



Class: MSc Sem 1

Subject : Insurance

Chapter: Unit 3 Chp 2

Chapter Name: Underwriting

Today's Agenda

1. Define underwriting
 1. Principles of underwriting
 2. Why is underwriting important?
 3. Types of underwriting
 4. Underwriting process in Life insurance
 5. Underwriting process in General insurance
 6. Factors that influence underwriting decisions
 7. Risks involved in underwriting process

1 Define underwriting



Insurance underwriting is the process of evaluating a risk to determine if the insurance company will insure it and, if yes, then pricing it.

OR

Is the process of consideration of an insurance risk.

- Assumption of liability
- To manage risk

1.1 Principles of underwriting

1.) Minimization of Loss

The insurance underwriter must have the best interest of the insurance company in mind before initiating an underwriting activity. He or she must strive to minimize the loss factor of an insurance company while conducting his assessment. Along with loss minimization, the underwriter should also keep an eye on the profitability factor of underwriting an insurance policy.

2.) Known Hazards

There is implied risk when an insurance company issues an insurance policy. These risks are generally called known hazards. There are a number of known hazards that are associated with a particular client profile. The insurance underwriter must be cognizant of these known hazards while conducting the underwriting process.

3.) Information

An insurance underwriter must gather as much high quality information with respect to client profile, area of insurance, moral hazards, implicit and explicit risks, and beyond. Generally, an abundance of high quality data will lead to better risk profiling, which will lead to higher quality decision making, which would finally lead to more profits for the insurance company.

1.1 Principles of underwriting

4.) Growth of Business

Underwriters should also keep an eye on business expansion, and calculated risk taking. An underwriter should not be so rigid in his approach that he misses opportunities of growth. One eye should be on effective risk profiling and the other eye should be on dynamism and business growth opportunities. It is a fine balancing act.

5.) Solvency

It is absolutely imperative that an insurance company will only underwrite insurance contracts that it can service. At no point should the financial stability of a business be compromised on. Generally, this issue should not arise as there are regulators above insurance companies that exercise strict regulation.

1.2 Why is underwriting important?

The **underwriting policy** for life insurance aids your insurer in:

- Find out if you qualify for insurance coverage.
- Decide how much insurance you can afford.
- Set a premium for your insurance coverage that you can live with.

1.3 Types of Underwriting

Financial Underwriting

- Financial underwriting in life insurance is the process of evaluating an applicant's financial status to determine the risk of insuring them and to classify them fairly so that appropriate premium rates can be charged.

Claims underwriting

Claims underwriting in insurance refers to the process of evaluating and assessing insurance claims to determine their validity and to ensure that they comply with the terms and conditions of the insurance policy.

Medical underwriting

- All aspects of an individual's health and medical history are taken into account throughout the medical underwriting process (if any). After thoroughly evaluating the applicant's health, the underwriter grants coverage for the policy.

1.4 Underwriting process in Life insurance

Proposal form review

- The insurer will review the completed proposal form for accuracy first. This form requires careful completion.
- The insurer verifies the supporting papers.
- The underwriting procedure follows verification of the application's details.
- When you apply for an insurance policy, the underwriter evaluates your financial stability to see if you can afford the premium.

Medical examination

- If your insurance policy needs verification of your health, the medical exam results will be reviewed.
- The underwriter evaluates the medical reports, which may include the results of a blood test, a drug test, and some basic measures (height, weight, and body mass index), before deciding whether or not to approve the insurance policy.

Final approval

- The underwriting procedure may take between three to eight weeks.
- Once all the information has been verified, the insurance application is either accepted or denied.
- If the application is accepted, the premium and policy are confirmed.

1.5 Underwriting process in General insurance

1.Application and Information Gathering: The first step is to obtain relevant information from the applicant or the insurance intermediary. This includes completing an application form that captures details about the insured party, the nature of the risk, desired coverage, and any previous claims history.

2.Risk Assessment: Underwriters assess the risk presented by the applicant based on the information gathered. They analyze factors such as the nature of the risk, its location, the applicant's experience and qualifications, the loss history, and any other relevant factors. This evaluation helps in determining the insurability of the risk and the level of coverage that can be provided.

