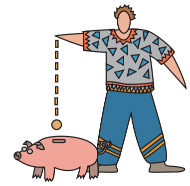
Managing Family Financial Risk



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No amount of money can totally protect a family from the risks that come with being alive. We deal with risks, both large and small, every day. Their financial impact can be devastating. Fortunately, risk can be managed through a variety of techniques.

What is a risk? A risk is a condition where there is a possibility of an adverse deviation from a desired outcome you expect or hope for. In simpler terms, things can go wrong. A risk can be as minor as the risk that your three-year-old will throw her new shoes in the trash or as major as the risk that you will cause a car accident where someone is hurt or killed.

Insurance is one way to protect your family's financial interests in the face of risk. With insurance, you are "financing" the risk of a large loss by paying premiums to an insurer, who will cover your loss if the insured event takes place—like fire, natural disasters, accidents and disability. Through insurance, you are **transferring** your risk to someone else, for a price.

There are other ways to control or finance risks. They are not mutually exclusive, and they can be used in addition to insurance. You can control your exposure to risk by **avoiding** or **reducing** it; and you can finance all or part of the risk by **retaining** it (keeping enough money in savings to cover the financial impact of whatever might happen).

For example, you could totally *avoid* driving and face no risk of a car accident at all. It might make more sense, though, to *reduce* driving risks by wearing seat belts, driving safely, not drinking alcohol before driving and keeping your car in good repair.

You would still *transfer* a large part of the risk of driving by buying auto insurance to protect yourself financially in case you injure or kill yourself or someone else, damage someone's property or need major repairs to your own car.

You can *retain* the risks that are not very likely to happen, and that wouldn't be that hard to cover if they did. You can generally keep enough money in the bank to cover things like a toddler's "tossed shoes" or broken dishes.

Well-chosen insurance coverage is a good (and often overlooked) way to protect your family's financial future-especially when it works together with the other risk management strategies.

Try to keep a reasonable balance between the out-of-pocket costs and the potential benefits of any insurance product. Going deeply into debt to pay insurance premiums does little to protect your family's overall financial health.

To choose your best mix of risk management tools, think about the risks you face and how severe each event would be if it happened. Consider *transferring* risk through insurance coverage for things that rarely happen to any one person, but are catastrophic when they do-like home fires, automobile accidents, liability lawsuits, disability, or death. *Avoid* and *reduce* the risks you can through your own behavior, even those for which you are insured. Keep a little money in savings to *retain* smaller risks. Then hope for the best, and enjoy yourself. You've done the best you can to prepare and protect your family for the worst.

For additional information on a variety of insurance topics, see http://insurance.mo.gov/index.htm

Sources:

Israelsen, C. Consumer and Family Economics 183, Personal and Family Finance, Winter 2003 Class Lectures, University of Missouri, Columbia, Missouri.

Israelsen, C. & Weagley, R. Personal and Family Finance Workbook, 3rd ed., 2002, Kendall/Hunt Publishing Co., Dubuque, Iowa.

If you'd like to learn more about this and other personal finance topics, the University of Missouri offers 'Personal & Family Finance' a correspondence course, through the Center for Distance and Independent Study (800-609-3727). Information about this course is available at http://cdis.missouri.edu/CourseInfo/DetailCourseInfo.asp?1985