**REPORTING ISSUES**

**UNDERWRITING METHODOLOGIES**

# **Introduction**

There are several underwriting methodologies that are used by direct writing companies. The use of one methodology over another can be determined by a number of factors including product design, policy face amount, applicant health status and age.

## **Purpose of the document**

• Present definitions of the primary underwriting methodologies

* Present discussion of the primary underwriting methodologies
* Discuss risks that Underwriters must assess
* Present Best Practices on using the underwriting methodologies and assessing risks

## **Definition of Underwriting Methodologies**

1. Fully Underwritten: The applicant is required to provide information regarding their health status including their current health status, a complete medical history, full documentation of their financial position including financial statements and tax returns for their personal finances as well as any ownership in any businesses.
2. Simplified Issue: The applicant is required to provide a limited amount of health and/or financial information and if none of that information fall outside of set limits then the policy will be approved for issue.
3. Guaranteed Issue: The applicant is only required to provide the normal application and the policy is guaranteed to be issued within the guarantee issue parameters. These parameters can include policy face amount limits as well as health restrictions.

## **Discussion of Underwriting Methodologies**

The Fully Underwritten (FUW) methodology is most often used for applications for large face amount policies (i.e. greater than the company retention limit) and/or where the applicant has current or a history of significant health issues. This methodology allows the underwriter to get a full picture of the potential risk being taken by the company so that an appropriate risk rating can be assigned and as a result an appropriate amount of premium charged to the policyholder. This process is normally not a quick process because the applicant is required to gather and provide a comprehensive set of health and financial information, potentially including doctor visits, medical test, financial statements and tax returns and other required documents.

The Simplified Issue (SI) methodology has fewer requirements than the FUW methodology but the applicant still may be required to provide some limited additional information including answering some medical questions. However, no blood or urine testing is done. The issuing company normally sets face amount and other policyholder rating limits on products that can be issued via SI. This process is normally quicker than FUW so an applicant can have a policy issued in a shorter time span.

The Guaranteed Issue (GI) methodology is the quickest route to issuing a policy because it has the fewest information requirements from the applicant. Normally this methodology only requires a normal application or in some cases the issuing company may utilize a more streamlined application including few if any medical questions. The industry is also starting to adopt online application processing so for GI products the applicant may only be required to answer a few questions online and if the answers are acceptable a policy may be issued within a few days. Policies issued on a GI basis are typically small face amounts.

## **Underwriting Risks**

Aviation Risk: Applicants who are pilots or do a significant amount of flying often have the risk amount retained by the issuing company reduced thereby ceding more of that risk to reinsurers. Aviation risk is a very specific risk that the insurance industry pays close attention to especially for pilots or others who fly frequently like professional athletes. Because of the inherent risk in flying many issuing companies limit the amount of risk they will retain on a life that flies a lot. This can result in more risk on a life being ceded to a reinsurer than would have normally been ceded. This can also impact whether a policy can be issued on this life using the SI or GI methodologies. It is interesting to note that statistically flying is safer than driving but the industry does not limit its risk tolerance for that risk. The primary reason for this is that most people drive/ride in cars and so that risk is already built into the rates whereas not everyone flies a lot so that risk is not built into the rates.

Smoking Risk: The distinction between smoking and non-smoking applicants began in the 1980’s. The health risks for smoking are well documented and insurers distinguish all applicants between smokers and non-smokers. Insurers define smoker in different ways with some requiring the applicant to have never smoked whereas other insurers allow some tobacco use like occasional cigars, pipe and chewing tobacco use.

Health Risks: Other than smoking insurers also assess various health risks such as blood pressure, alcohol/drug use, cholesterol, diabetes, weight, family history and others. The applicant’s health history has a significant impact on the underwriters rating of the applicant. Many insurers use a scoring system to determine the impact of each of these health risks on the policyholders class and/or mortality rating.

Financial Risks: When underwriting applicants requesting large face amount policies underwriters review the applicants financial situation to determine whether their net worth and/or current or potential future income are sufficient to require and support the size of policy applied for. Financial information such as tax returns, bank and brokerage statements, company financial statements and other financial data is used to evaluate this risk.

Other Risks: Other Risks such as lifestyle risks may also be considered. These would include things like skydiving, car racing and other higher risk activities.

## **Best Practices**

1. Reinsurance administration should work closely with Underwriting to learn about and understand the different Underwriting Methodologies and Risks.
2. Reinsurance Administration should pay attention to how these methodologies and risks could be written into the treaties they administer to see if they impact the rates or other reinsurance classifications on policies.
3. Reinsurance administration should provide the Underwriting Methodology used on each policy to the reinsurers in their regular reporting. This allows the reinsurer to know the method used and better understand the risks they are accepting.

## **Conclusion**

This discussion is meant to give a high level view of the Underwriting Methodologies and Risks most often used by companies issuing life insurance policies. Reinsurance administration teams are encouraged to contact their underwriting departments to learn more about what methodologies and risks their company uses and accepts, how their company defines those methodologies and risks and how they may impact the reinsurance treaties their companies are a party to.

Sources

Klein, Allen, Life Insurance Underwriting in the United States – Yesterday, Today and Tomorrow. Mr. Klein’s paper can be found at the following source:

<http://www.actuaries.org/CTTEES_TFM/Documents/Underwriting%20in%20the%20US_Yesterday%20Today%20and%20Tomorrow_Paper%20for%20the%20BAJ_2012-Feb-10.pdf>