

## INTRODUCTION TO RISK MANAGEMENT (50-1)

EO 1. **RISK MANAGEMENT TERMS AND CONCEPTS** are defined and/or explained in context throughout The Burnham System. So you can find them easily, they are both **bolded and underlined** and **CAPITALIZED** too if they're used in an educational objective. And, as a bonus, they are given separately at the end of your study material, assignment by assignment.

**Risk management** manages **risk** (uncertainty about the occurrence of loss) by minimizing the negative effects of accidental loss.

Traditionally, risk management dealt only with **pure risks** (events that result in loss or in no loss), but the newer, broader view includes **speculative risks** (events that result in loss, in no loss, or in gain).

A **loss** occurs when one's property or rights lose value or when one's ability to perform is reduced.

**Loss frequency** (measures how often losses occur) is used to predict the likelihood of similar losses in the future.

**Loss severity** (measures the size of losses in dollar terms) is used to predict the possible or probable cost of future losses.

**Total expected loss** (equals average loss frequency times average loss severity) is used to set self-funded reserves or to estimate premium loss costs.

EO 2. A **LOSS EXPOSURE** is the possibility of accidental loss with measurable financial consequences.

### **The three elements of a loss exposure:**

1. **the value exposed to loss--the subject matter that can be lost**--real or personal property, money or property, life or health, net income and continuing expenses.
2. **the peril--the cause of loss**--fire and theft, negligence and defense, death and disability, prior direct damage loss.
3. **the financial consequence--how much value can be lost**--as a result of the peril acting on the subject.

### **THE FOUR TYPES OF LOSS EXPOSURES:**

1. **Property loss**--involves damage to something owned: *either*
  - a. **real property** (land, building, and other structures attached to land--what you'd leave behind if you moved) *or*
  - b. **personal property** (owned property other than real property--what you'd take with you if you moved).
2. **Liability loss**--involves being sued for an alleged wrongdoing that injured another or damaged his property.
3. **Personnel loss**--involves the death, disability, or injury of one's self or of an employee.
4. **Net income loss**--involves
  - a. a reduction in revenue *and/or*
  - b. an increase in expensesthat reduces **net income** (revenues minus expenses in a given accounting period).

EO 3. **THE BENEFITS OF RISK MANAGEMENT**--

Risk management (**RM**) prevents or reduces losses and finds ways to pay for those losses that do occur. RM reduces both anxiety and the financial consequences of losses for both individuals and organizations. Society saves resources that would have been lost in accidents or used to recover from accidents. Risk management allocates capital to more productive uses.