
Risk Management and Insurance

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*To Steve, Dalit, Liat, Aviva, Josh, Jeremy, and
Timy, for their patience and support.*

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BRIEF CONTENTS

INTRODUCTION: Risk and Insurance After September 11, 2001 1

PART I

FUNDAMENTALS OF RISK MANAGEMENT AND INSURANCE 9

- 1** Risk 10
- 2** Insurance 28
- 3** The Evolution of Risk Management 44

PART II

INSURANCE OPERATIONS, INSTITUTIONS, AND MARKETS 69

- 4** Insurance Company Operations 70
- 5** Insurance Institutions, Markets, and Regulation 93

PART III

INSURANCE CONTRACTS 121

- 6** Fundamental Doctrines Affecting Insurance Contracts 122
- 7** Structure and Analysis of Insurance Contracts 142

PART IV

PROPERTY AND LIABILITY RISKS 161

- 8** Property Risk, E-Commerce Property Risk, and Global Risk 162

- 9** **The Liability Risk** **180**
- 10** **Managing Home Risks** **204**
- 11** **Managing Automobile Risks** **238**
- 12** **Business Insurance** **269**
- 13** **Workers' and Unemployment Compensation** **300**

PART V

LIFE, HEALTH, AND RETIREMENT RISKS **329**

- 14** **Life Insurance** **330**
 - 15** **Social Security** **369**
 - 16** **Employee Benefits: Fundamentals, Life, and Disability Risks** **390**
 - 17** **Employee Benefits: Medical Care** **415**
 - 18** **Employee Benefits: Retirement Plans** **441**
 - 19** **Annuities, Individual Health Products, and Need Analysis** **469**
-
- Case 1** **503**
 - Case 2** **509**
 - Case 3** **525**
 - Case 4** **541**

CONTENTS

Preface xx

About the Author xxv

INTRODUCTION: Risk and Insurance After September 11, 2001 1

Losses Paid to Hypothetical Victims' Families 2

Losses Paid to a Hypothetical Nearby Business 5

Importance of the Loss Cases and September 11 6

Discussion Questions 7

Exercises 8

Notes 8

PART I

FUNDAMENTALS OF RISK MANAGEMENT AND INSURANCE 9

1 **Risk** 10

Connection 10

Nature of Risk 11

The Feelings Associated with Risk 11

Definition of Risk 12

Measurement of Risk 13

Specific Measurement Techniques 13

Law of Large Numbers 16

Elements of Pure Risk 16

Exposures and Risks 17

Perils 18

Hazards 18

Emerging and Growing Risks 21

Key Terms 23

Discussion Questions 23

Exercises 25

Notes 25

Appendix 1.1 26

Appendix 1.2 27

2 Insurance 28

Connection 28

Nature of Insurance 29

Definition of Insurance 29

How Insurance Works 30

Risk Transfer (Assumption) 30

Loss Sharing (Risk Distribution) 31

Discrimination: The Essence of Pooling 32

Ideal Requisites for Insurability 34

Many Similar Exposure Units 34

Accidental Losses 35

Small Possibility of Catastrophe 36

Definite Losses 37

Determinable Probability Distribution 37

Economic Feasibility 38

Summary of Insurable Risks 39

Types of Insurance 40

Personal, Group, or Commercial 40

Life/Health or Property/Casualty 40

Private or Government 41

Voluntary or Involuntary 41

Selecting an Insurer 41

Financial Strength 41

Key Terms 42

Discussion Questions 42

Exercises 43

Notes 43

3 The Evolution of Risk Management 44

Connections 45

The Risk Manager's Functions 45

The Traditional Risk Management Process 48

Communication Tools 48

Identification Tools and Risk Management Decision Tools: The Risk Management Matrix 48

On-Going Monitoring 52

First Expansion of the Risk Management Scope: Risk Mapping 53

Risk Profiling 53

Risk Mapping: Creating the Model 53

Risk Management Information System 58

Most Recent Expansion: Enterprise Risk Management 58

Risk Management Using Insurance: The First Step 59

Technology and Communications 59

Quantitative Techniques and Models: The Tools 59

Evolution of the Financial Markets 60

Risk Management using Capital Markets 62

Key Terms 64*Discussion Questions* 64*Exercises* 65*Notes* 66**Appendix 3.1 67****PART II****INSURANCE OPERATIONS, INSTITUTIONS, AND MARKETS 69****4 Insurance Company Operations 70****Connection 70****Marketing 72**

