

# NEW ZEALAND SOCIETY OF ACTUARIES

## GUIDANCE NOTE NO.3A

### HEALTH INSURANCE PREMIUMS

#### Scope and Purpose

- 1.1 This Guidance Note is effective from 1 March 2002.
- 1.2 It sets out considerations that the actuary should taken into account when providing advice in relation to premiums for health insurance products in terms of the Human Rights Act 1993 (the Act), particularly in relation to the issue of age.
- 1.3 This Guidance Note is subsidiary to and should be read in conjunction with the Guidance Note headed The Human Rights Act 1993.

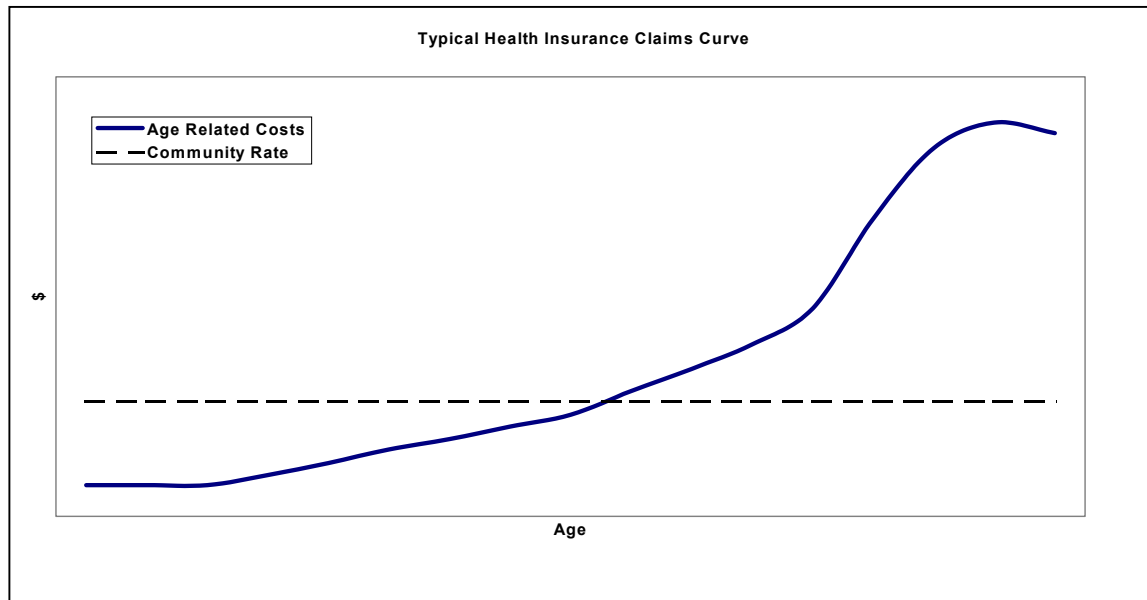
#### Background

- 2.1 At the time of developing this Guidance Note, market practice relating to the pricing of health insurance products varies between market participants. All insurers offer premiums based on current age, with some offering premiums related to each year of age. Variations include premiums with 5-year age bands, as well as premiums based on broader age bands.
- 2.2. The compliance of the premium variations with the Act has not been tested in Court, but the range of market practices has caused concerns regarding the likelihood that all such diverse practices can comply.
- 2.3 Section 44 of the Act states that it is unlawful for any insurer:
  - to refuse or fail on demand to provide goods, facilities or services; or
  - to treat any other person less favourably in connection with the provision of those goods, facilities, or services than would otherwise be the case,by reason of any of the prohibited grounds of discrimination.
- 2.4 Section 48 of the Act provides an exception to Section 44 for insurance products, which includes health insurance products. It is allowable to offer individual persons or groups of persons different terms or conditions for each sex or for persons with a disability or for persons of different ages if the different treatment:
  - is based on actuarial or statistical data, upon which it is reasonable to rely, relating to life expectancy, accidents, or sickness, or...
  - where no such data is available in respect of persons with a disability, reputable medical or actuarial advice or opinion, upon which it is reasonable to rely; and....

- is reasonable having regard to the applicability of the data or advice or opinion, and of any other relevant factors, to the particular circumstances.

2.5 Persons with a disability may have their policy coverage restricted to exclude claims in relation to that disability, if that exclusion is justified by advice in terms of Section 48 of the Act.

2.6 The diagram below illustrates the “shape” of the premium scales under approaches outlined in 2.4 above. The curves are illustrative only and will differ between products, insurers and over time.



