



# What is insurance?

KS3

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Ages 11-16 ⌚ 3 min read

Insurance is based on a simple idea: bad things are unlikely to happen to you on any given day, but very likely to happen to *someone* in a large group over time. If everyone in the group chips in a small amount, and that pool of money goes to whoever has the misfortune of needing it, everyone gets protection at a reasonable cost.

Imagine 1,000 people in a village, and once a year, on average, one of their houses burns down. Rebuilding costs £100,000. If they all put £100 into a shared pot each year, the pot has £100,000 — just enough to rebuild the one house that burns. Nobody knows whose house it'll be. But everyone gets protection for just £100 instead of gambling their entire home on luck. That's insurance, in its purest form.

## How does a real insurance company work?

You pay a regular amount called a **premium**. The insurer collects premiums from thousands or millions of customers. When you make a **claim** — something covered by your policy goes wrong — the insurer pays out from that pool. The insurer's job is to calculate how much premium to charge so that the total collected exceeds the total paid out, leaving a profit. They employ mathematicians called **actuaries** to calculate these risks with great precision.

## Why do premiums vary so much?

Because risk varies. A 17-year-old learning to drive statistically has more accidents than a 45-year-old with 25 years' experience. So car insurance costs more for young drivers — they're statistically more likely to claim. A house in a flood zone costs more to insure than one on a hill. An extreme sports enthusiast pays more for life insurance. The premium reflects how likely you are to cost the insurer money.

## What's an excess?

Most policies have an **excess** — an amount you pay yourself before the insurance kicks in. If your excess is £250 and your claim is £1,000, you pay £250 and the insurer pays £750. Excesses exist to discourage very small claims (it's not worth claiming for

something cheaper than your excess) and to ensure you have "skin in the game," reducing careless behaviour.