Overview of Personal Insurance

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ELEMENTS OF LOSS EXPOSURES

Individuals and families sustain significant property and liability losses each year, as well as losses that affect their personal financial planning. Homes accidentally catch fire and are destroyed, individuals involved in automobile accidents are sued, and wage earners are disabled and lose income. All of these events have financial consequences for individuals and families. To what extent could they have identified the presence of risk in their lives and better managed those exposures?

Individuals and families incur losses when assets they own, such as a home or an auto, or assets they generate, such as earning power, experience a reduction in value. Additionally, they could expose their assets to loss through their activities if they cause another person to suffer injury or loss. The chance that a tree will fall on a home and damage the roof is an example of a **loss exposure**. An actual loss need not occur for a loss exposure to be present; rather, simply the possibility of loss must exist. Every loss exposure has three elements:

Loss exposure
Any condition or situation that presents a possibility of loss, whether or not an actual loss occurs.

- Asset exposed to loss
- Cause of loss
- Financial consequence of loss

To the extent that individuals and families understand the conditions or situations that present the possibility of loss to their assets, the causes of loss, and the financial consequences of loss, the better they can manage their own personal loss exposures. See the exhibit "The Loss Exposure 'Equation'."

The Loss Exposure 'Equation'

The "product" of the elements "equals" a loss exposure. Remove any one of the three elements, and a loss exposure is no longer present.

Loss exposure = Asset exposed to loss × Cause of loss × Financial consequence of loss

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Asset Exposed to Loss

The first element of a loss exposure is an asset exposed to loss. Most individuals and families seek to achieve a standard of living that provides them with comfort and security. In the course of achieving this desired standard of living, people accumulate assets. However, asset accumulation can be jeopardized when assets are exposed to loss.

An asset exposed to loss can be any item with value that is exposed to a possible reduction in that value due to loss. For example, individuals and families own (or have furnished for their use) assets that can be exposed to loss, such as homes, personal property, and money; additionally, they may operate automobiles and watercraft. Other assets exposed to loss can include those that can generate, accrue, or sustain value, such as a worker's income, a couple's retirement investment portfolio, or a wage earner's good health.

Cause of Loss

Cause of loss (peril)

The actual means by which property is damaged or destroyed.

A cause of loss is another element of a loss exposure. A **cause of loss** (or peril) is the means by which an asset can be reduced in value.

Individuals and families should, to the extent possible, identify and guard against causes of loss that could present the possibility of damage to or a reduction in value of their assets. Fire, wind, hail, lightning, theft, vandalism, auto collision, loss of employment, and long-term illness are all examples of causes of loss that can occur to assets. See the exhibit "Cause of Loss and Multiplier Effect."

Cause of Loss and Multiplier Effect

Sometimes one cause of loss can have a multiplier effect, demonstrating the unpredictable nature of causes of losses. For example, a fire burns down a three-unit rental dwelling owned by a retired couple. The couple suffers not only the loss of the dwelling but also the loss of rental income they rely on as their primary source of monthly income. Additionally, consider a homeowner whose vacation property is vandalized. Because a broken rear window in the house goes unnoticed for several days, a subsequent rainstorm causes extensive water damage to the owner's hardwood floor.

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Financial Consequence of Loss

The third element of a loss exposure is the financial consequence of loss. An asset exposed to loss is affected by a cause of loss, generating a financial consequence.

The financial consequences of a loss depend on the type of asset exposed to loss, the cause of loss, and the severity of the loss. In the case of a primary wage earner who suffers a short-term illness and returns to work after a brief period of disability, the financial consequences, although they may be significant to the wage earner, are not severe. A primary wage earner who suffers a long-term illness and is unable to return to work for many months because of disability is likely to suffer a severe financial consequence as a result of the loss. Similarly, an individual whose auto sustains a dented bumper as the result of a collision suffers the minor financial consequence of having the bumper repaired. However, if that individual is sued by another motorist who claims that she was seriously injured in that same accident, the financial consequences of loss could be severe.

PROPERTY LOSS EXPOSURES

Virtually all individuals and families have property. Property used, stored, enjoyed, or displayed is property that may be exposed to loss. Such property may include a family's house, an individual's television, or a child's framed photograph. Losses to property can result in serious financial consequences to those who suffer the losses.

All property is subject to **property loss exposures**. Property may be destroyed, damaged, stolen, or lost, or may otherwise suffer a decrease in value because of a particular cause of loss (or peril).

Property loss exposure

A condition that presents the possibility that a person or an organization will sustain a loss resulting from damage (including destruction, taking, or loss of use) to property in which that person or organization has a financial interest.

Individuals and families face countless situations in their daily lives that present the possibility of a property loss that has financial consequences. For example, an individual's belongings could be destroyed by a flood, or a family's home and its contents could be destroyed by a tornado. These situations, and many more, are loss exposures that individuals and families might face.

Property loss exposures can be examined in terms of three loss exposure elements:

- Assets exposed to loss
- Causes of loss
- Financial consequences of loss

Assets Exposed to Loss

Assets exposed to loss are any items of property that have value. A common method of classifying property uses two broad categories—**real property** and **personal property**. Much like the term "real estate," real property includes land, buildings, attached structures, plants growing on the land, and anything embedded in the land, such as minerals. All other property, such as a bicycle or a sofa or a computer, is classified as personal property. Individuals and families can be faced with loss exposures by owning or having a legal interest in one or both of these types of property. See the exhibit "Examples of Assets (Property) Exposed to Loss."

Real property (realty)

Tangible property consisting of land, all structures permanently attached to the land, and whatever is growing on the land.

Personal property

All tangible or intangible property that is not real property.