LIFE INSURANCE

Underwriting

What is Risk??

- Potential of losing or gaining something

OR

- Intentional interaction with uncertainty

• Outcome of taking risk.

Success   OR   Failure

• Chances of success can be enhanced by risk management.

• Element of risk is present in every line of business.

Risk Management

- Risk Management is the process by which individuals and businesses, identify and assess the risks they face and take measures to eliminate or reduce their exposure to that specific risk.

Four Techniques To Manage Financial Risk

1 - Avoiding Risk:

- The first, and perhaps most obvious, method of managing risk is to simply avoid the risk altogether.

Example:

- We cannot effectively avoid the risk of having our personal possessions destroyed or damaged.

Financial success comes from MANAGING RISK, not avoiding it.

2 - Controlling Risk:

- We can try to control risk by taking steps to prevent or reduce potential losses.

Example:

- People can reduce the likelihood of contacting a number of diseases by exercising regularly and maintaining a healthy life style.

Four Techniques To Manage Financial Risk

3 - Transferring Risk:

- When you transfer risk to another party, you basically shift the financial responsibility for that risk to the other party.

Example:

- You give money to your neighbor, Jerry Anderson. You face the risk that Jerry may not repay the loan when due, so you require Jerry's Father, George to guarantee the loan. Thus, George will have to repay you in case Jerry defaults.

Four Techniques To Manage Financial Risk

4 – Accepting Risk:

- Accepting a risk is to assume all financial responsibility for that risk.

- Any risk you face that is not managed by other methods – either avoided, controlled, or transferred – is always accepted, whether you are aware of it or not.

Example:

- The financial loss of losing a pencil is not great enough to show much concern. We assume the cost of replacing the pencil ourselves.
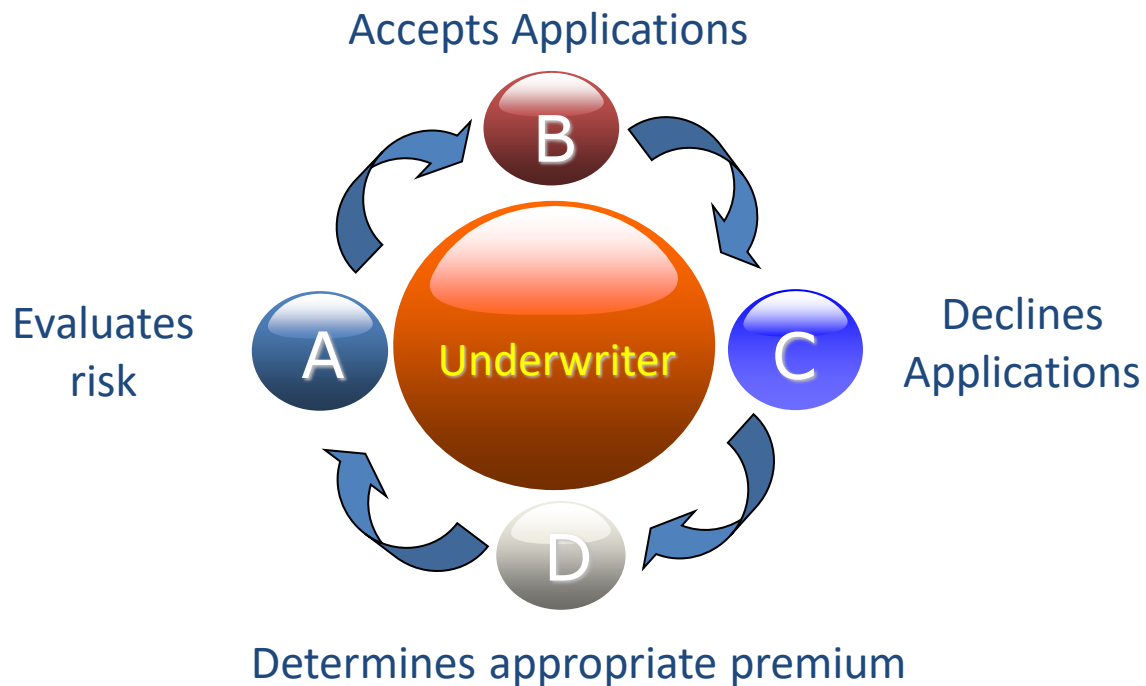
What is Underwriting?

