GENERAL SECTION

Elements of insurance

We have seen that the process of insurance has four elements

- Asset
- Risk
- Risk pooling
- Insurance contract

Let us now look at the various elements of the insurance process in some detail.

1. **Asset**

An asset may be defined as 'anything that confers some benefit and has an economic value to its owner'
Economic value
Serving needs

2 Risk

The second element in the process of insurance is the concept of risk. We shall define risk as the **chance of a loss**. Risk thus refers to the likely loss or damage that can arise on account of happening of an event. We do not usually expect our house to burn down or our car to have an accident. Yet it can happen.

Examples of risks are the possibility of economic loss arising from the burning of a house or a burglary or an accident which results in the loss of a limb.

This has two implications.

i. **Firstly,** it means that that the loss may or may not happen. The chance or likelihood of loss can be expressed mathematically. Risk always implies a probability. Its value always lies between 0 and 1, where 0 represents certainty that a loss will not happen while 1 represents certainty that it will happen
ii. **Secondly,** the event, whose occurrence actually leads to the loss, is known as a **peril**. It is the cause of the loss

3. **Risk pooling**

The third element in insurance is a mathematical principle that makes insurance possible. It is known as the principle of risk pooling.

4. The insurance contract

The fourth element of insurance is that it involves a contractual agreement in which the insurer agrees to provide financial protection against specified risks for a price or consideration known as the premium. The contractual agreement takes the form of an insurance policy.