

Personal Insurance Underwriting

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THE PERSONAL LINES UNDERWRITING PROCESS

Insurance, which is sometimes referred to as a commodity or a mass-produced product, differs from retail or manufactured operations primarily because of risk selection. The idea that an insurer might reject an applicant who needs coverage is contrary to, for example, the approach taken by an auto manufacturer, who would welcome a customer who needs a new vehicle. Because insurers pay losses as part of their business, they must select applicants and submissions that are less likely to incur losses than anticipated. Without the risk selection process, this would be impossible.

Personal lines underwriting is a process of selecting eligible and acceptable submissions according to legislative and regulatory published rules and an insurer's underwriting guidelines. This process has evolved from one in which underwriters manually and individually assess risks and price policies to a more automated and efficient operation in which underwriters are involved mainly for more unusual or high-value loss exposures. Until and even after automation has been fully implemented, underwriters should understand the standards and guidelines that drive the automated procedures that screen applicants and that ultimately lead to acceptance or rejection of submissions. They should also know how to modify an unacceptable loss exposure so it can become acceptable for the insurer.

Personal Lines Underwriting

Underwriting applications and existing policies is a foundation of the insurance business. Underwriting is the process of reviewing new applicants' and existing insureds' risk characteristics and selecting those that match the company's underwriting and rating criteria. Underwriting guidelines help insurers select insureds who present potentially profitable loss exposures.

Eligibility and Acceptability

Most personal lines forms, rates, and rules are filed for approval with state regulatory authorities. Risk eligibility is usually determined by the rules that apply to each type of coverage. A submission cannot be written on a policy for which it is ineligible. For example, a truck that is used commercially is not eligible for a personal auto policy.



Underwriting guidelines (underwriting guide)

A written manual that communicates an insurer's underwriting policy and that specifies the attributes of an account that an insurer is willing to insure.

Risk acceptability is generally defined by the **underwriting guidelines** published by an insurer. These guidelines provide a broad framework of loss exposures normally accepted for coverage. In some states, the guidelines must be approved by or filed with regulatory authorities.

A personal lines underwriter might find many submissions that are eligible for coverage based on the insurer's filing but that are not acceptable based on the submission's specific characteristics. An example of an eligible but unacceptable submission for homeowners insurance is a twenty-year-old single-family residence (eligible) that has a roof in need of replacement (unacceptable).

Point-of-Sale Underwriting

Point-of-sale underwriting involves screening the presented loss exposures by comparing them to the insurer's basic underwriting criteria at the first point of contact with the customer. Traditionally, a producer did this when approaching or being approached by an insurance customer. Insurers have relied on and stressed the importance of underwriting applicants at the time of first contact because of the benefits of point-of-sale underwriting:

- If the customer's loss exposures are clearly outside the insurer's guidelines, the customer can be notified immediately. Then he or she can pursue other coverage right away, rather than wait for acceptance or declination of coverage from the insurer. Any negative reaction to declination might be mitigated because the customer is not delayed from securing other coverage.
- If the customer has unique loss exposures requiring a higher classification and premium charge than expected, he or she can be informed of the higher premium at the initial meeting. The customer can then decide whether to shop for other coverage or to accept the higher premium. Otherwise, an insurance applicant who has been quoted a premium and receives an unexpected additional bill will probably form a negative impression of the insurer.
- For the insurer, having an unacceptable application declined at the initial time of contact is more efficient than having the application declined later in the underwriting process, as it saves other screening and processing efforts and expenses.

Point-of-sale underwriting is part of the entire streamlined effort toward automated insurance operations. It offers the same benefits whether it is done by an individual underwriter or by automation at the first point of contact with a customer.

Underwriting Decision Making

Underwriting guidelines list acceptable risk criteria along with the maximum limits of coverage that the underwriter may provide. The limits that underwriting guidelines permit are usually derived from the insurer's overall



risk preference, its capacity, and its reinsurance limits. The underwriting guidelines represent one level of authority. Underwriters, senior underwriters, and underwriting managers are generally granted progressively higher levels of **underwriting authority**. An underwriting manager's authority might be limited by the insurer's reinsurance treaties. As the level of underwriting authority increases, the responsibility for accurately applying experience and judgment also increases.

Although a personal lines underwriter's expertise is still needed for high-value or unusual loss exposures, insurers are automating the underwriter's traditional role for routine and predictable loss exposures. High efficiency, quicker service, and cost savings are also evidenced by an insurer's use of predictive modeling and expert systems. In addition, underwriters may review entire books of business as well as individual losses, to better track trends and measure long-term results.

Underwriting by Exception

Personal lines underwriting previously involved an underwriter making a decision on each application submitted to the insurer. This approach—individual account underwriting—has been gradually replaced by automated systems that screen files so that only those requiring decisions are reviewed by underwriters. Underwriting by exception eliminates most files from the individual underwriting review process. Under this system, computer programs process policies for acceptable files and issue cancellation notices for unacceptable renewals. Application details are entered into the computer, which filters them with the insurer's particular underwriting standards, accepting or declining applications accordingly. Only applications that fall into a middle ground are referred to a personal lines underwriter.

Screening may be done using a checklist or scoring approach. Acceptable and unacceptable risk characteristics are defined and entered into a checklist or software program. For example, a roof that is more than twenty years old might be coded as unacceptable. If a scoring system is used, that characteristic might be given a high (meaning poor) score. Submissions that fall outside an acceptable profile (with a high score) are referred to an underwriter for review.

