Article from:

News Direct Newsletter

September 2002 – Issue No. 41

The Survival of Most Insurers Hinges on Underwriting Faster, Cheaper, Better

by Maria Thomson

Editor's note: The following is drawn from the Society of Actuaries seminar on Feb. 28 – March 1, 2002 entitled: "Underwriting to Expand Market Share: Faster, Cheaper, Better." Faculty members were the authors as representative of the actuarial profession and three underwriters: Hank George, SVP of Lab One, Kathleen Elzeer, VP of Great American and Mary Fernald, SVP of Scottish Re.

Insurers Love the Affluent

Statistics tell the story of disturbing trends in the industry. From 1989 to 1999 the number of individual policies in the United States declined from 180 million to 162 million, according to the ACLI. The average policy size more than doubled, from $27,553 to $56,749. Additionally, LIMRA surveys show a big drop in sales to households with less than $30,000 in income. But sales to the affluent have increased, and one-third of all life sales now are to households with incomes above $100,000, according to LIMRA, and two-thirds of sales are to the over-$60,000 income group, according to Conning & Company surveys. The IRS announced that in 1999 the top 10 percent of taxpayers had at least $88,000 in taxable income—so about 50 percent of all life insurance production today is to the top 10 percent of the market.

> *The consequence of this narrow market focus is shocking:*
>
> *30 insurance conglomerates write over 70% of the life insurance industry's new premium!*

This statistic from LIMRA raises the stark question: how will the remaining 1,300-plus insurers continue to survive living off the crumbs of the remaining 20 percent? Clearly, the paradigm for the industry must change to re-claim the neglected 90 percent of the market.

Is Alternative Distribution the Answer?

To expand distribution and cut costs, the industry has looked beyond traditional agents since the 1970s. The cost of acquiring $100 of new first-year premium is $135 to $160 through an agency, compared to $105 to $115 via a bank or stockbroker, $100 on a direct sale and about $15 through the Internet, according to figures compiled by the consulting firm Booz-Allen & Hamilton and LIMRA. The great surplus strain created by generating new business has driven insurers to pursue increasingly higher premium per sale through their agency systems in order to boost their ROEs.

Alternative efforts have included direct mail, affinity-group marketing, worksite, bank distribution, and selling through mass media. As a result, today's distribution systems are diverse, and alternate distribution methods are maturing. However, what do we have to show for it? Only about 12 percent of Americans buy direct (this includes mass media and the internet), about 8 percent buy voluntary insurance at work, and about 7 percent buy through banks. Thus, alternate distribution accounts for about one-quarter of all insurance production after over 30 years of effort—split almost evenly over three different channels.

These channels have demonstrated success in penetrating the mid-market. Two-thirds of all direct mail sales and three-quarters of all worksite sales are to the mid-market, according to Conning & Company. Sadly, the bottom line is that in spite of the growth of alternate sales channels and their success in the mid-market, total sales to the mid-market continue to shrink.

The Final Barrier

Why have efforts to reclaim the mid-market met with such limited success? I believe there is still one significant hurdle to be overcome—traditional underwriting, which makes sales difficult and policy issue expensive. The process is cost-effective, from both the insurer's and the salesperson's point-of-view, only for large policies.

Some insurers have tried to solve this problem by turning to guaranteed-issue or simplified-underwritten policies for low face amounts. This provides fast, cheap issuance, but mortality is so high that most carriers still lose money, despite high premiums and low benefits.

On the other hand, classic "extreme" underwriting is slow. Requirements for attending physician statements (APS), paramedical exams, or fluids slow down the evaluation process and are a major cause of the lengthy issue process, six weeks on average. About 15% of the business is lost due to withdrawals, incomplete information or not-takens. To minimize not-takens, particularly if a policy is rated, the agent must re-sell it upon issue. Furthermore, the agent is burdened with helping to acquire underwriting information—a big distraction from selling. The underwriting requirements, the application fallout and the paper-intensive processing combine to create high direct and indirect costs.

Today, though, the choice isn't limited to either guaranteed issue or full underwriting. With revolutionary new underwriting tools now becoming available, faster, cheaper underwriting and issuance can be combined with quality risk selection. By slashing costs and boosting speed, 21st-century underwriting lets insurers sell to average people and make a profit.

New Underwriting Tools to the Rescue

Obtaining the APS is a time-consuming, expensive process that significantly slows underwriting and issuance. The underwriting faculty argued that insurers need the APS less often with tele-underwriting and new tools like pharmaceutical databases. The latter is arguably the most important underwriting development in many years.

