Exam 1 Study Guide

What is risk?
Define strategic, financial and operational risk?
   Be able to give examples of each
What are the major types of business risk?
What are the different classifications of risk in the risk and insurance industry?
What are the characteristics of pure risk?
What is the importance of difference between direct and indirect losses?
What are the steps in the risk management (RM) process?
What is the scope of corporate RM activities?
What is the objective of the RM process?
Why is identification a vital step in the RM process?
What are some common characteristics used to identify risks?
Describe the legal system in the US used to resolve liability issues
What are the components of negligence?
What are absolute, contributory and comparative negligence?
What are the defenses against negligence?
What are a trespasser, licensee and invitee?
What are the main business risk exposures?
What are expected loss, frequency and severity? How are they related? Define “more risky”
What is \( \sigma/\sqrt{n} \)? and why is it important?
What is the maximum probable loss (MPL)?
   How is it related to Value at Risk and Earnings at Risk?
What is the effect of expanding a risk pool on expected loss, risk, variance MPL?
   If risks are independent? If risks are correlated?
What are the cost advantages of insurance companies?
Describe loss control, risk transfer and loss financing
   Be able to give examples of each
What are loss prevention and loss reduction?
Describe methods use to transfer risk
   Insurance, contractual transfer, hold-harmless, indemnification, limited liability
Differentiate between internal and external loss financing
Describe the advantages and disadvantages of insurance for loss financing
Explain how frequency and severity affect the choice of RM method
Identify and describe several risk bearing institutions
Describe the risk management services provided by risk bearing institutions
Describe how hedging can be used to manage risk
What are derivatives, forwards, futures, calls, puts and swaps?
What are the payoffs to forwards and futures?
What is the relationship between spot and forward prices?
What are the payoffs to long calls, short calls, long puts, short puts?
Why is equity a call option on the firm’s assets?
   How does this create a conflict of interest between equity- and bond-holders?
What is the Black-Scholes formula used for?
   What is the interpretation of \( N(d_2) \) in the Black-Scholes formula?