Not So Simple – The State of Traditional Underwriting

While there is no doubt that simplified underwriting has been a growing trend in the life insurance industry, almost 90 percent of all new business volume originates through the traditional underwriting process. Ken Conners, Vice President and Chief Underwriting Officer, and Hank George, Executive Officer of Hank George Inc., discussed trends and challenges facing traditional underwriting.

A candid speaker and author, Hank has 40 years of life underwriting experience, starting with Northwestern Mutual in 1973. His consulting firm provides educational resources for both new and experienced underwriters, and he has been prolific both in written literature and on the industry speaking tour.

Ken Conners: Simplified issue seems to dominate underwriting discussions today, yet 90 percent of all face amount originates through the traditional underwriting process. What’s the current state of traditional underwriting?

Hank George: Yes, simplified issue business is growing, which means a decline in the use of laboratory testing and paramed exams. But what hampers traditional underwriting today is the excessive emphasis on cost containment and productivity, which causes people to make value judgments about screening tools. Unfortunately, the people pushing cost containment often have little appreciation of the implications to a company’s mortality experience. Overemphasis on underwriting productivity, driven by metrics, also compromises the traditional underwriting approach – which is to carefully read all of the information and make the best decision possible.

And then there are the various sales practices that jeopardize traditional underwriting. For example, the brokerage community is known to “spreadsheet” companies and direct business to specific insurers that take more favorable underwriting action on certain conditions like diabetes. This hampers the maintenance of traditional, consistent underwriting.

KC: Consistency is one of the core things you look for as a manager in an underwriting shop. Looking specifically at the preferred market, do you see the lack of consistency in applying underwriting criteria as a big problem for the industry?

HG: Well, I’m a big believer in consistency, but at the end of the day, I’m more concerned about the underwriting being accurate than whether it’s consistent with a dozen or so rules. If a case comes in and you have information that justifies taking a more liberal approach – giving credits that are not on any official crediting list – then it’s appropriate to modify the preferred practice. It would be my wish that everybody adhere to agreed-upon preferred criteria but review the criteria frequently and change the ones that make no sense. For example, I think it’s unrealistic to automatically decline as Super-Preferred someone with a family history of cancer. And there are many other examples where preferred criteria should be fine-tuned. But once the guidelines are as accurate as possible they should be cast in stone in the absence of additional information.
And adherence to criteria goes across the board, not just for preferred business. If an underwriter is evaluating a diabetic who’s a borderline standard or a minimally rated or moderately rated risk, that’s when they need to apply manual guidelines. Lack of consistency in these cases is unfair to the buyer, and it also will come back to haunt you with the producers. Because once you open Pandora’s Box and make an inappropriately liberal decision, then a lot of business is going to flow through that portal to your disadvantage. Agents talk – trust me! I’ve given a lot of presentations at producer gatherings and get intensive questioning about underwriting practices – substandard, older age, etc. These guys know this business inside out.

**Higher Retention and Underwriting Practices**

**KC:** Carriers have increased retention levels in recent years. Has this affected their approach to underwriting guidelines?

**HG:** The first thing I would say is that a lot more shops use internal guidelines to modify the reinsurance manuals. This trend has increased substantially along with higher retention levels because companies have flexibility now to use their guidelines up to the threshold where they cede the business. We see internal guidelines modifying, for example, what is recommended on lab tests, blood pressure, etc. Higher retentions give producers more latitude to demand “business decisions.” So we’ll see more “good” business decisions – which means the underwriter has reviewed the whole risk and come up with a complete, correct and common sense assessment – even though he may be chastised by his reinsurer. Unfortunately, we’ll also see more “bad” business decisions – those not grounded in underwriting reality but in “I need it for year-end business” reality. That’s just the inevitable effect of retaining more of the risk.

**KC:** So you think producers will look for opportunities in rising retention levels?

**HG:** Absolutely. If a company is going to raise its retention level, then producers are going to take advantage of that. That’s their job. The company’s job is to make sure they’re not creating a situation that works to the detriment of their bottom line – and we both know that happens.

**Cost Containment and Productivity**

**KC:** You’ve referred to management emphasis on cost containment. How do you think this will influence underwriting requirements in the near future?

**HG:** Chief underwriters will face increasing pressure to eliminate assessment tools and raise the threshold for various tests, paramedical exams and what have you. In this environment, it’s important to have good protective value data so that chief underwriters can push back against overly aggressive cost containment advocates.

Look, I have no problem with using prudence on requirements that are perceived as client unfriendly or that are extremely expensive or delay the underwriting process. Exercise EKGs are enormously expensive – the average cost, based on my last survey, is $750. What bothers me is that there are tests that companies should be using and they’re not because they’re looking at the cost of the test and not the protective value. There are so many protective value studies done on the direct side, but they are held close to the vest. So if you’re a big company that can produce protective value studies, you have very good insight into your cost containment decision. Most companies don’t have that luxury and often don’t know what they are giving up when they eliminate assessment tools or raise testing thresholds.

**KC:** Turning to your concerns about productivity metrics, what are the trade-offs between productivity and quality risk assessment in traditional underwriting?

