AMERICAN ACADEMY *of* ACTUARIES

The Bottom Line

on

Risk Classification in Individual Health Insurance

$ Group insurance provided through government programs and employer-based plans generally base premiums on the risk profile of the group as a whole.

$ Individual health insurance requires individual underwriting, i.e., deciding whether or not to accept an individual=s application (*risk selection*), and appropriately categorizing the application to ensure that the policy provisions and premiums are consistent with the risks involved (*risk classification*).

$ Biased selection, antiselection, or adverse selection occurs when applicants can expect to gain financially by making insurance purchase decisions based on risk characteristics that are known or suspected to them but unknown to, or not considered by, the insurer.

$ Biased selection results in program participants with higher than average health care costs, and thus a higher average premium is required, resulting in healthier individuals dropping coverage and possibly insolvency for the insurer.

$ Insurers evaluate a risk primarily by estimating the probable influence of current impairments and previous medical histories on future claims. Since most individual policies are in force for only a few years, underwriting focuses on short term medical costs.

$ Risk classification and risk selection protect the solvency of insurance programs, hold down premiums.

$ If insurers are prohibited from using information on risk characteristics made available to applicants through new technologies, biased selection could become an increasingly costly problem.

For more information about these issues, please see the January 1999 Academy issue paper *Risk Classification in Individually Purchased Medical Expense Insurance*. The staff contact is Tom Wilder (202) 785-7875 (wilder@actuary.org).

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1100 Seventeenth Street NW Seventh Floor Washington, DC 20036 Telephone 202 223 8196 Facsimile 202 872 1948 www.actuary.org