

Risk assessment and management

Contributed by Travis Morien

A financial planner is trained to analyse personal and property risks as well, and will make suggestions to eliminate, minimise or control risks.

The process starts with risk identification, the planner then measures each risk, develops alternative strategies and helps you make a decision in choosing each strategy. Risk analysis

Speculative risk is risk taken in the hope of making a profit. Running a business, investing and gambling all carry speculative risk.

Pure risk is risk with no upside, there is a possibility of making a loss, but the risk is not assumed in the hope of making money. Pure risk comes in three forms, personal risk, property risk and liability risk.

Personal risk is the risk of death or disablement and medical costs. To minimise this risk you can change your diet and lifestyle (quit smoking, drinking, womanising and playing dangerous sports), but it can never be totally eliminated. It is not a financial planner's place to tell you to quit smoking or sell your motorcycle, but he will note any excessive risks and suggest ways of managing them. Other major risks of this sort are genetic, the financial planner may ask about family history of illnesses, which may influence his thinking on how much you need health insurance or life insurance.

Property risk is the risk of having possessions lost, destroyed or stolen. Along with primary property risk are secondary risks, if your shop burns down you also lose income, if the fridge breaks down you lose the contents (a big deal if you run a fish shop!).

Liability risk includes risks under statute, common law and contract. Statute risks include the risk faced by producers if their product causes harm to consumers, like salmonella in peanut butter, substantial lawsuits can eventuate. Common law risks are risks of facing legal action over negligence. For example if someone kicks down your door and then breaks his leg tripping on the rug while chasing your wife down the hallway with a meat cleaver, you face serious risks of being found negligent in failing to provide a safe environment for the psychopath to work in (however you can countersue for damage to your door and rug). Contract risk is the legal risk you face over being in breach of any contract you entered into. Risk management

The five different ways of solving risk problems are:

Elimination or prevention. Clear away combustible material from your house, install smoke alarms, quit your hobby of pistol duelling, put bars on your windows, install burglar alarms, get immunised, build a big wall in front of your place and keep guard dogs, give away all your property and become a trappist monk, write "Caution: HOT" on all your coffee mugs.

Reduction or partial prevention. Stop parking your WRX in the street overnight, eat a healthy diet, take up archery instead, move to a safer neighborhood, drive a Volvo at 30kmh everywhere (though this introduces a serious risk of becoming a victim of crime), educate employees on harassment laws, insist workers adopt safe work practices, repair or upgrade faulty equipment.

Retention. Arrange with the insurer to pay a lower premium in exchange for larger excess payments if you make a claim. Consider not insuring against trivial or highly unlikely losses.

Contractual transfer. Insist your tenant be responsible for insuring the house against fire, water damage and vandalism.

Insurance. Pay money to an insurance company to insure against big specific losses.