Straight-Through Processing

Straight-through processing is another way in which personal lines underwriting is becoming more efficient. It is an attempt to automate all policy and claim processing from the initial customer contact through the final policy payment, including all events and transactions in between. Existing and emerging technologies help make this process possible, often in incremental steps for an insurer, as legacy systems are replaced and underwriting standards become more efficient and consistent throughout an organization. By relying on electronic submissions, an established "business rules engine" to support the underlying decision criteria, and more agency involvement, policies flow

Underwriting authority

The scope of decisions that an underwriter can make without receiving approval from someone at a higher level.



through processing with little or no human involvement. However, underwriters should fully understand the principles and guidelines on which this process is based.

The benefits of straight-through processing include cost savings, quicker policy issuance and claim processing, and overall efficiency. See the exhibit “Underwriting Process.”

Predictive Modeling and Expert Systems

Modeling involves defining the ideal risk characteristics as well as the acceptable ranges around the ideal. Online information is available regarding the acceptable variance from the ideal model and recommended standards, which can assist the underwriter in making a final decision on accepting a submission.

Predictive modeling takes data and forecasts future expectations applicable to underwriting, claims, sales, and pricing of insurance products. Computer programs provide almost limitless possibilities for uses and applications for the insurer. Credit-based insurance scores are a practical example of a predictor that has been used extensively in underwriting and pricing.

Insurers also use expert systems to assist with personal underwriting decision making. If a submission falls outside an insurer’s acceptable range, the computer presents hypothetical scenarios to help determine which modifications could be made to make the submission acceptable. The expert system conducts much of the investigation and analysis of alternatives.

Portfolio Underwriting

Portfolio underwriting is a monitoring approach insurers use in evaluating a group of related policies. Premium volume, loss frequency, loss severity, and retention are a few of the factors an underwriter analyzes when evaluating a portfolio. Reviewing a portfolio of policies enables an underwriter to measure trends over time and to determine corrective actions for a group of policies.

One of the advantages of using a scoring system when screening applications is the ability to monitor a portfolio by reviewing the average scores. A book of preferred business in which each submission barely satisfies the preferred criteria can indicate problems that require further investigation. Average scores that deteriorate over time also reflect the need for additional research to remedy the situation.

Apply Your Knowledge

XYZ Insurance primarily writes auto policies. It has known for many years that students with good grades are generally better drivers, so it asks its student-discount drivers to submit their report cards twice a year. A new computer program gives the underwriters additional information, suggesting which



Underwriting Process

<i>Steps</i>	<i>Tasks</i>	
1. Evaluate the submission	<ul style="list-style-type: none"> • Weigh the need for information • Gather the necessary information 	<p>Categories of information:</p> <ul style="list-style-type: none"> • Essential • Desirable • Available <p>Resources:</p> <ul style="list-style-type: none"> • Producers • Applications • Inspection reports • Government records • Financial rating services • Loss data • Field marketing personnel • Premium auditor • Claims files • Production records • Consultants' reports
2. Develop underwriting alternatives		<p>Alternatives:</p> <ul style="list-style-type: none"> • Accept • Reject • Modify—require risk control measures • Modify—change insurance rates, rating plans, or policy limits • Modify—amend policy terms and conditions • Modify—use facultative reinsurance
3. Select an underwriting alternative		<p>Factors to consider:</p> <ul style="list-style-type: none"> • Underwriting authority • Supporting business • Mix of business • Producer relationships • Regulatory restrictions
4. Determine an appropriate premium		
5. Implement the underwriting decision	<ul style="list-style-type: none"> • Communicate the decision • Issue documents • Record information 	
6. Monitor underwriting decisions	<ul style="list-style-type: none"> • Monitor individual policies • Monitor books of business 	<p>Triggering events:</p> <ul style="list-style-type: none"> • Substantive policy changes • Significant and unique losses • Preparation for renewal • Risk control and safety inspections • Premium audits

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students should continue to turn in report cards and which ones need not to receive the discount.

Which term describes this process?

- a. Underwriting by exception
- b. Portfolio underwriting
- c. Predictive modeling
- d. Point-of-sale underwriting

Feedback: c. Predictive modeling. The computer program uses other information about the students to determine which ones will most likely continue to have good grades and therefore not need to continue to turn in their report cards. This approach saves time and resources for the insurer by allowing it to avoid monitoring the grades of all its student-discount drivers.

EVALUATING PERSONAL INSURANCE SUBMISSIONS

Evaluating personal insurance submissions begins with an insurer establishing acceptability guidelines that applicants must meet to qualify for coverage; a personal lines underwriter then determines whether an applicant meets those guidelines so that a policy can be issued.

After an application has been submitted to the insurer, a decision must be made about whether to accept it. Although many insurers automate this step for routine homeowners and auto policies, personal lines underwriters need to understand the procedures and guidelines that drive this decision as well as make their own determinations for unusual or high value submissions. The personal lines underwriter first identifies loss exposures gathered from the application and other sources. Then he or she identifies hazards that could increase the frequency or severity of a loss and determines the relative importance of each.

Identifying Loss Exposures

Property and liability loss exposures are constantly evolving. At one time, personal property losses were primarily from fire and wind damage, and personal liability losses mostly involved auto accidents or premises mishaps. Personal insurance policies are now much broader in coverage. New liability exposures have appeared, and existing ones have become more pronounced. For example, day care loss exposures are relatively new and may involve incidents of sexual molestation. Dog bites, while not a new occurrence, have become a growing and significant financial liability for personal insurers—in part,