- Underwriting is the process of;

  - Analysis and Assessment of risk.

  - Taking necessary actions to Mitigate risk.

  - Examining, Accepting or Rejecting risk.

  - Classifying the risk, in order to charge the appropriate Premiums.

What does an Underwriter do?

- An Underwriter is an Employee of the Insurer who -

Accepts Applications

B

Evaluates risk

A

Underwriter

C

Declines Applications

D

Determines appropriate premium

The decision to provide insurance coverage or not, is commonly referred to as an *underwriting decision*

These decisions greatly affect the success or failure of an insurance company

- Accept the application but attach certain conditions for coverage.

  - Extra premium

  - Exclusion clause

  - Alteration of contract conditions
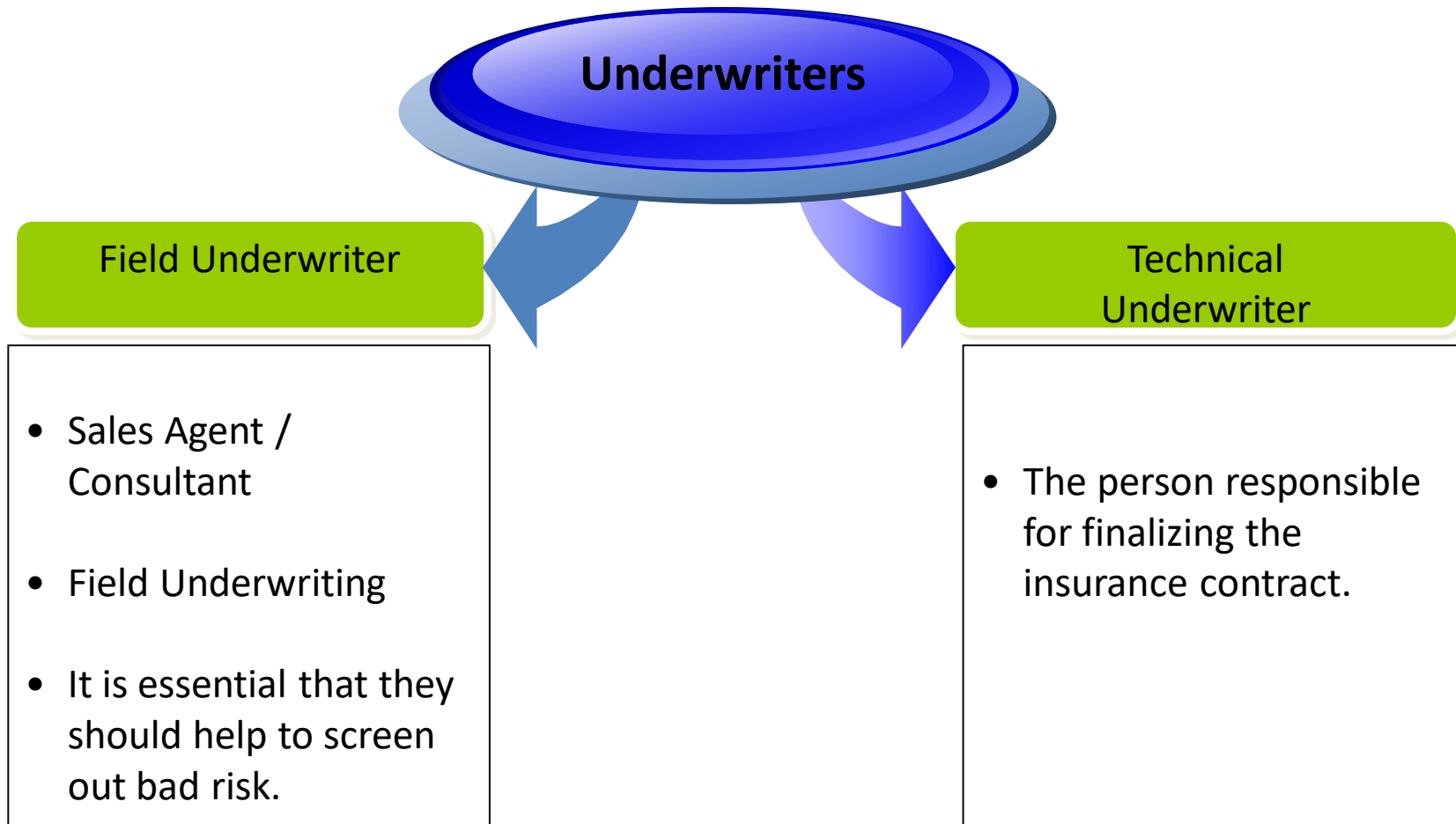
Basic Information Needed:

