIABILITY

- Risks arising out of intentional or unintentional injury or damage to others assets through negligence or carelessness
- Liability risks generally arises from the law

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CLASSIFICATION OF PERSONAL RISKS

- PREMATURE DEATH
- OLD AGE (INSUFFICIENT INCOME AFTER RETIREMENT)
- DISABILITY OR SICKNESS
- UNEMPLOYMENT

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POOLING OF RISK

- Risk pooling refers to spreading of risks (financial risks) evenly among a large number of contributors who are exposed to similar risks.
- Risk pooling brings large number of people together to minimise the cost impact on high risk individuals.
- Some individuals who are low-risk prone also buy insurance
- Risk pooling combines high risk and low risk to reduce the burden on high risk individuals at the same time low risk individuals are also equally covered
- Low risk people buy insurance because it costs less than paying from own funds if the risk materialises into loss.

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POOLING OF RISK

- Large insurance pools lead to lower in costs to both individuals and insurance companies.
- Few insurance pools are created by law (Motor Insurance)
- Lower risk pools may lead to insolvency of insurer or very high premium rates.
- Through pooling of risks (losses), the AVERAGE LOSS is substituted for ACTUAL LOSS.
- Primary purpose of Pooling is to reduce the variation in possible outcomes (S.D. σ)

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RISK HANDLING METHODS

- Risk Avoidance – steering clear of risk
- Risk Reduction – minimise the loss exposure to risk
- Risk Sharing – insurance with deductibles
- Risk Transfer – through insurance
- Risk Retention – self-insurance, high deductibles, Captive Insurance

There is no single fit-for-all method for all types of risks in all situations.

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INSURANCE VS HEDGING

- Insurance is to indemnify the loss whereas Hedging is to ensure there is no loss.
- Insurance transfers the risk whereas Hedging Off-sets the risk.
- Hedging eliminate the risk of loss by giving up potential for gain whereas Insurance eliminate the risk of loss but retain the potential for gain.
- Insurance is for the assets already existing but Hedging is against the receivables to be realised / received in future.
- Insurance is meant for risk reduction but Hedging only transfers the risk.

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RISK HANDLING – ROLE OF INSURANCE

- Loss minimisation
- Risk transfer
- Capital Protection
- Business Continuity
- Reduce uncertainty
- Expand business
- Explore new markets / products

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ROLE OF INSURANCE -ADVANTAGES

- Indemnification – Loss of the insured are indemnified
- Continuity – Continuity of business / operations are assured
- Reduction of uncertainty – Risk is transferred to the maximum extent, uncertainty is reduced
- Business Development – Long term planning is possible. Business can assume more risks.

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ROLE OF INSURANCE - DISADVNATAGES

- Less Incentive for Loss Control – Premium paid is non-refundable on expiry of policy period.
- Limited coverage – Insurance does not cover all financial risks
- Change in Attitude – Lax attitude towards insured assets have impact on non-insured assets

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REINSURANCE

- Reinsurance is insuring the insurer
- Reinsurance is risk management tool for insurance company
- Cede – To pass on to another insurer (reinsurer) all or part of the insurance written by insurer (insurance company)
- Ceding Company – Reinsurer
- Ceded Company – Insurance company
- Cession – The unit of insurance passed to a reinsurer
- Retrocession – Reinsurer cedes to another reinsurer
- Retrocedent – The ceding reinsurer in a retrocession
- Retrocessionnaire – Assuming reinsurer in a retrocession

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FACTORS AFFECTING REINSURANCE

- Original Risk (Risk emanating from the insured)
- Risks emanating from the Insurer or Reinsurer
- Risks beyond the control of Contractual Parties
- Risks inherent to reinsurance
- Uberrima Fides (Utmost Good Faith)