Life/Health Insurance Marketing 72

Property/Casualty Insurance Marketing 73

Internet Marketing 75

Mass Merchandising 75

Financial Planners 75

Professionalism in Marketing 76

Underwriting 77**Administration 78**

Service 78

Actuarial Analysis 79

Prices and Reserves 79

Investments 84**Reinsurance 86**

How Reinsurance Works 86

Benefits of Reinsurance 87

Legal and Regulatory 88**Claims Adjusting 88**

Claim Practices 89

Management 89*Key Terms* 89*Discussion Questions* 90*Exercises* 91*Notes* 91

5 Insurance Institutions, Markets, and Regulation 93

Market Conditions	94
Reinsurance Organizations and the Marketplace	98
Insurance Regulation	99
Licensing Requirements	100
Financial Requirements	101
Solvency Regulations	101
Policy and Rate Regulation	102
Control of Agents Activities	103
Control of Claims Adjusting	104
Control of Underwriting Practices	104
Impact of the Gramm-Leach-Bliley Act on Insurance Regulation	105
Private Insuring Organizations, Their Markets, and Their Regulation	108
Stock Insurers	108
Mutual Insurers	109
Lloyd's of London: A Global Insurance Exchange	110
Banks and Insurance	111
Captives, Risk Retention Groups, And Alternative Markets	112
Government Insuring Organizations	113
State Insuring Organizations	113
Federal Insuring Organizations	114
<i>Key Terms</i>	115
<i>Discussion Questions</i>	115
<i>Exercises</i>	116
<i>Notes</i>	117
Appendix 5.1	119

PART III

INSURANCE CONTRACTS 121

6 Fundamental Doctrines Affecting Insurance Contracts 122

Connection	122
Agency Law	123
Agents	123
Requirements of a Contract	128
Offer and Acceptance	128
Consideration	128
Competent Parties	128
Legal Purpose	129
Legal Form	129

Distinguishing Characteristics of Insurance Contracts 129

Based on Utmost Good Faith 129

Contracts of Adhesion 131

Indemnity Concept 131

Personal 137

Key Terms 138*Discussion Questions* 138*Exercises* 139*Notes* 140**7 Structure and Analysis of Insurance Contracts 142****Entering Into the Contract 143**

Applications 143

Binders 144

Conditional and Binding Receipts 144

The Contract 145

Declarations 145

Insuring Clauses 146

Exclusions And Exceptions 151

Conditions 153

Endorsements and Riders 155

Key Terms 156*Discussion Questions* 156*Exercises* 157*Notes* 158**PART IV****PROPERTY AND LIABILITY RISKS 161****8 Property Risk, E-Commerce Property Risk, and Global Risk 162****Property Risks 163**