- Proposal Form

- Routine Medical Requirements

- Financial Requirements

- Occupational Requirements

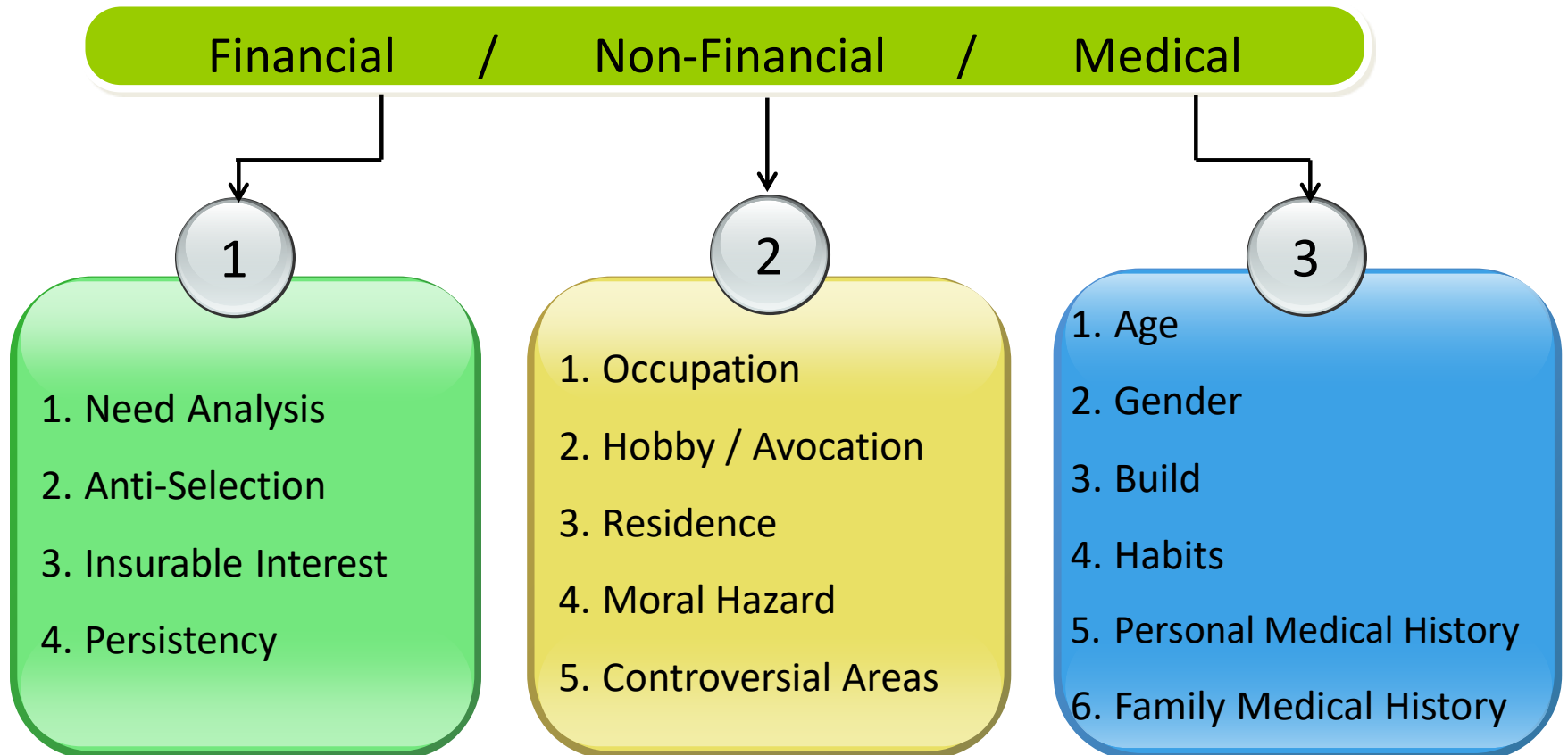- Any other Requirement called by the Underwriter

