Risk Management: Why Do I Need Insurance?

Everyone faces risk in his or her daily life, whether it's hitting someone with your car on the way to work, being diagnosed with a terminal illness or losing your house in a flood. Risk is anything that threatens your life, property or ability to generate income. Risk management is the process of identifying these risks in your particular situation and handling them responsibly.

There are different ways to manage risk, and you can use a combination of tactics to manage your personal risk effectively. The four components of risk management are:

1. **Elimination:** Eliminating risk means avoiding certain risky activities or circumstances. For instance, you can eliminate the risk of losing your home to a landslide by not buying a house on a hill.

2. **Retention/Acceptance:** The risk you retain is what you're willing to accept in your risk management plan. For example, you might choose not to get collision insurance on an old car because the cost of insurance premiums isn't worth it to you. Here, you're accepting the risk of getting into a car accident.

> Anything worth earning is worth protecting, so if building your savings account, investing in real estate and buying your dream car are important to you, managing the risks that threaten these assets should be important, too.

3. **Reduction:** You can reduce part of your risk merely by changing certain habits or circumstances. An example of reducing your risk is installing smoke detectors in your home. It won't preclude you from having a house fire, but it lowers the risk of losing your home in the case of a fire. Reducing your risks may even qualify for insurance premium discounts.

4. **Insurance:** Insuring yourself is the cheapest way to protect against personal risk that you couldn't afford on your own. Think of it as pooling your risk with a large group of people and sharing the burden.

How do you determine what is at risk in your life?

Consider your assets: your home, car and other personal belongings that could be lost in an accident or disaster; your ability to earn income; and your assets that can be taken from you if you're hit with a liability claim.

Why is risk management important?

You need enough insurance to adequately protect your assets. Anything worth earning is worth protecting, so if building your savings account, investing in real estate and buying your dream car are important to you,

managing the risks that threaten these assets should also be important to you. You also need to protect your family's well-being in the event that you can no longer provide for them as you currently are. Life insurance, disability insurance and an emergency fund will all protect you and your family from the risk of losing your income earning potential to death, disease or disability. Finally, keep in mind that your assets may be on the line if you're sued and found liable, so insuring against liability is an integral part of risk management.

In order to manage your risk, you first have to analyze your risks and then determine what balance of the four components of risk management will work for you. After you've eliminated, reduced and accepted some risk, it's vital to insure against the remaining risk in order to protect yourself, your assets and your family.