Property Coverages and Determination of Payments 164

E-Commerce Property Risks 169

Causes of Loss in E-Commerce 170

Risk Management of E-Commerce Exposures 172

Global Property Exposures 173

Legal Risk 174

Data Risk 175

Currency Risk 175

Cultural Differences Risk 175

Global Risk Management 176

Key Terms 177

Discussion Questions 177

Exercises 178

Notes 178

9 **The Liability Risk** 180

Nature of the Liability Exposure 181

Basis of Liability 182

Defenses 184

Modifications 185

Major Sources of Liability 186

Property 187

Activities and Conduct 189

Possible Solutions 198

Key Terms 200

Discussion Questions 200

Exercises 201

Notes 202

10 **Managing Home Risks** 204

Connection 204

Packaging Coverages 206

Homeowners Policy Forms 206

The Special Form (HO-3) 208

Insuring Agreement and Definitions 210

Section I—Coverages 210

Section I—Perils Insured Against 213

Section I—Exclusions 216

Section I—Conditions 217

Determining Coverages 220

Section II—Liability Coverages 220

Section II—Exclusions 222

Section II—Additional Coverages 223

Section II—Conditions 224

Sections I and II—Conditions 224

Endorsements 225

Earthquake Endorsement 225

Personal Property Replacement Cost Endorsement 226

Scheduled Personal Property Endorsement 226

Business Pursuits Endorsement 226

Personal Injury Endorsement 226

Mold Endorsement	227
Other Risks	228
Flood Risk	228
Title Risk	230
Personal Umbrella Liability Policies	231
Excess and Broad	231
Minimum Underlying Coverage	231
Exclusions	231
Shopping for Homeowners Insurance	232
Key Terms	234
Discussion Questions	234
Exercises	235
Notes	237

11 **Managing Automobile Risks** 238

Connection	238
The Fault System	240
No-Fault Appraised	240
Financial Responsibility Laws	242
Assuring Auto Insurance Availability	243
Auto Insurance Plans	243
Reinsurance Facilities	244
Joint Underwriting Associations	244
Maryland State Fund	244
Personal Auto Policy	244
Declarations	245
Definitions	245
Liability Coverage—Part A	246
Medical Payments Coverage—Part B	251
Uninsured Motorists Coverage—Part C	253
Coverage for Damage to Your Auto—Part D	255
Duties after an Accident or Loss—Part E	259
General Provisions—Part F	259
Insuring Other Vehicles	261
No-Fault Coverages	261
Auto Insurance Premium Rates	261
Types of Automobile Policies	264
Key Terms	265
Discussion Questions	265
Exercises	266
Notes	268

12 Business Insurance 269

Connection 270

Commercial Package Policy 272

Commercial Property Coverages 272

Direct Property Coverage: The Building and Personal Property (BPP) Form 273

Causes of Loss 276

Consequential Property Coverage: Business Income Coverage (BIC) 280

Other Property Coverages 284

Commercial Crime and Fidelity Coverage 284

Inland Marine 285

Boiler and Machinery Coverage 285

Capital Assets Program 285

Business Owners Policy 286

Commercial General Liability Policy 286

CGL Policy Format 286

Coverages 287

Who Is an Insured? 292

Limits of Insurance 292

CGL Conditions 293

Definitions 293

Commercial Umbrella Liability Policy 293

Other Liability Risks 294

Automobile Liability 294

Professional Liability 294

Employment Practices Liability 294

Key Terms 296

Discussion Questions 296

Exercises 297

Notes 299

13 Workers' and Unemployment Compensation 300

Connection 301

Workers' Compensation Laws and Benefits 302

History and Purpose 303

Coverage 304

Benefits 307

How Benefits Are Provided 311

Workers' Compensation Insurance 311

Employer's Risk 315

Self-Insurance 316

State Funds	318
Second-Injury Funds	318
Nature and Purpose	318
Financing	318
Workers' Compensation Issues	319
Unemployment Compensation	322
State Laws	322
Coverage	322
How Benefits Are Financed	323
Administration	324
<i>Key Terms</i>	324
<i>Discussion Questions</i>	325
<i>Exercises</i>	325
<i>Notes</i>	326

PART V**LIFE, HEALTH, AND RETIREMENT RISKS 329****14 Life Insurance 330**

Connection	331
How Life Insurance Works	331
Other Premium Elements	331
Level-Premium Plan	332
The Life Insurance Market and Products	335
Term Insurance	336
Duration	337
Renewability	337
Convertibility	337
Death Benefit Pattern	337
Premium Patterns	338
Summary: Features of Term Life	338
Whole Life Insurance	338
Straight Life	338
Limited-Payment Life	340
Single-Premium Life	340
Investment Aspects	340
Participation Feature	341
Summary: Features of Whole Life	341
Universal Life Insurance	342
Separation of Elements	342
Death Benefit Options	344

