Standard 11: **The student will describe and explain how various types of insurance can be used to manage risk.**

Identifying Risk

Priority Academic Student Skills
Personal Financial Literacy

Objective 11.1: Identify common risks to life and property (e.g., illness, death, natural catastrophe, and accident).

Objective 11.2: Explain the purpose and importance of insurance protection as a risk management strategy (e.g., life, health, property, liability, disability, and automobile).

Suppose you overhear this conversation between Steven and George in the hallway:

"George, what is hot for the holidays?"

"Ah, man, we are headed to the mountains to go skiing. Do you want to go? There are still seats on the bus, Steven."

"Not me, George. That is too high risk for me. I would probably break a leg or bust my head on a tree. I am staying here to ride my new 'cycle. Mom and Dad said with gas prices so high, it was okay for me to buy one."

"Steven, my friend, why are you worried about risky behavior on skis when you are riding a bike? That seems crazy to me."

What do you think? Are George and Steven both taking a risk?

If so, what can they do to lower their risks?

Lesson Objectives

⇒ Identify possible risks.
⇒ Explain strategies for handling risk.
⇒ Recognize the role of risk.
⇒ Explain how insurance transfers risk to a third party.

Personal Financial Literacy Vocabulary

Risk: A measure of the uncertainty of an investment's rate of return; possible losses involving income or standard of living; the possibility of a loss from peril to people or property covered by insurance.

Introduction

Life is about risk. Individuals face some type of risk in everything they do and every decision they make. In most cases, we try to minimize the impact of risk by having insurance or other types of protection from loss. Or, we may look for ways to avoid risk by taking steps to prevent it. Finding a way to manage our risk will help protect our financial assets today and in the future.

Lesson

Suppose you are riding in your friend's car. As she approaches the intersection, the light turns yellow, signaling that the light will soon change to red. Instead of slowing down to stop, your friend speeds up to "get through the light before it turns red."

Your friend's behavior is an example of taking a risk. As a result of her actions, you have also been exposed to risk. What is **risk**? It is defined as the likelihood of loss or profit, either from an investment or from some threat to your well-being. Running a red light puts you and your friend at risk of having an accident that would cause injury to you, your friend, anyone else in the car, and anyone who happens to be in other vehicles involved in the accident.

PRESENTATION

The slide presentation for this lesson outlines the content in this section. You may want to use it with your students, or print off the slides to use as lecture notes.

Interestingly, our ability to tolerate risk varies from person to person. What seems like "high risk" to one person may seem to be perfectly acceptable behavior to someone else. Because of differences in perception, it is sometimes difficult to accurately label activities or behaviors as always this or that.

Most people would agree that running a red light is a high-risk activity. High risk means that you are really pushing the limits on what is safe. Putting yourself and others in any situation where it is ***probable*** that someone will be harmed is high risk. While high-risk behaviors may seem exciting and challenging or provide a rush of adrenaline, they also tend to be dangerous. Making a habit of high-risk behavior will eventually catch up with you and may wreck your financial goals.

Risk is based on uncertainty. It involves a loss, a catastrophe, or some other undesirable or negative outcome. Sometimes it is possible to control risk, and other times it is not. Even so, your behavior can frequently increase or decrease the potential of those undesirable or negative outcomes. In the example above, your friend is taking a big risk running red lights, and that kind of behavior greatly increases the potential for something negative to happen. At the same time, driving carefully may not eliminate all risk, but it does reduce it.

Following are three examples explaining potential sources of risk.

- If you drink and drive, you are responsible for the choice you make and for the risk you take.
- If you happen to be in the car with a friend who runs a red light, you are subject to risk because of your friend's actions.
- If your house gets hit by a tornado or your car gets damaged by half-inch hail, your loss is a result of circumstances beyond your control.

Managing Risk

Risk comes from many different sources, and it is in everything we do. Because you live with risk every day, learning how to manage it will help you reach your personal and financial goals. The purpose of learning to manage risk is to help you identify and evaluate situations where you may have a loss, and then make a plan for dealing with the loss. Your goal is to minimize risk and your loss. For example, if your car is stolen or involved in an accident, you want to either get it repaired or to get another vehicle. Imagine trying to make the payments on a car that has been stolen when you are trying to buy another one!

Congratulations! You are correct if you said that both George and Steven are taking a risk. Most things in life do involve some type of risk, but some behaviors are higher risk than others.

From listening in on their conversation, they have different criteria for "risky" behavior.

