The trouble with underwriting is – Financial Adviser – November 2005

Speak to any insurer today and they will all agree that underwriters are a scarce resource. With the growth in the housing market and the increase in those selling pure protection products the volume of business needing some form of underwriting has grown rapidly in recent years, albeit reduced recently from the heady heights achieved up to the 2nd quarter of last year.

Although it may seem an obvious statement to make that "underwriting lies at the heart of every insurer's term strategy" it is worth pointing out that the quality, consistency and skill of the underwriting department can help drive insurers' profitability on so many fronts. Whether it is because a good underwriting reputation can win you business from IFAs and help you secure panel positions, or because the quality of your underwriting underpins improved reinsurance terms, leading to improved competitive positioning and with that improved volume, margin etc.

It was as early as 1998 that a number of key individuals within the forward thinking life insurance providers had identified that, in the future, the resourcing issues facing underwriting departments would prove problematic. Not simply in terms of coping with the projected changes in overall volume, but also because of the continuing difficulty most providers suffer in managing their new business proposal count over time and now the scale of such problems would be even greater. Simply put, any price competitive provider operating in the IFA market can experience significant fluctuations in their week-to-week volume, based almost entirely on their relative competitive position on the portals. Whilst insurers' pricing teams work hard to secure the optimum volume their underwriting and administration departments can mange efficiently, they cannot control the same activity undertaken by their competitors. If your competitors' re-pricing makes you less competitive you get less business, yet your fixed cost base remains largely unchanged and profits reduce. If your competitors' activity makes you more competitive than you had planned for, and you are priced towards the top end of the table, then your volume can increase by as much as 300%. Such shifts can prove disastrous for underwriting departments, turnaround times increase and reputations for good service can be destroyed. It is for this reason that the market has seen a significant increase in pricing activity, as actuarial teams do their bit to help manage the flow of business into underwriting departments.

Big businesses however do not want to be resource constrained indefinitely and therefore other solutions are needed to be thrown into the mix to ensure large appetites can be fulfilled and understandably insurers turned to technology for answers. Convenient then that the re-insurers had been working on developing rules based underwriting software that could be adapted to suit individual insurer needs. The original thinking was that insurers could employ operatives with less knowledge, skill and experience than a fully trained underwriter, using the technology to reach decisions on some of the cases that might otherwise occupy underwriters. Rapid developments were suddenly in demand as the term market started to grow but insurers were not satisfied with simply keeping such tools in their back office and therefore 'user friendly' front ends were developed in tandem. The new idea being to deploy the decision making tools further up the food chain and as far forward as the sales process itself. It is not hard to see the basic drivers for having intermediaries do the keying, and today, if you don't have some form of underwriting tool attached to your online new business submission front end, then you are very much behind the market leaders and certainly constrained by the 'human only' solution. However, technology will only ever play a part and will never fully replace skilled underwriters, unless of course your business model is only to accept a small percentage of the applications you receive. The issues here are (1) customers' circumstances do not always fit into the 'straight lines' such tools are inevitably developed around and (2) the software is only going to perform as well as the person feeding it with the answers it demands.

However, if nothing else had changed in underwriting over the last six years then such technological developments may well have proven to be the panacea insurers were in search of. The changed competitive and regulatory environments, however, have made things a little more complicated than was the case in 1998. We have seen fierce price driven competition during this time, which has led insurers to demand better and better terms from the re-insurers. As in any industry, however, you can only squeeze your suppliers so far; before they need to change the terms of their supply contracts and so it is in insurance too. The effects of this change can be seen in the increasing number of lifestyle and health questions asked of applicants and today the percentage of the population able to secure ordinary terms has reduced, with many insurers rating more cases than would have been the case just a few years ago.

The changed competitive landscape has also presented the re-insurers (now on the front foot) with the opportunity to introduce clauses in their agreements that allow them to decline contributing to claims where the agreed underwriting process or policy was not adhered to in practice. This could prove very expensive for insurers, having to meet 100% of a claim when they thought they were only carrying as little as 10% of the risk. It is this concern that has helped to maintain the bottleneck issues in underwriting departments that were so prevalent at the top of the market. Insurers have moved to tighten up their procedures to ensure they meet the quality standards that were written down when the contracts were agreed. Gone are the days when underwriting managers under pressure could take a slightly more relaxed line to maintain turnaround times, ultimately at the re-insurers expense. This more rigorous approach has also led to insurers becoming increasingly reliant on third parties to help them make their underwriting decisions, in particular GPs, who have a reputation for being notoriously slow and awkward to deal with. All of which mean that at a time when the insurers underwriting teams should be offering faster turnaround times than say a year ago - they are not.

The regulatory changes however, have presented insurers with an opportunity to shift a little of the risks they carried under the old ABI guidelines, to the intermediary. In particular the risks presented by taking responsibility for the sales process, including the effect it may have on, or contribute to, non-disclosure. Prior to statutory regulation all such risks were carried by the insurer as part of their agreement with the ABI; since regulation all such risks have shifted to advisers. Examine the responsibility intermediaries now accept for collecting the answers to, and explaining the meanings of, underwriting questions held on forms or via online underwriting tools and you can see why some are choosing to circumvent such risks by using businesses that offer tele-underwriting and tele data-capture services. Whilst this is largely a good business decision for them it can also have beneficial ‘knock on’ effects for the insurer as the quality of the information gathered by such companies for consideration by underwriters is often clearer and of a higher quality.

As we look forward we can see that underwriting is not going to become less complicated and intrusive than it is today, it will become more so, as the providers look to segment the population into a higher number of better defined insurance risk groups. As well as the underwriting we have today, we can expect more medical questions, more chemical testing (blood, urine or saliva) and more lifestyle questions, including details about any driving convictions etc. Yet as this market continues to change and develop (and sometimes it seems that it changes almost on a monthly basis) the insurance company winners will be the ones that meet the genuine needs of distributors and their customers. The primary needs of both are quite simple, they want what they asked for when they asked for it, they want it provided efficiently and quickly and they want to pay the price they were led to believe was available to them at the outset.

All of the above will have to be managed in the near future by underwriting departments which on the whole are not living up to the expectations we have of them today. Therefore managing the expectations of customers and their advisers is going to have to become a core competency of insurers as they seek to maintain relationships through the continuing change.

On the plus side insurers are working hard to increase the number of humans that can support their underwriting demands; they are using lower skilled ‘sifters’ to filter cases that do not need a fully trained underwriter to deal with. They have opened regional based centres, to avoid localised recruitment issues, and introduced more flexible working hours and conditions to suit ‘returnees’ and those with children. But it takes six years to train an underwriter and the clock has already been ticking for some time.

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