Knowledge of the pharmacological treatment, coupled with follow-up explanations provided by the applicant in a personal history interview, can provide the underwriter with all the information required in most circumstances. Thus, learning the applicant's prescription history is the starting point for obtaining medically significant information in a fast, far cheaper manner.

In many situations, it is very clear what the implications are of a particular prescription history, coupled with the applicant's divulged medical history. For example, as Kathleen Elzeer pointed out, a divulged history of heart palpitations coupled with a prescription of alprazolam is minor and can be issued standard. However, if this applicant is taking amiodarone, a serious medical condition is indicated which will have to be rated or rejected.

The development of pharmaceutical databases is a breakthrough that is a win/win situation for insurers and consumers. Consumers will have fewer insurance carriers reading their private medical history obtained from their physicians. Insurers benefit because the pharmaceutical database is fast and electronic. The information can often allow the insurer to avoid obtaining further medical information. If the database and the personal history, coupled with a fluid sample, provide sufficient information, we would expect that a company could issue a policy within 11 days, on average, for fully underwritten business—instead of the normal six weeks. If fluids are not required, a policy could be issued in less than a week, as pharmaceutical data is available within 24 hours.

(continued on page 16)

Hank George touted tele-underwriting as another major tool that helps speed issuance, while removing from the agent the burden of taking a personal history. Tele-underwriters typically use reflexive (drill-down) medical questions (a PHI) to get an accurate picture of applicants. Hank argued that experienced tele-underwriters have learned that a neutral third-party interview is far superior to an agent or an underwriter interview in the quality of information obtained. There's no need for an agent to ask an applicant medical questions—only to have a tele-underwriter do it again. One high-quality interview is enough. George also urged underwriters to secure information on nutritional supplements in the PHIs, as these can be as revealing of medical conditions as pharmaceuticals are.

Other tools that speed underwriting and issuance include electronic applications/electronic signatures and use of the Medical Information Bureau, which makes its information available electronically. Motor vehicle records (MVRs) are another fast-emerging, powerful tool for speedy underwriting. They respect privacy because they use public records, are cheap (as low as 75 cents apiece) and fast (turnaround with about 24 hours). MVRs are particularly useful for lives below age 40, where accidents are the number one cause of death.

Blood tests are valuable at older issue ages because they let underwriters pin down risk for coronary disease and diabetes. However, for lives under age 40, blood work can often be replaced by less-expensive oral and/or urine tests, which detect the most serious health risks for younger people: HIV infection, tobacco use, and abuse of drugs and alcohol. Even without blood tests, the use of parameds is usually not essential. George argues that ECGs, X-rays, inspections and physician exams are outdated underwriting tools that have less value than modern data sources. APSs may soon prove to be rarely necessary as well.

Pushing the Envelope with Technology

Mary Fernald and I discussed the use of technology to further speed the issue process. Fernald stated that the Internet is primarily being used today to generate quotes, but showed one example of how an insurer, inviva, is using it to take an application and issue a temporary policy within 15 minutes. Inviva's online software has links to underwriting (including an expert system), administration, accounting, reinsurers and payment processing. *[Editor's note: see article, "American Life Binds Insurance Using Expert Underwriting," on page 11.]*

Four vendors exhibited Internet-based point-of-sale software that expedites new business and underwriting processing. Such software, coupled with readily accessible underwriting data, could ultimately make instant issue of fully underwritten policies feasible (for more on this, see my article on technology in *NewsDirect*, Jan. 2002).

It's estimated that about 30-50 percent of mid-market applicants can't be underwritten immediately by the computer because of age or health conditions; these have to be handled by human underwriters. But insurers using the rapid-issue techniques discussed in the seminar will still provide faster, lower-cost underwriting and issuance.

The faculty agreed that faster, better, cheaper underwriting and issuance is the key that will enable insurers to again profitably sell policies to average Americans. The cost savings can be passed onto clients in the form of more-competitive products. Facing fewer hassles and delays, agents can afford to sell average-sized policies, and alternative distribution through the Internet, banks, worksite and direct marketing becomes more attractive and feasible. The mid-market can and will be reclaimed by companies that move ahead of the pack by instituting cutting-edge underwriting and sales software now.

Maria Thomson, FSA, MAAA, is Managing Principal of Thomson Management Solutions, Inc. and she can be reached at mthomson@tmsolutionsinc.com.