- Premium Payments 345
- Mortality Charges 345
- Expense Charges 346
- Investment Returns 347
- Summary: Features of Universal Life 347
- Variable Life Insurance 348**
 - How It Works 348
 - Summary: Features of Variable Life 349
- Variable Universal Life Insurance 351**
 - Summary: Features of Variable Universal Life 352
- Current Assumption Whole Life Insurance 352**
 - Summary: Features of Current Assumption Life 353
- Taxation 353**
- Major Policy Provisions 353**
 - Policy Ownership 354
 - Death Benefits and Death Benefits Options Provisions 354
 - Payment of Benefits Provisions 355
 - Payment Methods 356
 - Premium Provisions 356
 - Dividend Options 357
 - Guaranteed Values Provisions 358
 - Policy Loan Provisions 359
 - General Provisions 359
- Life Insurance Riders 360**
 - Waiver of Premium 360
 - Disability Income 361
 - Accidental Death Benefit 361
 - Guaranteed Insurability Option 361
 - Accelerated Death Benefits 362
 - Catastrophic Illness Coverage 362
- Adjusting Life Insurance for Inflation 363**
 - Key Terms* 364
 - Discussion Questions* 365
 - Exercises* 366
 - Notes* 368

15 **Social Security 369**

- Connection 370**
- Definition of Social Security 371**
- Coverage and Eligibility Requirements 371**
 - Eligibility 372

Types of Benefits	372
Retirement (Old Age) Benefits	373
Survivors' Benefits	374
Disability Benefits	374
Amount of Benefits	375
Primary Insurance Amount	375
Other Factors Affecting Benefit Amounts	377
Cost of Living Adjustment (COLA)	378
The Earnings Test	378
Financing of Benefits	379
Taxation	379
Trust Funds	380
Medicare	381
Medicare Part A: Hospital Benefits	381
Medicare Part B: Medical Benefits	381
Administration	382
Social Security Issues	382
Global Trends in Social Security Systems	386
<i>Key Terms</i>	386
<i>Discussion Questions</i>	387
<i>Exercises</i>	387
<i>Notes</i>	388

16 Employee Benefits: Fundamentals, Life, and Disability Risks 390

Connection	391
Overview of Employee Benefits	391
Employer Objectives	394
Nature of Group Insurance	394
Administration	395
Underwriting	396
Pricing	398
Federal Regulation: Compliance with Nondiscrimination Laws	400
Age Discrimination in Employment Act	400
The Civil Rights Act	401
Americans with Disabilities Act	401
Family Medical Leave Act	402
Group Life Insurance	402
Benefits	402
Group Disability Insurance	405
Group Short-Term Disability Plans	405
Group Long-Term Disability Plans	406

- The Flexibility Issue 408**
 - Cafeteria Plans 408
 - Flexible Spending Accounts 410
- Multinational Employee Benefit Plans 410**
 - Key Terms 411
 - Discussion Questions 412
 - Exercises 412
 - Notes 414

17 **Employee Benefits: Medical Care 415**

- Connection 416**
- Group Health Insurance: An Overview 416**
- Indemnity Health Plans: The Traditional Fee-for-Service Plans 421**
 - Basic Health Care Benefits 422
 - Major Medical and Comprehensive Insurance 423
 - Coordination of Benefits 424
- Cost Containment Initiatives for Traditional Fee-for-Service Policies 425**
 - Plan Design Techniques 425
 - Administrative and Funding Techniques 425
 - Utilization Review 426
- Managed Care Plans 427**
 - Preferred Provider Organizations 428
 - Health Maintenance Organizations 428
- Continuation Provisions 430**
 - Continuity: COBRA 430
 - Retiree Eligibility for Group Medical Benefits 431
 - Portability: HIPAA 431
- Group Dental Insurance 432**
- Group Long-Term Care 432**
- Other Health Plans 435**
 - Medical Savings Accounts (MSAs) 435
 - Health Care Reimbursement Arrangements 435
- Medical Care Systems Worldwide 436**
 - Key Terms 437
 - Discussion Questions 438
 - Exercises 438
 - Notes 440

