

Life Underwriting Module 1 - Introduction

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- *In the insurance industry, the practice of underwriting refers to the process of accepting or rejecting risks.*
- *It is the very heart of insurance and is the first step taken by an insurance company to generate premiums.*
- *Originally, insurance = underwriting i.e., underwriting referred to the operation of the insurance business.*
 - *As the insurance industry developed, underwriting took on a more specialized meaning.*



In the early days insurance was more personal than it is today....

- A **contract was drawn up** between a property owner and a second party, who was willing to insure the specified property, or between the insured and the insurer.
- The contract **specified the terms** under which the property would be insured.
- The property **owner placed his name at the top** of the contract, stating that he was the owner of the property and beneficiary of the contract if the property was subsequently damaged.
- The **other party, who guaranteed the contract** and was the insurer, **signed his name below**, at the bottom of the contract.
- Literally, he "**underwrote**" the contract



Underwriting - Marine Insurance Origin

- . Years ago, when an insurance syndicate such as Lloyds decided whether to insure a ship, the person authorizing the assumption of that financial risk would **write his name under** the description of the risk.
- It was common practice for **individuals seeking insurance for a ship and its cargo** to meet with those desiring to write such insurance in coffeehouses.
- ...would bring a **paper describing the ship, its contents, crew, and destination** to the coffeehouse.
- The paper would circulate, with each **individual who wished to assume some of the obligation signing his name at the bottom** and indicating how much exposure he was willing to assume.
- Since these people signed their names under the description of the risk, they became known as **underwriters**.



UNDER WRITING'S FOUR BASIC FUNCTIONS

- 1) selection of risks,
 - 2) classification and rating,
 - 3) policy forms, and
 - 4) retention and reinsurance.
- By performing these four functions the underwriter *increases the possibility of securing a safe and profitable distribution of risks.*



RISK SELECTION.

- **...deciding whether or not to accept a particular risk. It involves:**
 - **securing factual information from the applicant,**
 - **evaluating that information,**
 - **and deciding on a course of action.**

- **The underwriter is typically aided by a list of acceptable and prohibited risks.**



CLASSIFICATION AND RATING.

- **Once the risk has been accepted, the underwriter then classifies and rates the policy.**
- **Several tentative classifications are usually assigned before a final decision on classifying the risk is reached.**
 - **The purpose of using classifications is to separate risks into homogeneous groups to which rates can be assigned.**
 - **Insurers may have their own classification and rating system, or they may obtain a system from a rating bureau.**
 - **Read more: Underwriting (Insurance) - duties <http://www.referenceforbusiness.com/encyclopedia/Thir-Val/Underwriting-Insurance.html#ixzz16R5RuDHS>**



POLICY FORMS.

- **After determining the acceptability of an applicant and assigning the proper classification and rating, the underwriter is ready to issue an insurance policy.**
 - **The underwriter must be familiar with the *different types of policies* available as well as be able to *modify the form to fit the needs* of the applicant.**
 - **Read more:** [Underwriting \(Insurance\) - duties http://www.referenceforbusiness.com/encyclopedia/Thir-Val/Underwriting-Insurance.html#ixzz16R5kcI2s](http://www.referenceforbusiness.com/encyclopedia/Thir-Val/Underwriting-Insurance.html#ixzz16R5kcI2s)



- The first three underwriting functions—risk selection, classification and rating, and policy selection—are interdependent.
 - That is, the underwriter determines that a certain risk is acceptable when specified rates and forms are used.
- The underwriter also performs a **fourth separate function** on every risk before the underwriting is complete: **reinsurance**.



RETENTION AND REINSURANCE.

- ... involves protecting the insurance company against a certain portion of potential losses.
- Every risk presents the possibility of loss that will equal or exceed the policy limits.
- The underwriter's job is to protect his or her company from undue financial strain and he/she does this **by retaining only a certain portion of the risk and securing reinsurance for the remainder of the risk**





Life Underwriting

- The underwriting of a life insurance policy is the process of the life insurance company underwriter ***deciding whether to insure you and at what rate*** based on your medical history and the activities that you may engage in such as certain sports or flying an airplane.



The Life Underwriter

- the person who decides whether or not to insure risks for which applications have been submitted.
- The underwriter's tasks are to:
 - evaluate a risk,
 - estimate the potential exposure,
 - determine the likelihood of loss,
 - then make a decision whether or not to accept the application for insurance.



“rating classes” “policies”

- Preferred rates,
- Standard rates
- “preferred plus” or “super preferred” - very healthy individuals qualifying for newer discounted rate levels
- “rated policies” means one is charged extra because of health or what may be considered dangerous activities.



Levels to Qualify - Samples

- Occupation
- Medical test results,
- Built Issues: height and weight ratios / BMI
- History of medical difficulties
- Habits: Cigarette / tobacco smoking / Alcohol
- Dangerous sports /
- Family history of longevity / Diseases

Further Reading -References

- **Dearborn Financial Institute Staff. *Introduction to Life Underwriting. 11 th edition. Chicago: Dearborn Financial Publishing, 1998.***
- **Morgan, Joseph F. *Underwriting Commercial Property. 2nd ed. Malvern, PA: Insurance Institute of America, 1997.***
- **Randall, Everett. *Introduction to Underwriting. 2nd ed. Malvern, PA: Insurance Institute of America, 1994.***

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Next → Module 2: Income & The Hazards of Life: Role of Life Insurance