Broad Classification of Underwriters

Underwriters

Field Underwriter

- Sales Agent / Consultant

- Field Underwriting

- It is essential that they should help to screen out bad risk.

Technical Underwriter

- The person responsible for finalizing the insurance contract.

Classification of Underwriting

1. **Financial**
2. **Non-Financial**
3. **Medical**

Financial /	Non-Financial /	Medical

1
1. Need Analysis
2. Anti-Selection
3. Insurable Interest
4. Persistency

2
1. Occupation
2. Hobby / Avocation
3. Residence
4. Moral Hazard
5. Controversial Areas

3
1. Age
2. Gender
3. Build
4. Habits
5. Personal Medical History
6. Family Medical History

- Purpose of insurance is to cover genuine income loss.

Objective of Financial Underwriting

The Underwriter must establish that, in every case:

- There is a valid reason for the insurance.

- To ascertain if the coverage being applied is aligned with applicant's needs and covers the actual loss of income in the event of his death.

- The contract and sum assured requested are appropriate for the needs that have been identified.

- There are sufficient resources available for the payment of future premiums.

Tools for Financial Underwriting

Individuals are assessed on the basis of:

1. Declared Annual Income (DAI)
2. Multiple of Salary
3. Information provided in Financial Questionnaire Form
4. Bank Statement, Third-Party Financial Investigation Reports and Tax returns, in case of High Sum Assured.

Need Analysis

To ascertain whether the proposed plan fulfills the need of the member.

<u>What do you think about ...?</u>

38 years, male

Married, Three children

Annual income: Rs 2,000,000

Occupation: Business (Doctor)

Sum Assured requested: Rs 4,000,000

And what about this one ...?

20 years, male

Un-married – father & elder brother alive

Annual income: Rs 300,000

Occupation: Student of MBA + income from family business

Sum Assured requested: Rs 3,000,000

Riders requested: ADDB+, WOP

Anti Selection

- **Anti-Selection:** The Tendency of individuals who believe they have a greater-than-average likelihood of loss, (Chance) to seek insurance protection to a greater extent than do other individuals.

Anti Selection (Cont..)

EXAMPLES

- Financial:

  Individual working at a coal mine applies for a coverage above his actual worth.

- Medical:

  An individual suffering from a life-threatening ailment tries to get maximum coverage.

Insurable Interest

- An insurable interest means that the policy owner must likely suffer a genuine loss in case of an adverse event occurs.

- Insurance proceeds cover immediate loss of income faced by the family in event of member's death.

Insurable Interest (Cont..)

EXAMPLES

i.   A 35-year-old male gainfully employed as an accountant, married, having three school going children and parents. All dependant on his income. Applies for a coverage.

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Valid insurable interest

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ii.   A 55-year-old retired widower with 5 kids, all grownup, married, living independently applies for a coverage.

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No insurable interest

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Persistency

- The likelihood of insurance business (Policy) not lapsing or being replaced by another insurer's product.

- High persistency means that a high percentage of policies stay in force till the end of the coverage period.

- Low persistency means that a high percentage of policies lapse for nonpayment of premiums.

Persistency Analytics

Non-Financial Underwriting

- Non Financial underwriting helps underwriters to gather information other than financial information which can help them in assessing and classifying the risk.

Occupational Underwriting

- Individuals involved in hazardous occupations are prone to work-related accidents, amputations or fatal injuries.