2.7 Note that other approaches to product design and premium rating are possible, but do not feature in the New Zealand health insurance market at the time of developing this guidance note. Such an approach might include pre-funding future health costs for individuals.

### Health Insurance Premiums

3.1 In the context of health insurance, a community rating approach, which charges the same premium to all persons covered under the same product with the same policy terms, is deemed to comply with Section 44.

3.2 A community rating approach may not be financially viable or sustainable in a voluntary health insurance market. It is acceptable for the actuary to adopt an alternative approach utilising the exceptions in Section 48 of the Act.

- 3.3 There is evidence that health costs vary with a number of factors including age. For insurance purposes Section 48 is taken to mean that premiums that vary with age directly comply with the Act.
- 3.4 One of the particular difficulties in applying Section 48 to health insurance products is the volatility in claim costs due to variation in the incidence and the propensity to claim, changes in public health provision and rapid changes in medical techniques and technology. Claims costs will also vary due to different policy terms and benefits.
- 3.5 Although it may be difficult to obtain actuarial or statistical data upon which it is reasonable to rely, the start point for any approach other than community rating requires the actuary to construct a best estimate claim curve with values for each individual year of age.
- 3.6 The actuary is expected to make use of the available experience to obtain estimates of future age related claims experience, which may include experience from other analyses. Actuarial judgement will be applied to the derived estimates, using quantitative and/or qualitative approaches as appropriate, to produce an age-related claims curve which is the actuary's best estimate of what expected future claims experience will be. Appropriate graduation of the claim curve is acceptable.
- 3.7 There will always be some uncertainty about both the best estimate claim values and the confidence interval associated with those estimates. Greater statistical credibility in determining the best estimate claim values and confidence intervals may be achieved by grouping. That grouping may, for example, be by sex and/or by subsets of ages. The actuary must be satisfied that any grouping of data does not introduce any bias.
- 3.8 The claim values derived by the actuary as the basis for the premium rates should be such that the chosen value at any age is within a reasonable confidence interval of the best estimate claim value for that age. In many cases the confidence interval may still be wide even after the data is grouped. In these cases it may not be appropriate to use a claims rate at the outer end of that interval. The actuary should apply judgement to ensure that the deviation from the central estimate is reasonable at each age.
- 3.9 The premiums produced by the actuary will take the derived claim values and allocate additional elements such as expense loadings, cost of capital and profit margins. The allocation of such elements should also be equitable and reasonable in terms of the Act, and should be allocated as closely as possible to the cause they have arisen from.
- 3.10 The actuary should ensure that the progression of premium rates from age to age, or from age band to age band, is reasonable.
- 3.11 While the overall premium scale is of importance, it must be noted that the Act applies at every individual age. In particular, if age banding is used the actuary must be able to justify the level of increase in the premium rate from one age band to the next by reference to the underlying claims costs.
- 3.12 Similar considerations also apply to revisions of premium rates. In revising premium rates, the actuary should also consider the increase to the rates at each age. Where a change in premium for one age or one age group would be significantly greater, in

percentage terms, than that for other age groups, then the actuary may delay applying the full change.

- 3.13 It is important when finalising the premium rates that the intention of the Act is kept in mind, and any differentiation based on grounds of unlawful discrimination is justifiable under s.48 or s.51 relating to reduced charges.

### **Promotional Material**

- 4.1 The actuary should provide sufficient information and advice to the insurer to enable them to prepare accurate and complete marketing, promotional, and sales training material to be used in conjunction with the premium rates.
- 4.2 It is important that the premium rates and their application over time are clearly explained so that current and future policyholders can be made aware of the potential for future premium increases. The insurer may, for example, need information so they can:
- illustrate the relationship between premium rates and the age of the person insured,
  - highlight that future premium rate changes are likely to result from changes in both the cost of medical services and coverage in the public system, and/or
  - describe the potential impact of changes in the demography of the insured portfolio.

### **Documentation**

- 5.1 In the process of producing premium rates, the actuary should consider such matters as:
- recent claims history,
  - expected future claims costs, and the basis of their derivation,
  - allowances for expenses, cost of capital, profit margins and any other adjustments made to the risk premium in developing the final premium scales,
  - the expected adequacy of the premium rates, and
  - the degree of consistency between pricing and the insurer's reserving philosophy.
- 5.2 The actuary should document the premium pricing policy, including the process by which the claim estimates are obtained from the experience data. The documentation should include statements as the extent of compliance with this Guidance Note, as well as details of any areas of non-compliance and justification for such non-compliance. The documentation should be sufficient to allow an independent actuary to assess the degree of compliance with the Act and this Guidance Note.