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**A N S W E R S   A N D   R A T I O N A L E S   T O   U N I T   T E S T**

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1. 4 A.; 2 B.; 1 C.; 3 D. Risk is the chance or uncertainty of loss. Insurance is a contract or device for transferring the risk of loss from a person, business, or organization to an insurance company that agrees, in exchange for a premium, to pay for losses through an accumulation of premiums. A peril is the cause of loss. A hazard is something that increases the chance of loss.
2. **B** A pure risk is one that involves only the possibility of loss. Choice A is an example of a speculative risk in which there exists both the possibility of gain and the possibility of loss.
3. **C** The law of large numbers says that the more examples used to develop a statistic, the more reliable the statistic will be. Insurers use the law of large numbers to predict the number of losses that will occur so they can charge the correct premium.
4. A and D are correct. Insurable interest exists when there is an actual economic interest in the safety or preservation of the subject of the insurance from loss or destruction or financial damage or impairment. LaTonya has an insurable interest in the home because she owns it. First City Bank has an insurable interest as long as it carries a mortgage on the home.
5. Any four of the following: Insurable interest; pure risk, not speculative; loss must not happen to a large number of insureds at the same time; risk of loss must be definite; loss would cause financial hardship; cost of loss is calculable; cost of insurance covering the risk is affordable; large number of persons with similar potential for loss.
6. **B** A sprinkler system can reduce the severity of fires, but it does not prevent them altogether or reduce the number that occur.
7. **C** By not producing the drug, Benson avoids the risk of being sued by consumers who are injured by the drug.
8. **A** By not carrying health insurance, Donna is retaining the risk of financial loss from unexpected medical expenses.
9. A peril is the cause of loss. In these exercises, the perils are: A. Fire; B. Flood; C. Collision.
10. A peril is the cause of loss. In question A, the peril is theft. A hazard is something that increases the chance of loss. In question B, the hazard is leaving the door unlocked.