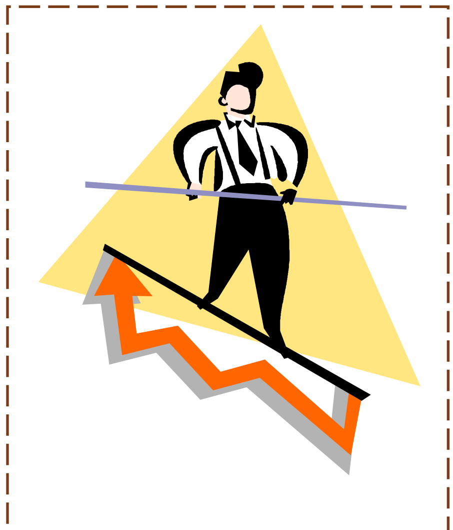
If George wants to reduce his potential for risk, he can take lessons before getting on the slopes, wear a helmet to protect his head in case of a fall or collision with a tree, and be aware of any changes in the weather.

Steven can wear protective gear (such as a helmet) to protect himself in case of an accident, ride according to his level of skill, and obey the speed limits.

Some of the risk management tools you can use include avoiding it, reducing it, accepting it, or transferring it to someone else. Here is a brief description of these tools:

- ***Avoiding risk*** means that you choose not to act on a behavior you know is risky. For example, if you have never owned a business and know nothing about running one, you can avoid the risk associated with owning a business by working for someone else. Unfortunately, avoiding risk is not always the best answer because all choices have costs. If you decide it is too risky to own a business, you could miss out on the profits and satisfaction of being a successful business person. Deciding against opening a business to avoid the risk of loss also avoids the possibility of earning profits. Your friend could choose not to drive, or you could choose not to ride with her to avoid risk.

- ***Reducing risk*** lowers the severity of loss or likelihood of loss occurring. Installing smoke detectors in your home or school reduces the risk of fire damage. Your friend could have reduced their risk and yours by stopping at the intersection.



- ***Accepting risk*** of loss, or choosing to self insure, is a viable strategy for small risks where the cost of insuring against the risk would be greater over time than the total losses sustained. All risks that are not avoided or transferred are retained by default. If your friend's car manual recommends changing the oil every 5,000 miles, she waits to have the oil changed at 5,200 miles it is a small risk that will most likely not cause severe loss.

- ***Transferring risk*** is most often achieved by buying insurance. In other words, the insurance policy you purchase by paying a premium protects you from catastrophic loss and describes the risk the insurance company is covering. Your friend is required by law to purchase insurance on her car. Even if it was not required, it is still a smart investment. If your friend continues to take risks by running yellow lights, your friend will definitely increase the possibility of having an accident or filing a claim with the insurance company.

If you are like most people, you will rely heavily on insurance when putting together a risk management plan. The idea of transferring risk to a third party (an insurance company) reduces your "out of pocket" financial responsibility and your potential losses. Estimating the impact of a potential loss on your budget will help determine the kinds of insurance you need to purchase.

In the table below, write down one behavior you consider a risk. Then, identify one way to do each of the following: avoid the risk, reduce the risk, accept the risk, and transfer the risk.

A Risky Behavior	
A way to avoid the risk	
A way to reduce the risk	
A way to accept the risk	
A way to transfer the risk	

Explain three things you have learned in this lesson.
1.

2.

3.

How has this lesson changed your perspective of "risk?"

Conclusion

Because risk is a part of life, developing a risk management plan to minimize the potential loss will help you reach your financial goals. A good risk management plan has two requirements. First, be aware of what risk problems you are going to face. Second, gather the information you need to manage the potential risk. After taking these two steps, you are ready to make informed choices about your insurance needs. Remember to use the PACED Decision-Making Model!

Name: ___________________________ Class Period: __________________________

Identifying Risk
Review Lesson 11.1

Answer the following questions and give the completed lesson to your teacher to review.

1. Which one of the following statements best describes risk?

   a. The potential of having a financial loss.
   b. The potential you will make a bad choice.
   c. The losses you have from negative outcomes.
   d. The negative results of bad choices.

2. Developing a risk management plan involves

   a. buying insurance to cover all potential losses.
   b. identifying and evaluating all potential losses.
   c. finding ways to avoid losses from risky behavior.
   d. eliminating risk from your daily activities.

3. Buying insurance would be classified as a way to ____________ risk.

   a. avoid
   b. minimize
   c. transfer
   d. accept

4. Which of the following statements is <u>TRUE</u>?

   a. It is impossible to reduce your risk.
   b. You can reduce your risk but not eliminate it.
   c. Your behavior has no impact on your level of risk.
   d. You can control all risk factors.