

Introduction to Risk Management and Insurance

Sarayut Nathaphan

Agenda

- Meaning of Risk
- Chance of Loss
- Peril and Hazard
- Categories of Risk

Meaning of Risk

Definition of Risk

1. Occurrence of a loss
2. Deviation of the actual outcomes and the expected value

Type of Risk

1. Objective Risk or Degree of Risk: magnitude or size of actual loss compared with expected loss.
2. Subjective Risk: being conservative (prudent behavior) due to high subjective risk or less conservative due to low subjective risk

Chance of Loss

Risk and chance of loss have a very close meaning

1. Objective Probability: long-run relative frequency of an event based on the assumptions of an infinite number of observations and of no change in the underlying assumptions.
2. Subjective Probability: individual's perception in estimating chance of loss, i.e., lottery ticket or slot machine

Difference between Chance of Loss and Risk

Chance of Loss is the probability that an event that causes loss will occur.

“The chance of loss may be identical for two different groups, but objective risk may be quite different”

Ex: Assume that a property insurer has 10,000 homes insured in Rangsit area and 10,000 homes insured in Thaprachan area and that the chance of a fire in each area is 1%.

If the variation of losses ranges from 75 to 125 in Thaprachan, but only 90 to 110 in Rangsit, objective risk is greater in Thaprachan.

Peril and Hazard

Peril is defined as the cause of loss.

Hazard is a condition that creates or increases the chance of loss.

There are four types of Harzards.

1. Physical hazard
2. Moral hazard
3. Morale hazard
4. Legal hazard

1. Physical hazard is a condition that increases the chance of loss.

Ex: icy roads increases chance of auto accident.

2. Moral hazard is dishonesty or character defects in an individual that increase the frequency of severity.

Ex: Faking an accident to collect from an insurer

3. Morale hazard is carelessness or indifference to a loss because of the existence of insurance.

Ex: Leaving a car key in an unlocked car which increases the chance of theft

4. Legal hazard refers to characteristics of the legal system or regulatory environment that increase the frequency or severity of losses.

Categories of Risk

Pure and speculative risk

Fundamental risk and particular risk

Enterprise Risk