- Underwriters ascertain the occupational risk from information received in proposal form and occupational Questionnaires and apply occupational loadings accordingly.

Hobby / Avocation

- An **avocation** is an activity that one engages in as a hobby outside one's main occupation

- Example: "I work on the computer all day, but when I leave work, my avocation is bungee Jumping."

Types of Avocations that are Considered Dangerous

- **Aviation:** Are you a student pilot? How many hours have you flown in the last two years? Purpose of flying? Details of the aircraft?

- **Ballooning:** How many hours have you flown in the last two years? Do you have proper training?

- **Auto racing:** Number of races in the past two years? Are you a professional racer? What kind of vehicle do you race? What is the maximum speed?

- **Scuba diving:** What is the purpose of the dive? Where and how deep do you dive? Are you a certified diver?

- **Mountain/rock climbing:** Average height of climb? Do you climb alone?

- **Skydiving/parachuting:** Number of jumps in the past two years? Where do you jump? Are you a professional stunt jumper?

Residential risk

Individuals Residing in the Countries where there is Political Instability, ongoing Civil War, Harsh living conditions, Severe Law and Order Situation they carry additional risk and are subjected to Residential Loadings, Restrictions, Special exclusions or even coverage can be Declined.

Example :   Afghanistan, Iraq, Iran etc

Controversial Areas

- Housewives, Students, Minors are offered only restricted main plan as per company's policy.

  Reason: No insurable interest. No direct loss of income but only emotional loss in event of death.

- Landlords and Individuals dependent on Rental Income or Investment returns are also offered only restricted coverage.

  Reason: Stream of income continues even after their death or disability.

Moral Hazards

Moral Hazard is a characteristic that exists when the Reputation, Financial Position, or Criminal Record of an Applicant or a Proposed Insured indicates that the person may Act Dishonestly in the Insurance Transaction.

The Following Situations may Lead to Suspicion of Moral Hazard:

Moral Hazards (Cont..)

1

- A person who has recently been declared Bankrupt.

2

- A history of Unethical and Unlawful Business Operations.

3

- Persons convicted for Tax-Evasion, Fraud or similar offences.

4

• Bogus signatures on proposal form or applicant concealing proper identification.

5

• Poor Medical Risk found on medical examination or Investigation.

6

• Unwillingness by the Life Assured to co-operate in providing further Underwriting Requirements.

Medical Underwriting

Healthy individuals tend to live longer.

- Ideally the longer the policy holder lives the better it is for himself and the insurance company.

- Underwriters cannot predict how long an individual applying for insurance lives or when will he die.

- Medical underwriting helps underwriters to ascertain if the applicant is enjoying good health or is suffering from any ailments which require special terms to be imposed while issuing the policy.