18 **Employee Benefits: Retirement Plans 441**

- Connection 441**

The Nature of Qualified Pension Plans	444
ERISA Requirements for Qualified Pension Plans	444
Eligibility and Coverage Requirements	447
Retirement Age Limits	447
Vesting Provisions	448
Nondiscrimination Tests	448
Distributions	449
Loans	449
Types of Qualified Plans	449
Defined Benefit Plans	452
Qualified Defined Contribution Plans	455
Other Qualified Defined Contribution Plans	456
Profit-Sharing Plans	456
401(k) Plans	457
Employee Stock Ownership Plans	458
Other Qualified Plans: 403(b) and 457 Plans	458
Keogh Plans	459
Simplified Employee Pension Plans	460
SIMPLE Plans	460
Individual Retirement Accounts (Traditional IRA and Roth IRA)	460
Pension Plan Funding Techniques	463
Noninsured Trust Plans	463
Insured Plans	463
Nonqualified, Tax-Favored Retirement Plans	464
<i>Key Terms</i>	465
<i>Discussion Questions</i>	465
<i>Exercises</i>	466
<i>Notes</i>	467

19 **Annuities, Individual Health Products, and Need Analysis** 469

Connection	470
Annuities	470
Parties to an Annuity	470
Mechanics of Annuities	471
Settlement Options	472
Types of Contracts	474
Taxation of Annuities	476
Individual Health Insurance Contracts	477
Cancer and Critical Illness Policies	479
Dental Insurance	480
Individual Disability Income Insurance Contracts	481

Definition and Cause of Disability	482
Benefits	483
Long-Term Care Insurance	485
Medicare Supplementary Insurance	486
How Much Life Insurance To Buy?	489
Data Collection	489
Objectives	493
Alternative Solutions/Exposure Evaluation	493
Estate Planning	497
Objectives	497
Wills	497
Trusts	498
Life Insurance	499
Key Terms	499
Discussion Questions	500
Exercises	501
Notes	502

Case 1 503

Case 2 509

Case 3 525

Case 4 541

Appendix A 549

Appendix B 575

Appendix C 589

Appendix D 597

Appendix E 599

Appendix F 613

Index 627

PREFACE

INTRODUCTION AND BACKGROUND

This textbook, designed to reflect the dynamic nature of the field of risk management and insurance, serves as an introduction to the field. This is a comprehensive revision of the seventh edition of *Risk Management and Insurance*, by S. Travis Prichett, Joan T. Schmit, Helen I. Doerpinghaus, and the late James L. Athearn. It includes new pedagogical enhancements, as well as discussion of new products, laws, conditions, and technologies in the field.

In the first years of this century, the terrorist attacks on the World Trade Center and the Pentagon and the accounting scandals of Enron and WorldCom all highlighted the importance of risk management and insurance. Giving particular attention to the market's increased sense of vulnerability and the newest technologies, *Risk Management and Insurance* provides a clear introduction to the complexities of this field. With chapters including topics such as e-risks and enterprise risk, EGTRRA 2001, loss development triangles, the health insurance evolution, the newest property/casualty endorsements, and a focus on connecting each chapter to the bigger picture, the objective is to show students how the latest developments and the field's traditional approaches fit together into holistic risk management.

In both the areas of property/casualty and life/health, the newest products, laws, and applications are explained in simple terms to allow hands-on learning. To this end, sample policies, examples, and cases are provided.

The objective of this revision is to retain the strengths of the previous edition while enhancing the pedagogical methods with new and updated areas relevant to the field of risk and insurance today. The clarity and simplicity of the previous text with its operational emphasis is maintained.

TEXT ORGANIZATION

- **An emphasis on the big picture—the Connection section.** The insurance industry, operations, and markets have been brought to the front of the book to clarify the “big picture” for students. Risk and insurance can appear to be a complex puzzle composed of many pieces. In addition to the early overview of industry, operations and markets, a “Connection” section begins each chapter to highlight the relationships between various concepts and components of risk and insurance, so that students know how the pieces fit together.
- **Chapter 3 presents current risk management practices, including enterprise risk management.** The chapter moves from traditional risk management through risk mapping to enterprise risk management, including the use of the capital markets and cat bonds. Chapter 3 can be used to introduce risk

management or for advanced study. Out of the cases at the end of the text, two are particularly relevant to this chapter: Case 3 provides advanced risk management tools for a large corporation, and Case 4 experiments with the financial risk management tools described in Chapter 3.

