

Learning Objectives :

Understand

1. Underwriting basics
2. The objectives & principles of underwriting
3. . Underwriting Life & non-life insurance business

Structure :

- 3.1 Underwriting basics
- 3.2 The objectives & principles of underwriting
- 2.3 Underwriting in Life insurance
- 3.4 Underwriting in non-life insurance
- 3.5 Key Terms
- 2.5 Activity
- 2.6 Summary
- 2.7 Suggested Readings / Web resources

1. Underwriting basics

History of underwriting -

Underwriting began in the UK when the sailors wrote down details of the voyage and the cargo on a slip & carried it to the Lloyds where the person read the risk & agreed to cover them by writing below the risks. Thus the insurer was known as 'underwriter'.

The genesis of the insurance business also evolved from the UK and the first insurers were the Lloyd's industries.

1. Underwriting basics

Underwriting defined -

Underwriting is the process of selecting & classifying exposures and is directly related to the pricing function of the insurer.

The underwriter is responsible for

→ evaluation and acceptance / rejection of risks

→ computation of premium.

If the risks are evaluated correctly, pricing becomes effective & generates business that lends financial stability to the insurer.

1. Underwriting basics

Trade off -

Underwriting is the trade off between business & survival.

If it sets high standards for risk cover, it loses premium income that can cost survival.

If premium charged is high, it can lose to competition.

On the other hand loose standards for risk & low premiums can attract business, but result in failure of income to match the large amount of claims!

1. Underwriting basics

The conflict -

The conflict between production & underwriting is common in underwriting similar to between sales and credit control in other business.

If underwriting is too strict it harms potential premium income and if it is loose, income cannot match resultant quantum of claims.

1. Underwriting basics

Two guiding principles -

'Adverse selection' and 'Persistency' are principles guiding prudent underwriting.

Underwriter has to guard against adverse selection of risks, as there is a tendency among those likely to be affected by the happening of the event to go for insurance.

Underwriter has to offer products that consumers can afford and policies need to be continuously renewed to assure continuous income to the insurer.

2. The objectives & principles of underwriting

a] Product equitable to customer – insurer to fully assess the risk and charge premium accordingly.

b] Deliverable to the customer – it is insurer's job to offer products that consumer accepts. If a product is a flop, the onus lies with insurer.

c] Financially feasible to the insurance company – though underwriters do not determine price, their contribution is as vital as that of actuaries, as they put the business of risk to work.

3. Underwriting in Life Insurance

Life insurance is mainly concerned with mortality. Any impairment in personal health, medical history, habits, family history, occupation etc affect mortality adversely.

Detailed data is collected on these parameters and the insured is categorized into Preferred, Standard or Sub-standard class denoting higher degree of risk.

3. Underwriting in Life Insurance

The underwriting process

The process involves:

performing field underwriting

reviewing the application in the office

gathering additional information, if required &

taking an underwriting decision.

3. Underwriting in Life Insurance

The underwriting process

Receiving proposals / applications.

The insured or the agent submit proposal with required general & medical information.

The medical report

Is a formal examination in most cases. If any deficiencies are noticed in this common check up additional examinations are requested.

3. Underwriting in Life Insurance

The underwriting process

Underwriting review.

Here the risk is evaluated by the underwriter and appropriate rate of premium offered. If the risk is unacceptable, a person with cancer or HIV, the proposal may get rejected.

Policy writing

Since life policies run for a long period, or literally for the life of the insured, thorough contracts are built into policies. Generally automated systems are used.

3. Underwriting in Non-Life Insurance

is more complex than life insurance as

- ⇒ insurance ranges from small shops & work shops to large MNCs,
- ⇒ variety & size of risks is wide,
- ⇒ operations cover many countries.

but principles remain recognizable.

The essence of the task is evaluation the hazard associated with the proposed risk .

3. Underwriting in Non-Life Insurance evaluation of risk - contd.

For smaller proposals data in the proposal form, plus a site visit can be adequate.

For larger proposals, we need

a] application containing the insurers statements tailor made for each line of insurance.

b] information from broker or agent specially appointed for this purpose

c] review of history & past experience of claims raised

d] inspections & surveys by experts.

3. Underwriting in Non-Life Insurance

Underwriting practices

Underwriting is normally completed by 'new business department' of the company. It uses the policy & guidelines issued by the HQ. They include -

- Acceptance of normal risks irrespective of sums involved.
- Acceptance of normal risks up to a certain sum of money.
- Acceptance of normal classes of business but with prior approval of controlling office.

3. Underwriting in Non-Life Insurance

Underwriting practices

- Acceptance of risks with prior approval as above.
- Acceptance of risks subject to underwriting safeguards.
- Procedural matters.

The risks in fire, marine and motor insurance have generally high levels of acceptance. While in case of jewellery, baggage, personal accident the limits are low. Higher limits are accepted after approval of HQ

3. Underwriting in Non-Life Insurance

Underwriting practices - contd.

In case of buildings insurance break up of values into parts of building, plant & machinery, inventory, furniture etc is required.

Insures can exclude damages from storm, earthquake etc from cover.

Rates indicated by Tariff Advisory Committee are minimum, firms are free to charge higher premiums.

In case of comprehensive motor insurance cover is subject to specified year of manufacture.

There are many more such guidelines for underwriting.

Key Terms

Adverse Selection.

Persistency.

Underwriting Philosophy.

Claims Experience.

Comprehensive Risks.

Activity

Visit insurance agent and obtain a copy of recent life & non-life proposal submitted to the insurance company by him. Study them.

Next, visit the insurance company and meet concerned managers to ascertain how the underwriting decision was arrived by them.

To summarize

Underwriting is the insurance function that is responsible for assessing & classifying the degree of risk a proposed insured or group represents and making a decision concerning coverage of that risk. The underwriting is a trade off between the business & survival. If the insurance company sets high standards for risk, which can be undertaken, the company may lose the market and consequently , the potential premium income, which can be threat to survival.

To summarize – contd.

The conflict between production and underwriting are common to insurance companies. The two main principles of underwriting are Adverse selection and persistency.

The underwriter must always guard himself against the adverse selection of risks. The underwriting concerns for any insurer are – product equitable to Customer, Deliverable to the Customer, Financially feasible to the Insurance Company.

To summarize – contd.

The underwriting process for life assurance involves [1] performing field underwriting, [2] reviewing the application in the office, [3] gathering additional information, if required and [4] taking and underwriting decision.

In non life insurance underwriting practice differs across products. The important concerns are insurable interest, premium loading, risk classification etc.

Suggested Readings

Practice of General Insurance – by Insurance Institute of India, Mumbai 1999.

Genes Store, Insurer Company, Operations, LOMA, 2000.

Essentials of Risk Management & Insurance – by Vaughan & Vaughan - 2002

Web Resources

www.life-insurnace-underwriting.org

www.insuranceinform.org

www.insuremagic.com

The end !

Next Chapter Four

‘Claims Management’

Good luck!