

# How Insurance works

## It's a numbers game

The fundamental basis of insurance is a large number of people pooling their money (premium) to pay out relatively large amounts (the sums insured) to people who have a legitimate claim.

By calling on the vast amount of data available, an insurance company will have a very good idea of the probability of the average number of claims they will get each year for the particular type of insurance the policy cover.

These probabilities will be for each age, and split into male & female and smokers & non-smokers.

They will also be for people who have no significant medical conditions nor engage in work or leisure activities considered "risky" for the type of cover.

This gives them the underlying premium by age, sex & smoking status.

They then add an allowance for their costs, including the cost of getting the insurance "on the books" and a further margin for their profit to arrive at the premium they need to charge, usually on a rate for \$100,000 of cover.

However, if the person has a medical condition or is involved in a "risky" occupation or leisure-time activity that could be a cause of concern, the insurance company can determine, as a group, how that impacts on the likely number of claims and so adjusts the premium accordingly. This is referred to as a "loaded" premium and the insurance company will require signed consent to issue the policy with this loading.

Another way the insurance company may treat the added risk is by applying an exclusion to the particular health condition or activity. Again they require a signed consent to issue a policy with an exclusion.

Note that insurance companies do **not** distinguish on an individual basis, but on the characteristics of groups of people. Therefore, as the statistics show that the group of people who smoke have higher rates of death and medical problems than those who don't, premiums for smokers are higher. Note that not all the added risk might be caused by smoking alone as it could relate to the lifestyle of smokers as a group (& not specifically individuals within that group).