

## UNDERWRITING

### Underwriting - Basic concepts

#### 1. Underwriting purpose

We begin with examining the purpose of underwriting. There are two purposes

- i) To prevent anti-selection or selection against the insurer
- ii) To classify risks and ensure equity among risks

#### Definition

The term **selection of risks** refers to the process of evaluating each proposal for life insurance in terms of the degree of risk it represents and then deciding whether or not to grant insurance and on what terms.

**Anti-selection** is the tendency of people, who suspect or know that their chance of experiencing a loss is high, to seek out insurance eagerly and to gain in the process.

#### 2. Equity among risks

Let us now consider equity among risks. The term "Equity" means that applicants who are exposed to similar degrees of risk must be placed in the same premium class. We have already seen how life insurers use a mortality table to determine the premiums to be charged. The table represents the mortality experience of standard lives or average risks. They include the vast majority of individuals who propose to take life insurance.

##### a) Risk classification

To usher equity, the underwriter engages in a process known as **risk classification** i.e. individual lives are categorised and assigned to different risk classes depending on the degree of risks they pose. There are four such risk classes.

##### i. Standard lives

These consist of those whose anticipated mortality corresponds to the standard lives represented by the mortality table.

##### ii. Preferred risks

These are the ones whose anticipated mortality is significantly lower than standard lives and hence could be charged a lower premium.

##### iii. Substandard lives

These are the ones whose anticipated mortality is higher than the average or standard lives, but are still considered to be insurable. They may be accepted for insurance with higher (or extra) premiums or subjected to certain restrictions.