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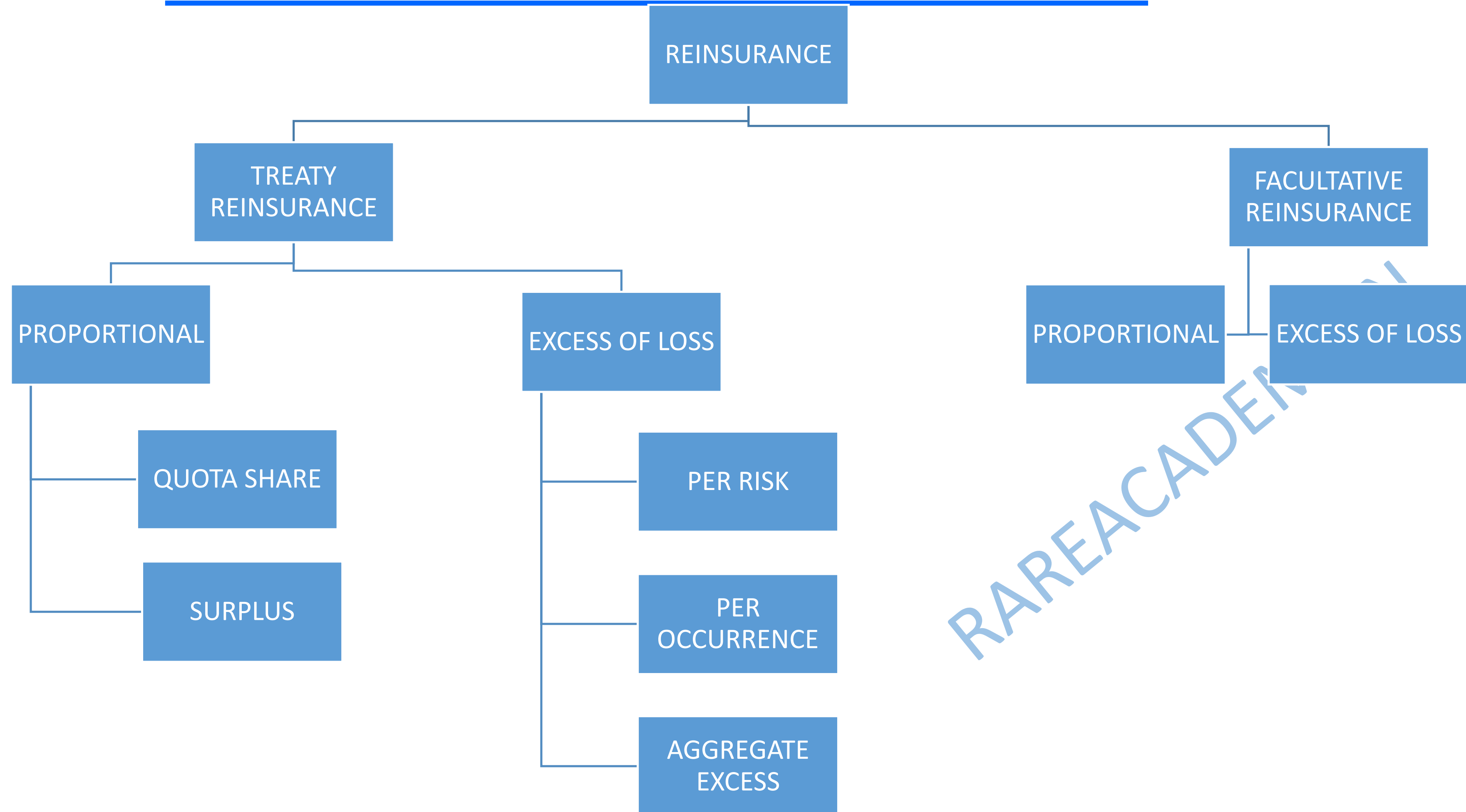
FORMS OF REINSURANCE



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FORMS OF REINSURANCE

- Treaty Reinsurance – Agreement between original insurer an reinsurer where reinsurer automatically accepts a certain liability for all risks falling within the scope of agreement.
- Facultative Reinsurance – Insurance company offers to Reinsurer on transaction basis or risk basis.

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METHODS OF REINSURANCE

PROPORTIONAL	NON-PROPORTIONAL
• SURPLUS • QUOTA SHARE	• EXCESS OF LOSS

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ADVANTAGES OF REINSURANCE

- More capacity to accept insurance
- Stabilisation of premium and losses
- Wide distribution of incidence of loss
- Accumulation of claims under different classes
- Financial stability
- Flexibility to accept untested risk exposures
- Experience and expertise of Reinsurer

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