iii) How would they know if they are paying too much or too little?

Obviously someone has to initiate and organise the process and bring members of the community together for this purpose. That 'someone' is known as an 'Insurer' who determines the contribution that each individual must make to the pool and arranges to pay to those who suffer the loss.

The insurer must also win the trust of the individuals and the community.

1. How insurance works

a) Firstly, these must be an asset which has an economic value. The **ASSET**:
   i May be **physical** (like a car or a building) or
   ii May be **non-physical** (like name and goodwill) or
   iii. May be **personal** (like one's eyes, limbs and other aspects of one's body)

b) The asset may lose its value if a certain event happens. This chance of loss is called as **risk**. The cause of the risk event is known as **peril**.

c) There is a principle known as **pooling**. This consists of collecting numerous individual contributions (known as premiums) from various persons. These persons have similar assets which are exposed to similar risks.

d) This pool of funds is used to compensate the few who might suffer the losses as caused by a **peril**.

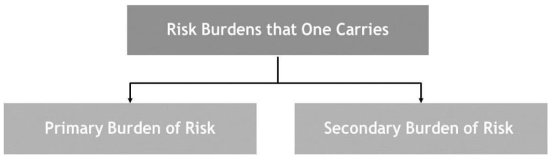
e) This process of pooling funds and compensating the unlucky few is carried out through an institution known as the **insurer.**

f) The insurer enters into an insurance **contract** with each person who seeks to participate in the scheme. Such a participant is known as **insured.**

2. Insurance reduces burdens

Burden of risk refers to the costs, losses and disabilities one has to bear as a result of being exposed to a given loss situation/event.

Diagram 3: Risk burdens that one carries



There are two types of risk burdens that one carries - **primary and secondary**.

a) Primary burden of risk

The **primary burden of risk** consists of losses that are actually suffered by households (and business units), as a result of pure risk events. These losses are often direct and measurable and can be easily compensated for by insurance.