3.Underwriting Guidelines: Insurance companies typically have underwriting guidelines that outline the acceptable levels of risk and the specific criteria for providing coverage. Underwriters refer to these guidelines to ensure consistency and compliance during the assessment process.

4.Pricing and Rating: Underwriters determine the appropriate premium to charge for the insurance coverage. This involves evaluating the potential cost of claims, considering factors such as the risk exposure, historical loss experience, market conditions, and the company's pricing strategy. Underwriters use actuarial techniques, statistical models, and rating manuals to arrive at a fair and competitive premium.

1.5 Underwriting process in General insurance

5. Policy Terms and Conditions: Underwriters establish the terms and conditions of the insurance policy based on the risk assessment and the company's guidelines. This includes defining coverage limits, deductibles, exclusions, and any specific provisions or endorsements required. The policy wording is prepared, outlining the rights and obligations of both the insured and the insurer.

6. Decision Making*: Based on the risk evaluation, underwriters make a decision regarding whether to accept the risk and offer insurance coverage, or to decline the application. If the risk is accepted, the underwriter determines the terms and conditions, including the premium amount. In some cases, additional risk mitigation measures or policy modifications may be recommended.

7. Documentation and Policy Issuance: Once the decision is made, the underwriter prepares the necessary documentation, including the policy contract and any associated endorsements or riders. The policy is then issued to the insured party, along with any relevant policy documents, such as policy schedules, certificates of insurance, or renewal notices.

1.6 Factors that influence underwriting decisions

Underwriting in insurance involves assessing the factors that determine a potential customer's risk profile. The specific factors depend on the type of insurance you're applying for.

These are the most common factors:

- Type of business
- Age of business
- Financial characteristics (size, sales, assets)
- Prior financial behavior (credit score, bankruptcies)
- Condition of property
- Prior insurance claims
- Safety / security systems
- Loss-prevention practices

1.7 Risks involved in underwriting process



What is Underwriting risk?

Underwriting risk in insurance refers to the potential for financial loss that an insurer faces due to inaccurate assessment of risks associated with insuring a policyholder.

1.7 Risks involved in underwriting process

- **Adverse Selection:** Adverse selection occurs when the insurer attracts a higher proportion of high-risk policyholders compared to low-risk ones. If underwriters fail to accurately assess the risk profile of applicants, they may end up insuring a disproportionate number of high-risk individuals or businesses. This can lead to higher claim payouts and financial losses for the insurer.
- **Moral Hazard:** Moral hazard arises when the insured party has an incentive to take more risks or act in a way that increases the likelihood of a claim. For example, if a policyholder knows they will be fully compensated for any losses, they may be less inclined to take preventive measures or engage in risky behavior. Underwriters need to carefully evaluate the moral hazard associated with each policy to set appropriate premiums and coverage limits.
- **Catastrophic Events:** Underwriting risk includes exposure to catastrophic events such as natural disasters, large-scale accidents, or pandemics. Insurers need to consider the potential impact of such events on their policies and ensure that they have adequate reserves and reinsurance coverage to handle the potential surge in claims.
- **Pricing Inaccuracy:** If underwriters fail to accurately price insurance policies, they may set premiums too low, resulting in inadequate funds to cover claims and operational expenses. On the other hand, overpricing policies could lead to reduced market competitiveness and loss of business.

1.7 Risks involved in underwriting process

- **Regulatory and Legal Risks:** Insurance companies operate within a complex regulatory framework. Failure to comply with regulations or changes in regulations can expose insurers to legal and financial risks. Underwriters need to stay updated with regulatory requirements and ensure compliance to mitigate these risks.
- **Economic Factors:** Economic conditions, such as inflation, interest rates, and market fluctuations, can impact the profitability of insurance underwriting. Changes in economic conditions can affect investment returns, claim frequency, and severity, leading to potential underwriting losses.
- **Underwriting Errors and Omissions:** Underwriters may make mistakes during the assessment and evaluation of risks. These errors can lead to underpricing, overexposure, or overlooking critical information that may result in claims exceeding the premiums collected.