Factors Affecting Medical Underwriting
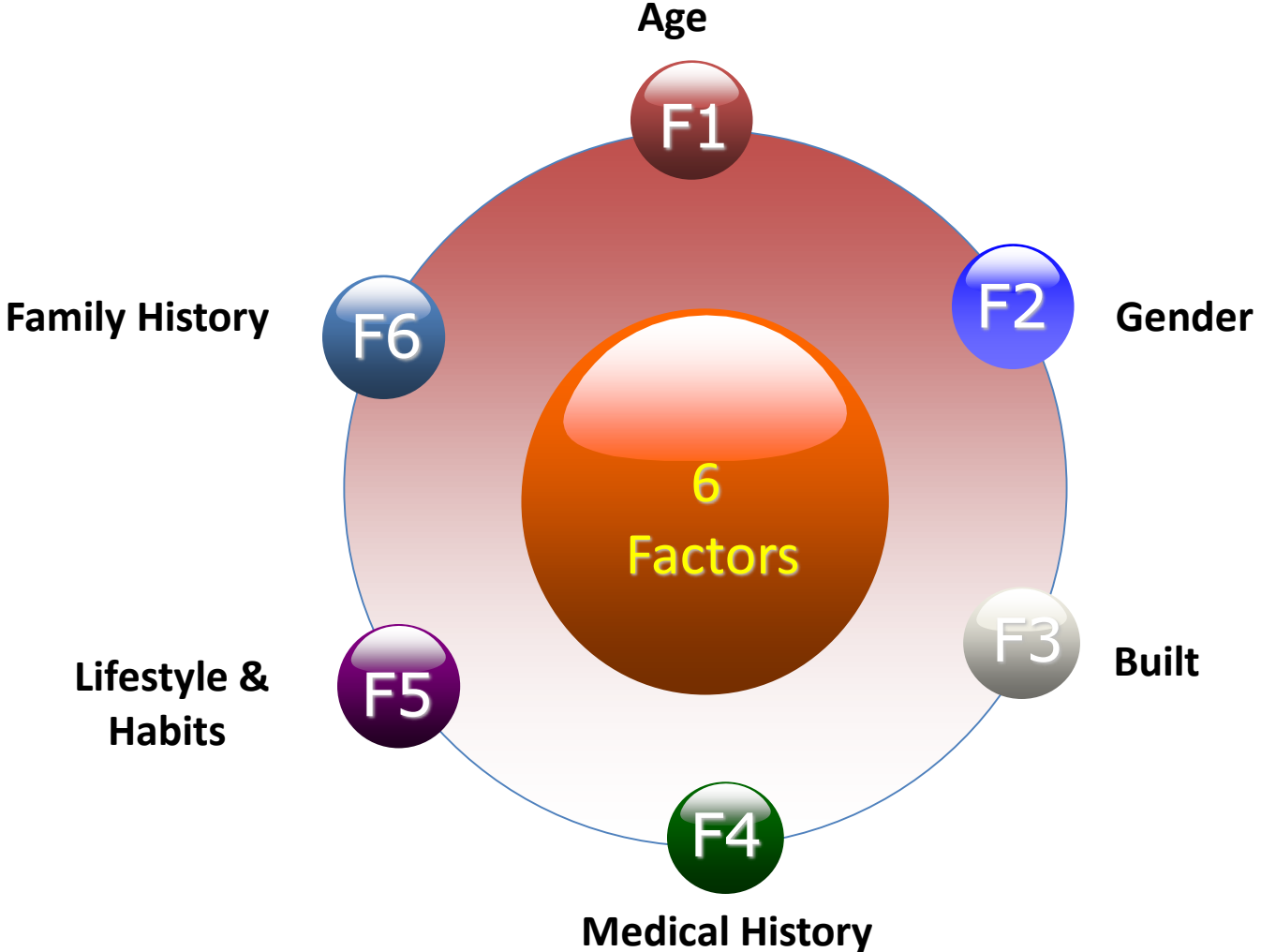
Age

- Younger applicants are usually healthier than applicant of older age groups.

- Mortality rate increases as individuals grow older.

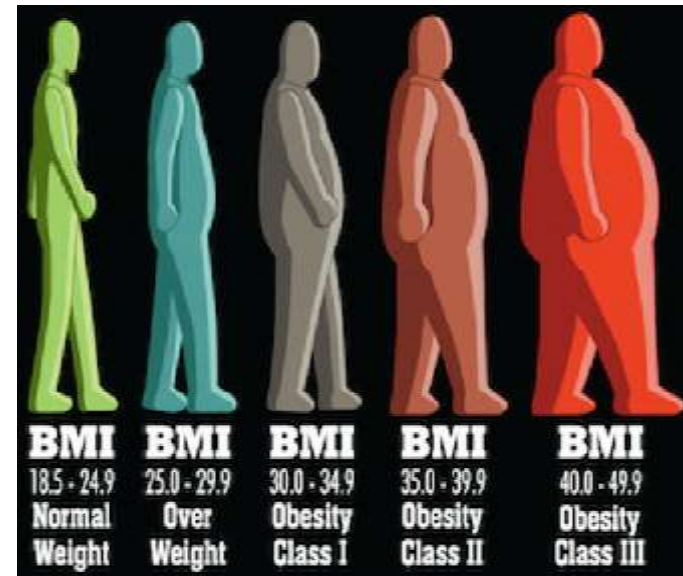- Premium rates are lenient in younger age groups than in older age groups.

