Life Underwriting

Recently, life insurance underwriting with regard to term insurance has become very rigid in that underwriters are no longer able to provide us with the "exception" that we are all used to receiving. The published underwriting criterion for any given carrier is being strictly adhered to. Why?

To understand why, you must familiarize yourself with how the underwriting process works.

A life insurance company shares the mortality risk of its policyholders through three basic layers:

- **Self Retention –** Self-retention is the amount of insurance the carrier will pay upon death without any contribution from reinsurance carriers. As an example, this amount may be $1 million for a 30 year old, but only $500K for a 70 year old.

- **Automatic Reinsurance Pool –** Once the self-retention window is exceeded, the excess face amount then carries over to the automatic reinsurance pool. Under the automatic treaty arrangement, the reinsurers are automatically bound to accept a carrier's decision and do not review the actual underwriting file until that face amount exceeds the treaty amount.

- **Facultative Reinsurance –** Once the automatic treaty amount is exceeded, the reinsurance carrier then receives a copy of the actual underwriting file, which is referred to as facultative underwriting. With facultative underwriting, whatever rate class the reinsurer determines is what the client gets, regardless of the rate class the insurance carrier may have given without facultative involvement. Facultative underwriting can be a double-edged sword so we rarely want to go beyond a carrier's automatic limit. Better to diversify the risk with more than one carrier where there is more control and expectation than to have the whole case go south without hope of recourse.

When an insurance carrier's actuaries put together the pricing of their products, they look for reinsurance carriers that will bid on that excess business without interference to product pricing. The reinsurer will look at the carrier's pricing in relation to the requirements needed to meet the different underwriting classes, and if acceptable, a treaty is implemented.

Recent Changes

- **The size of the reinsurance marketplace has shrunk.**

Having a multitude of reinsurers to bid on the opportunity for premium flow has historically given the direct writing carrier the “upper hand”. Now the reverse is true. In order to have a competitive product and achieve market share, the direct writing carrier must construct the pricing, underwriting and reserves that will be attractive for the reinsurer to take part in the risk pool. That is why we are seeing much stricter guidelines on preferred risk underwriting, higher table ratings for impairments by some carriers, and narrower table shave programs. In fact, many underwriting department heads are predicting the disappearance of table shave programs altogether within the next year.

- **Why has this happened?**

Why this has happened is really a matter of economics, and it comes down to return on investment capital. Interest rates and bond yields have been at the lowest levels in years and there hasn’t been a quick rebound or one predicted in the near future. Because of this, players both big and small in the reinsurance marketplace have bailed out or sold out due to lack of profitability for the risk incurred. Today we have less than ten major reinsurers compared to double that ten years ago.

- **What are the effects to underwriting?**

One effect from this situation is the lack of willingness by the carrier to grant exceptions for a better premium class on borderline risks. While this is frustrating we need to understand the carrier’s position. If the carrier grants the exception and the reinsurance company conducts an audit and discovers a decision not within the agreed to guidelines, the reinsurer will simply walk away from that particular risk, leaving the carrier holding the bag for the entire amount at risk.
Considering that the automatic reinsurance limits can be as high as $40-$50 million on an individual risk, the consequences could have a severe financial impact on the direct writing carrier. In extreme cases where there have been a number of exceptions, the reinsurer can rescind the entire treaty leaving the carrier to shop for another reinsurer willing to take on that risk pool. Not an easy task considering the number of players left in the market.

- **What does the future hold?**

The hope is that the 2001 Mortality Tables will offer some relief, though when that will happen and how much impact the end consumer will see is being hotly debated. There is also talk that there are other players, mainly in the banking field, that are eyeing the reinsurance market.

- **What should you do?**

You need to pre-underwrite your insured. Ask your insured the pertinent questions to ensure that you are quoting the proper premium class. Take advantage of our underwriting knowledge and expertise. Ask for our advice on pre-sale situations; what company may offer more favorable underwriting or how to present an impaired risk to a carrier.