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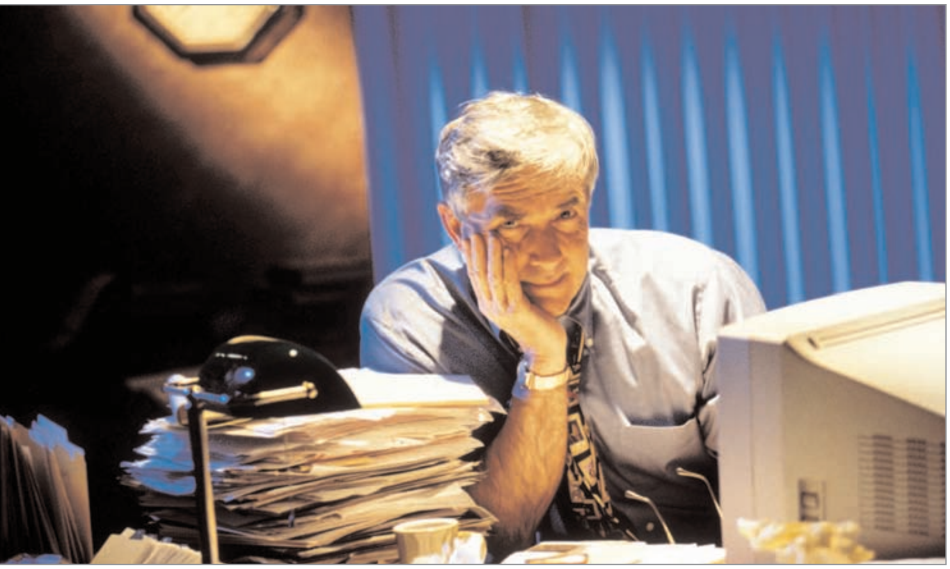

UNDERWRITING FOR THE NEW MILLENIUM: SIMPLIFIED PRODUCT SURVEY

BY VERA F. DOLAN

This article is based on a presentation made by Vera F. Dolan, FALU, at the Spring 2005 meeting of the Society of Actuaries.

Underwriting simplified products is in transition, for there are new tools out there that are compelling in their possibilities. These new underwriting tools include pharmacy databases, credit databases and teleunderwriting. In a survey conducted in early 2005, many managers of simplified underwriting programs said that they were upgrading or testing products with these new tools, but those products were not yet in widespread production.

So, until the new tools get a little more mileage, let's take a look at what is known to be tried and true. Twenty-one companies participated in the survey, sharing what they knew about their 31 top-selling products during phone interviews. It became quite clear right away that underwriting tools were necessary, but not sufficient, to manage the risk that was coming in the door.

Vera Dolan is principal of VFD Consulting. Sh can be reached at 707. 463.3200 or via e-mail at dolanvp@consultancy.com.

Simplified products are different than traditional products in that there is far less time and money with which to gather independent, objective information about an applicant's risk. For this reason, premium rates are higher and face amounts are lower than for traditionally underwritten products. However, bad things can happen, despite tight product parameters and underwriting controls.

Here is what one underwriter said about the nightmare that was his company's experience with simplified products:

"We had our clocks cleaned. Some claims arrived before the policies were issued. Brokers gamed the system by disclosing only within limits—if the myocardial infarction happened one month before our 24-month limit on the application, the case was submitted. We had very limited ways to check history.

"Brokers didn't care if they still had a contract with us the following week. We lost control of the risk assessment process. If we were to do this again, we would use a channel that is more controlled, but we are NEVER going to do this again!"

Other underwriters appeared older and wiser in their approach to channel control, which has resulted in success for their simplified product programs. Many said that they integrate channel control in their new business operations, and did not count on underwriting alone to safeguard their risk assessment process.

Different strategies are used to discourage brokers from cruising intensive care units, including random audits of business with traditional underwriting approaches, or canceling the contracts of brokers with a high incidence of early mortality. The "sentinel effect" is thus applied to the broker, because the nature of simplified products makes it less feasible to project this principle on the applicant.

Many of the simplified programs that have been around for a long time (over 15 years) are quite choosy when it comes to their channels, preferring to work with niche markets that they know well. Insurers working with affinity groups that are closely knit have tended to ward off anti-selection because of their access to insider knowledge. Insurers who get their leads from mailing lists drill down into those lists with great caution and selectivity.

Lesson Number 1 then is to make channel control a very high priority when underwriting cannot do all the heavy lifting by itself on risk assessment.

All the simplified products in the survey are designed as the "plainest vanilla" possible. Thirty-five percent do not offer riders of any kind. The loads that are allowed for compensation and underwriting are tiny when compared to traditional products. Turnaround to issue is a matter of hours or days, not the weeks or months that can be experienced for traditional products.

Given this situation, what underwriting requirements can be gathered when there is little money and less time to gather requirements and evaluate them? The top answer that over 80 percent of the survey respondents gave was the MIB check. The only programs that do not use MIB are either guaranteed issue or juvenile products. Just as with traditional products, MIB is a cornerstone of the industry.

Beyond MIB, the underwriting requirements that are obtained depend on the market served and if the simplified product program is partnered with a traditional product line. For example, the juvenile market (which goes up to age 17) does not need motor vehicle reports. Most programs obtain an underwriting requirement only when there is a disclosure made by the applicant that raises a red flag. Such requirements include personal history interviews, motor vehicle reports and yes, (surprisingly) attending physician statements (APS).

About 70 percent of products in the survey have the facility to trigger the retrieval of an APS. Apparently the idea is that this information would be used to make the applicant an offer using a more traditional product. Some new business systems supporting simplified issue programs share the same workflow as traditional product programs. In this type of operation, a case is diverted to a real underwriter when the simplified product application isn't clean enough to pass directly through the software or issue clerk.

Other simplified product programs are completely separate from traditional products, with new business systems that are customized to serve simplified issue products only. Additional underwriting requirements are less likely to be obtained in such operations.

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Lesson Number Two is that there is a bigger picture to be understood when choosing underwriting requirements and underwriting strategies for a successful simplified issue program. Just as with traditional products, underwriting is not a "black box" to plug and play. The use of underwriting and its tools has to be carefully considered and integrated within the program that you desire.

No two underwriting programs among 21 companies surveyed were exactly alike. Indeed there were some common themes, but each simplified product program reflected the unique constraints, choices and considerations involved.