C

hances are, if you are reading this article, you have a pretty thorough understanding of the concept of insurance. Our textbooks tell us that it’s all about “providing financial protection to individuals by means of transferring risk”. Our lecturers go into depth about the role of an actuary in underwriting, pricing, reserving and surplus analysis, amongst other exciting pursuits.

For the benefit of those who may not be fluent in the language of risk pooling, insurance is all about recognising the fact that a dollar you have before your house burns down is worth less to you than a dollar after your house burns down.

By managing the risks of large groups of people, insurance funds offer a vehicle through which you may transfer some of the money you have today into the state of the world where you would value it more. That is, insurance products provide a source of protective income, should devastation strike. While the theory behind benefits consulting may not be your cup of tea, the concept of insurance gives rise to some pretty intriguing ideas.

We have all heard the stories of moral hazard, where individuals pretend to be seriously injured as a result of a fall choreographed to extort their insurance funds. However, did you know that the game show Who Wants to Be a Millionaire? is actually insured against the possibility of a contestant winning?

Or that it is possible to insure yourself against the possibility of an alien abduction?

These days, you can insure almost anything of value – including your Fantasy Football or SuperCoach Team – often with quite attractive benefits, should the triggering event occur.

But before you take to the streets, begging “please steal my car”, we should consider how these unique insurance products are valued and how they work in the first place!

Take David Beckham for example. In 2006, he insured his legs for a cool £100m. Whilst some may argue that this sum of money is simply spare change for the soccer superstar and that the insurance policy is a mere publicity stunt, there are still sound actuarial principles behind the insurance of body parts, despite how absurd it may sound.

This type of policy is comparable to that of disability income insurance policies, which aim to ease financial strains should an individual injure themselves and be unable to work. Likewise, without the full capabilities of his legs, Beckham would not be able to play soccer competitively, thereby losing not only his primary source of income, but also any additional illustrious sporting titles he may have otherwise been able to achieve. Consequently, the policy would help to minimise the risks associated with playing the sport and ensure that should the unfortunate situation arise where the policy needs to be exercised, he would at least be financially protected.

Then the question becomes, how would the premium for this insurance policy be calculated? A series of assumptions would need to be produced by the relevant insurance company to assess the likelihood of being required to pay out the £100m sum insured. Broadly speaking, this would involve estimating the probability that Beckham would injure his legs as well as the severity of this injury, compounded with a series of estimates detailing potential time periods in which this event may occur.

As we all know, when we are younger, our bodies are more likely to recover faster from injury or other health issues. So it is safe to assume that in the earlier stages of his career, the chances of Beckham injuring himself to an extent that he would be totally incapable of playing soccer would be fairly low. Likewise, towards the end of his career, as he plays fewer matches on a lesser scale, this may also result in a reduced chance of critical injury.

On top of all that, an insurance company would need to take into account a range of possible claim sizes that they may be required to pay out. For example, if the company is required to pay for the cost of surgery on Beckham’s legs, this may only be a few thousand pounds. Conversely, if he were to become paralysed and unable to play ever again, this would likely result in the insurer paying out the full amount. These are just some of the factors that must be taken into consideration before a final premium can be set.

Another problem which may arise is the lack of insurance policies for body parts on issue, which means the usual risk pooling principle behind insurance would not be applicable in this case. Companies issuing such policies would be taking on a substantial amount of risk and potentially forecasting (or hoping) that they may never have to pay out the full sum insured; because chances are they don’t have exorbitant amounts of money lying around.

So what is the moral of the story? Unless you’re happy to exhaust your assets in insurance premiums or you have assets like Dolly Parton (in which case it’s probably best to cover your assets – pun intended), it’s probably a better idea to simply take out regular health cover.

So maybe, if you are in a position like us, you should reconsider insuring your wrist against the very likely event that your actuarial exams cause irreparable damage to it! A

To Insure or not to Insure? (That is the Question)