

How to ... recognise the level of risk you pose to a life assurance company

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By Bruce Cameron

Life assurance is not a case of all sizes fit all. Life assurance companies take all sorts of things into account in deciding whether you are "insurable" or not, and how much they will charge in premiums to cover anything from death to the loss of your job. In the third part of our "How to" series on life assurance, Personal Finance looks at the significant issues involved in determining how risky you are to insure.

When you apply for life assurance, you must complete a questionnaire that may ask questions ranging from the state of your health to the age of your parents or the reasons for their deaths, through to your qualifications and employment. You may also be required to undergo an extensive medical examination.

Leanne Dewey, Liberty Life's legal executive, says the reason for this is to allow a life assurance company to determine whether or not the policy you have applied for should be issued and what premium you should pay. This process of assessment is known in the assurance industry as underwriting.

Dewey says life assurance cover must be provided on an equitable basis. This means you will be charged a premium rate that corresponds to the risk you present to the company. The greater the risk you pose, say, of dying early because you smoke, earn your living from defusing bombs, parachute from high buildings for fun and suffer from a dicky heart, the greater the chance a life assurance company will refuse to insure you, or exclude certain causes of death and/or charge you a significantly higher premium than it would for a healthy, non-smoking, accountant who works from nine to five and goes to gym every day.

Anti-selection

If you deliberately, or even innocently, do not disclose all the information required, or if a life assurance company is prevented by law from asking for information it needs to understand your complete risk profile, it could be in trouble.

Any imbalance of information between you and a life assurance company where you withhold information is known in the industry as "anti-selection".

Dewey says that the costs of earlier-than-anticipated claims for benefits are cross-subsidised by all policyholders, called the insurance pool. An increased possibility of claims can cause premiums to go up for all policyholders, or products to be withdrawn, or even, in extreme cases, for the assurance company to collapse.

"These outcomes lead to lower availability, affordability and choice of private assurance for society as a whole," he says.

Dewey says underwriting is of considerable benefit to policyholders and allows insurers to provide cover for unexpected losses at fair and reasonable prices.

You cannot shop around hoping to catch out another life assurance company if you have applied to one and it has refused you or charged higher premiums because it and you have discovered you have a dicky heart. These are questions you will be asked when going through the underwriting process with another assurer.

Silly move

You may think you are being particularly smart by misleading a life assurance company, but it is a silly move because if, when it comes time to pay a benefit, the life company finds out that it has been misled, it will repudiate your claim.

This could result in your condemning your dependants to a life of penury in the event of your premature death; or both you and your dependants to poverty if you are disabled and unable to work.

It is better to pay more in premiums than to lose everything.

Dewey says the law compels you "to honestly disclose all information likely to influence the judgment of the assurer when determining appropriate policy terms and premiums".

WHAT YOU MUST TELL YOUR ASSURANCE COMPANY BEFORE IT CAN UNDERWRITE YOU

The starting point of what premium rate you will pay on a life assurance policy is based on mortality tables, which tell life assurance companies how many years on average anyone of a particular age is likely to live.

There are mortality tables for both men and women, because women, on average, live longer than men. So an average 60-year-old man will pay more in premiums than a 60-year-old woman because the man will, on average, die far earlier than the woman.

Leanne Dewey, Liberty Life's legal executive, says the life assurance company will then, through underwriting, assess whether the risk you present to it is above or below the average in the mortality table. There are a number of factors that influence the assessment of individual risk.

A life assurance company assesses both what is called mortality risk (the probability of an early death) and morbidity risk (the probability of ill health or disability).

Dewey says mortality risk is used for life assurance and morbidity risk for disability assurance. Factors that may influence the morbidity risk may not necessarily affect the mortality risk.