Gender

• Statistically and medically proven fact that women live longer than men.

• Premium rates are lower in females than males.

Built

- Built is an important factor in medical underwriting.

- Body mass index (BMI). BMI is a simple index of weight-for-height used in classifying overweight and obesity in adults.

- Formula to calculate - weight in kilograms divided by the square of the height in meters (Kg/m2).

- Individuals with BMI > 30 are prone to develop diseases like Diabetes, raised blood pressure, heart diseases, stroke and different types of cancers.

| BMI 18.5 - 24.9 Normal Weight | BMI 25.0 - 29.9 Over Weight | BMI 30.0 - 34.9 Obesity Class I | BMI 35.0 - 39.9 Obesity Class II | BMI 40.0 - 49.9 Obesity Class III |

Medical History

• Any medical history including details of past illnesses or ongoing treatments affect underwriting decisions.

• Additional requirements may be called for based on the information gathered.

Lifestyle & Habits

•**Healthy lifestyle contributes to long life free of illnesses. Special emphasis is being given on the following factor during underwriting:**

•Smoking and alcohol

•Work-related or emotional stresses

•Good dietary habits

•Active lifestyle - regular exercise
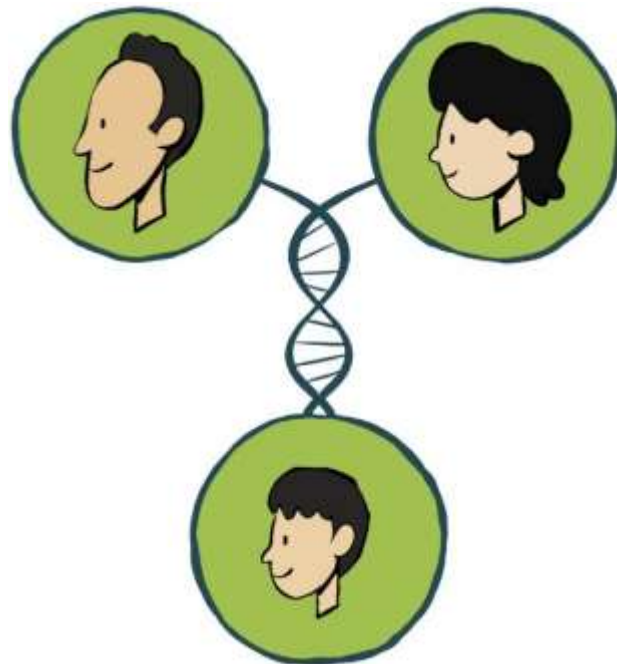
Family History

- Some diseases are genetically transferred and tend to run in the family for example Diabetes, heart disease, breast and ovarian cancers in female.

- Further and thorough underwriting is required in applicants who have a family history of such disease.

Tools For Medical Underwriting

Fresh Medical Examination

Based on the Medical examination reports, a decision can be taken about the health status of the Proposed Insured.

Attending Physician's Statement

The past health details of the Insured, would be available with his Attending Physician, hence the APS would become an important reference in such cases.

- **Medical Questionnaire**

  Whenever, the proposed Insured has undergone medical test or check up, the Medical check up Questionnaire will have to be provided.

- **Discharge Report Certificate**

  In case the applicant has been admitted to any hospital for any kind of treatment, the DRC has to be submitted along with the Medical

Classification of Risk

1- Preferred Risk

2- Standard Risk

3- Sub-Standard Risk

4- Decline

1- Preferred Risk

- Proposed insured who present a significantly lower than average likelihood of loss is classified as preferred risk.

2- Standard Risk

- Proposed insured who has a likelihood of loss that is not significantly greater than average is classified as standard risk.

3- Sub-Standard Risk

- Proposed insured who has a significantly greater than average likelihood of loss but is still found to be insurable is classified as sub standard risk.

4- Decline

- The Declined risk category consists of those proposed insured who is considered to present a risk that is too great for the insurer to cover.

Question & Answer

Have a great time ahead