

# How Insurance Works

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Every day, every individual faces the risk of loss – physical loss, emotional loss, financial loss. You buy a house; it could burn down. You drive a car; you can be in an accident. Knowing that risk of loss exists creates an uncertainty that makes planning difficult and diminishes the quality of life.

Insurance is a mechanism by which an individual or business can transfer risk. By transferring some of the risk that is a natural part of modern life, you can enjoy peace of mind and are better able to focus your energies on other, more important aspects of life.



Only a portion of certain types of risk can be transferred.

- **Financial Risk:** Insurance only addresses financial loss. It will not compensate for the sentimental value attached to the family photo album, for example. It usually does not compensate for emotional loss. And, do not expect compensation for your inconvenience.
- **Non-Speculative Risk:** Only certain types of financial losses can be transferred to an insurance company. An individual cannot insure speculative risks, such as a loss in the stock market.

There are three types of financial risks that can be transferred to an insurance company.

**The risk of loss of physical property**

(Your car is totaled in an accident.)

**The risk of being found legally liable for the loss of someone else**

(You cause an accident that totals your friend's car.)

**The risk of financial loss that occurs due to disability or death**

(You cannot work for six months because you were hurt in the accident.)

- **Selected Portion:** Insurance is intended to cover only a portion of the financial loss. Many insurance policies have deductibles as well as dollar limits. In selecting limits, you decide how much of your risk to transfer to an insurance company.

The individual who experiences an insured loss should not expect to be fully compensated for the loss; insurance is not designed to do that. It will not compensate for a lot of intangibles, such as inconvenience. And, in most cases, it will only pay for a portion of your financial loss.

The individual who buys good insurance and never has a loss is the real winner in the insurance transaction. That person has enjoyed the peace of mind that comes from proper insurance. Peace of mind is the real product of the insurance transaction.