- **Chapter 4 contains a review of insurance company operations and loss development techniques.** The chapter includes an actuarial loss development triangle technique for loss reserves and rate calculations. Understanding this process of estimating future losses based on past losses is at the heart of insurance operations. Students who understand how insurance companies deal with losses will understand the underlying dynamic of the industry. Thus, the up-front study of the loss development technique in this chapter is part of a conceptual framework that will help students learn the details of insurance that are covered later in the text.
- **Chapter 5 contains a review of insurance markets, underwriting cycles, regulated and unregulated markets, and regulation.** The chapter is designed to furnish an understanding of the global operations of insurance markets, so student can appreciate the importance of market conditions (and the underwriting cycles) on risk management decisions. The types of insurance institutions and the U.S. insurance regulation today are discussed, including the most recent updates. The chapter incorporates the insurance implications of the Gramm-Leach-Bliley (GLBA) Financial Services Modernization Act of November 12, 1999.
- **E-Commerce Risk:** This emerging and evolving risk is covered in detail in Chapters 8, which is devoted to property risk in general, and in Chapter 9, which is centered around liability risks.
- **Employee benefits and individual life/health products:** all new laws are incorporated, including EGTRRA 2001, along with case examples of a dental office for pensions, comparative matrices for group health insurance and group underwriting, and rate quotes and policy features for individual health policies (in Chapter 19.) This area is supplemented with Case 2, an employee benefits portfolio for a hypothetical company.
- **Social Security:** The chapter is updated with the most recent year's data (2003). All data will be kept current on the text's Web site.
- **Case studies:** The book begins with an introductory case on the losses of September 11, 2001, and concludes with a section featuring comprehensive cases in risk management and insurance for personal needs and business needs. These cases help students recognize the relevancy and applications of the book's concepts in the real world.
 - **Introduction with cases:** The introduction provides an overview of all the elements of the textbook, using the huge losses of September 11 as a first glimpse into the field. Two victim families are featured, and the insurance coverages discussed include the United States' social insurance programs, employer provided employee benefits, and private insurance. Also, one business that sustained losses during September 11 is featured, and this raises discussion of business interruption coverage.
 - **Conclusion with case studies:** To complete the "big picture" of holistic risk for a family with hand-on application, Case 1 features the hypothetical Smith family and their risk management portfolio. To complete the

understanding of the employee benefits packages offered by employers, Case 2 is featured. Cases 3 and 4 are for more advanced risk management techniques to augment Chapter 3.

NEW FEATURES

- **Important Issues:** Each chapter is filled with current real-life examples to liven up the study for the student and to clearly show the application of concepts of risks in our everyday lives. Important Issues boxes include discussions on topics such as punitive damages, mortality improvements, recent laws affecting health care, auto rates, business interruption issues, mold, and more.
- **Explore the Internet:** At the conclusion of each “Important Issues” box, the reader is directed to use Web sites applicable to the chapter and the stories. Within each chapter there are many references to Internet sites the student can use for additional information and updates.
- **Ethical Dilemma:** Each chapter features an “Ethical Dilemma” that deals with current issues such as the Federal terrorism insurance bill, redlining, obesity and lawsuits, the conversion of traditional defined benefit plans to cash balance pension plans, and the tradeoff between health care cost and benefits. At the conclusion of each story, questions are provided to prompt related discussion.
- **The newest sample personal and commercial property/casualty ISO policies** are discussed in detail along with the most up-to-date ISO sample endorsements for terrorism, e-commerce and mold coverages. Hands-on-examples using the policies encourage students to truly understand the workings of these policies.
- **New sample life insurance policies from State Farm** are furnished, along with a thorough explanation, to give a clear understanding of the coverages and life products available in the market place today.
- **Student-friendly:** A clear, readable writing style helps to keep a complicated subject from becoming overwhelming. In-chapters examples and the “Ethical Dilemmas” and “Important Issues” let students apply the concepts they’re learning.
- **New Discussion Questions and Exercises at the end of each chapter:** Many new questions and case exercises were added to provide more challenging applications to the students and encourage the use of the policies provided at the back of the text.

