



Identifying Risk

Standard 11

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

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

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

“Hey, George, what’s up for spring break?”

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

“Not 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 finally said I could buy one.”

“Steven, my friend, why are you worried skiing when you are riding a bike? That seems crazy to me. Both have risk...but at least skiing is fun and not around here.”

Is George right? Are both skiing and riding a motorcycle “risky”? If so, what can they do to reduce their risk?

Lesson

Life is about learning how to manage risk. Do you realize you face some type of risk in everything you do and every decision you make? While you probably have not thought about it, you take steps every day to try to minimize the impact of risky behaviors by looking for ways to avoid it or reduce the potential for it. In a financial sense, insurance is a tool you can use to help offset risk and protect your assets, today and in the future.

What is risk? It is defined as the likelihood of loss or gain, either from an investment or from some threat to your well-being. Running a red light while driving or texting while driving puts you at risk of having an accident that would cause injury to you, anyone else in your car, and anyone in other vehicles involved in the accident.

The ability to tolerate risk varies from person to person. What seems like “high risk” to you may seem to be perfectly acceptable to someone else. These differences in perception often make it difficult to accurately label activities or behaviors as high risk or low risk. However, most people can agree that running a red light or being distracted with your cell phone while driving is high risk, which is the reason both are against the law.

High risk means you are 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 for some, they also tend to be dangerous for everyone

involved. Making a habit of participating in high-risk behaviors will eventually catch up with you and may wreck your financial future.

The concept of risk is based on uncertainty, and 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. For example, you are taking on much higher risk by running red lights or texting while driving, which greatly increase the potential for a something negative to happen while you are driving. Obviously, being a careful, law-abiding driver does not eliminate all risks associated with driving a car, it does reduce the probability of an accident or other bad result.

Not all risk is under your control. 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. This risk is one that you, and only you, can control.
- 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. This risk is one that you may not be able to control initially, but you can take steps to control it in the future.
- If your house gets hit by a tornado, your loss is a result of circumstances beyond your control.

REMINDER

Making a habit of participating in high-risk behaviors will eventually catch up with you and may wreck your financial future.

Managing Risk

Because you live with risk every day, learning how to manage it can be a valuable tool in reaching your personal and financial goals by helping you identify the potential sources and evaluate potential situations. In addition, managing risk helps you have a plan for dealing with any potential losses and minimize its impact.

Taking steps to manage your risk includes finding ways to avoid it, reduce it, accept it, or transfer it to someone else. Following is a brief description of each of these strategies:

- Avoiding risk means that you choose not to act in ways that you know are 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. 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. Or, choosing not to get a driver's license to avoid the risk of driving reduces your independence and makes you more reliable on others for transportation.

- Reducing risk lowers the severity of loss or the likelihood of suffering a loss. Installing smoke detectors in your home or at school reduces the risk of fire damage, much like stopping for red lights reduces the risk of causing an accident. Reducing risk often involves taking responsibility for your own behavior and thinking of the potential impact your behavior can have on others.
- Transferring risk general involves buying insurance. The insurance policy you purchase describes the risk the insurance company is covering and requires them to help pay for any damages you suffer. For example, state law requires you have insurance on your vehicle to protect others involved in an accident you cause. But, even if it insurance was not required, it is still a smart investment because you are paying the insurance company to protect you from a financial loss.
- Accepting risk (sometimes called self insurance) of loss is a viable strategy for small risks where the cost of insuring against the risk is greater than the potential total losses. Any risk that is not avoided or transferred automatically becomes an accepted risk. For example, if your car manual recommends an oil change every 5,000 miles and you wait until 5,500 miles, you are accepting the risk of waiting; however, it is a very low risk and not likely to cause damage to your vehicle. However, if you wait 10,000 miles, you have still accepted the risk but may have other costs for engine repairs.

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 may want 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.

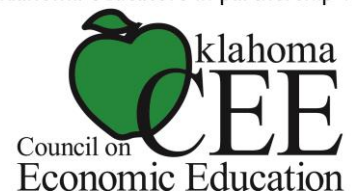
Conclusion

Because risk is a part of life, developing a risk management plan to minimize the potential loss it can cause. A good risk management plan has two requirements. First is being aware of what risk problems you are going to face. Second is gathering the information needed to manage your potential risks. After taking these two steps, you are ready to make informed choices about your needs, including deciding what types of insurance is necessary to help protect your financial future.

FINAL NOTE: If you said that both George and Steven are taking a risk, you are correct. Most things in life do involve some type of risk, but some behaviors are higher risk than others. Based on their conversation, it seems they have different criteria for determining “risky” behavior.

If George wants to reduce his potential 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. By taking steps to reduce their risk, they can increase the probability of enjoying their favorite past-times without having an accident. Of course, there are no guarantees!

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Name: _____ Class Period: _____

Identifying Risk Review 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 TRUE?
 - 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.

Name: _____ Class Period: _____

Risky Behavior Activity Lesson 11.1

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

A Risky Behavior	
A way to <u>avoid</u> the risk	
A way to <u>reduce</u> the risk	
A way to <u>accept</u> the risk	
A way to <u>transfer</u> the risk	

Write a brief paragraph explaining how this lesson changed your perspective of “risk.”