SUPPLEMENTS

Instructors’ Resources

All teaching supplements will be available for instructors to download from the password-protected Instructors’ Companion Web Site, at www.wiley.com/college/baranoff.

Instructor’s Manual

This guide for instructors begins with suggestions on how to use the textbook to teach different levels of students, from beginning to intermediate. Specific tips are given in each chapter for the various levels. Each chapter has an orientation, complete outline,

and answers to all discussion questions and exercises. In providing answers, we have included matrices for the comparison questions and spreadsheets for the more quantitative exercises.

Test Bank

The test bank consists of 30 multiple choice questions and 5 or more short answer questions for each chapter. Key concepts are emphasized throughout, with questions offered at a range of difficulty levels.

PowerPoint Presentations

PowerPoint slides provided for each chapter present key exhibits and outlines of the critical topics in each chapter.

Student Resources

The students' Web site, www.wiley.com/college/baranoff, will furnish current reading and exercises, including updates to the Important Issues and Ethical Dilemma boxes.

ACKNOWLEDGEMENTS

This book lists one author, but it is based on the 1996 edition of the text book *Risk Management and Insurance* (seventh edition) by S. Travis Prichett, Joan T. Schmit, Helen I. Doerpinghaus and the late James L. Athearn. Their textbook is the foundation of this text. Without this foundation and their recommendation that I undertake the overhauling of their book, I would not have accepted this large project.

My publisher, Leyh Publishing, provided extensive and excellent support in completing this work. Rick Leyh's excellent suggestions and support have been critical to my work. Rick has provided superb leadership in this undertaking. In addition, Lari Bishop, Kris Pauls and Camille McMorrow kept the production and development work on target. The Wiley team, including Susan Elbe, Publisher, Leslie Kraham, Acquisitions Editor, and Charity Robey, Senior Marketing Manager, was very supportive. Most important to me was the exceptional work of my copyeditor and author of the Important Issues and some of the Ethical Dilemma boxes, Christy Goldfinch. Christy has been more than a copyeditor. She studied each topic and provided excellent questions and suggestions while ensuring the simplicity and clarity of the text. Many thanks also to my daughter, Dalit Baranoff, for her fine work on the test bank and the Ethical Dilemma boxes for Chapters 10 through 19, as well as for her support and additional suggestions as I wrote each chapter.

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Risk management is the identification, evaluation, and prioritization of risks (defined in ISO 31000 as the effect of uncertainty on objectives) followed by coordinated and economical application of resources to minimize, monitor, and control the probability or impact of unfortunate events or to maximize the realization of opportunities. Risks can come from various sources including uncertainty in international markets, threats from project failures (at any phase in design, development, production, or Basic risk management steps. Identify each risk with a thorough analysis of the association's operations, activities and business. The association needs to decide how to manage risks by determining the likelihood of a risk occurring against the potential consequences.Â Treat risks by considering any existing risk control measures (eg insurance, security alarm, warning signs), deciding whether the existing measures are adequate and considering any additional measures that may be required. Monitor and review the process on a regular basis. It is important to regularly review if there has been any change in the association's risk position and, if necessary, repeat and review the process set out above.

Reasons for obtaining insurance. Appendix B Risk Management and Insurance. s e l f - i n s u r a n c e the process of establishing a monetary fund that can be used to cover the cost of a loss. Shifting Risks. Perhaps the most common method of dealing with risk is to shift, or transfer, the risk to an insurance company. An insurer (or insurance company) is a firm that agrees, for a fee, to assume financial responsibility for losses that may result from a specific risk. The fee charged by an insurance company is called a premium. A contract be-tween an insurer and the person or firm whose risk is assumed is known as an insur-an... Risk management techniques used in banks and trading floors are not applicable to insurance companies. Risk measures and risk monitoring approaches must be developed to respond to the challenges to the industry in recent years. This paper describes the current practices in the industry, for both the life and the general insurance businesses. And the paper describes the corporate model approach that extends the present approaches to provide corporate management solutions using fair valuation framework. View. Show abstract.