**HG:** This is an issue we need to confront because the number of productivity metrics that companies have introduced has exploded in the last five years, and it’s fueled by statistical data that are available through new business systems. I think this trend incentivizes shortcuts and careless risk assessment. In my study groups, some underwriting managers have said productivity is the most important factor in assessing underwriters. Of course I went ballistic. What this says, in other words, is that underwriters who generate a lot of cases and do sloppy work are just as good as underwriters who properly review 75 percent as many cases in the same amount of time. That’s completely antithetical to what underwriting is all about. This bias toward productivity over quality is more pervasive than you might think, and I wish more people were addressing it.

**Underwriting Expertise for Impaired Risk**

**KC:** With the growth of preferred risk programs, many companies walked away from impaired risk. We now have underwriters who haven’t been exposed to multiple-impairment, high-face-amount risk assessment.
HG: You only have to look at the increase in trial or informal applications to know there’s a huge market for impaired risk business. It takes really knowledgeable underwriters to play in this market, and you better commit to their continued education so they can stay current on changes in medicine. Often when a company wins an informal case, they have to wonder if they lost. You know, “Did my underwriter make a competitive bid and now I’ve got to pay for it?” I for one would be terrified if I were a chief underwriter with the most robust percentage of informal placements. I’d be much more comfortable in the middle of the pack or maybe the bottom third of the pack.

There’s no question that the industry has sustained a serious loss of aggregate underwriting acumen compared to what we had in the 1980s. And it’s not just from lack of experience; it’s also a lack of continuing education. People often assume an underwriter’s aptitude is based on years of service. But when I do underwriting audits for clients I find that underwriters with 7-12 years of experience generally do the best job on substandard business – better than underwriters with 20-25 years of experience. To me this indicates a knowledge gap among more tenured underwriters due to a lack of continuing education.

I’m concerned about the quality of underwriting knowledge in the home office, especially given the caliber of underwriting in the brokerage community. A lot of our superstar underwriters have walked out of the home office because they can make more money on the other side of the fence.

New Tools in the Underwriting Shop

KC: The attending physician statement (APS) is a notoriously unwieldy but valuable underwriting tool. Do you see a role for APS summaries in speeding up the process when an APS is required for full underwriting?

HG: I believe that APS summaries can be done effectively if the right methodology is used. The problem is it takes time to do it right, and providers can’t get the revenue they need unless they expedite the process, which often means not doing the job properly. Their underwriters are under the gun to turn the business around. If you do a super job as an APS summarizer, you might lose your job because you’re not grinding out enough summaries in a given interval.

Many of the companies I talk to are generally unhappy with their outsourced APS summaries. And their underwriters are re-reading the APS. So the company pays for the summary then pays again for their underwriters to read the APS.

KC: How about pharmacy databases? What role do you see Rx data playing in the productivity/quality balance?

HG: I think this is a great tool. It helps underwriters unmask a lot of people who have “amnesia.” More than that, it tells us whether the applicant is compliant. (I would quickly inject that some companies, in the spirit of cost containment, have instructed their underwriters to ignore the question of whether or not the applicant is refilling the prescription because investigating the response takes too long!)

I think the evidence for the protective value of Rx data is crystal clear. Underwriters don’t have as much aptitude for underwriting pharmaceuticals as we’d like them to have. We need more education and training in this area. But you can cost justify paying for Rx data just on the “red” drugs [tagged red for use for serious medical conditions] that are not acknowledged by the applicant. Beyond that, you have the ability to match up the pharmaceuticals with the medical history to see if it’s consistent. And you can identify the physician who prescribed the drug, who is not always the physician mentioned on the application, which is an interesting problem in its own right.

I think upwards of 80 percent of companies use Rx reports. The hit rate – I don’t like that word – the yield has been consistently 70 percent and higher, which is very good, and the yield on the geriatric side is even better. I just talked to an Rx data provider who said their yield rate for people age 70 and older was higher than for people in their 30s, so that’s good news.

KC: Like the APS, Rx reports also are lengthy and unwieldy. Do you see value in services that help interpret Rx reports?

HG: Yes, there are service providers with underwriting engines that have guidelines specifically for sorting out pharmaceuticals for various impairments. The problem with Rx reports, in my view, is it’s dangerous to consider pharmaceuticals in isolation or in a vacuum. The underwriting engine has to be able to correlate Rx data with other information on the risk. For example, if you’re going to develop a rule set for diabetes, you better be a very, very knowledgeable underwriter or medical director. An Rx tool is only as good as the person who designed it; and some of these tools are being built by people who do not have extensive – and in some cases any – underwriting experience. This is
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worrisome. You can’t assess the risks associated with drugs solely from a clinical perspective. You have to come at it from a knowledgeable underwriting perspective to judge the relative importance.

**KC: Use of tele-interviewers to get medical history has been around for a decade or so. How successful has this been compared to the traditional approach?**

**HG:** The baseline for judging tele-interviewing is the UK. They are further along the curve than we are. They ask questions that we are not yet asking routinely. Their work is exemplary, and their impact on the industry has been huge. We could seriously upgrade the quality of our telephone interviews, but even now, the outsourced stuff is good.

Let me put it this way: If you take the medical history over the phone – the applicant hears a pleasant female voice and doesn’t see or have to worry about her expression when he mentions sensitive information – and if you have this set up with appropriate drill downs to amplify areas of concern, then you have a state-of-the-art process for capturing medical history.

I’m guessing that 65-75 percent of US life insurers use outsourced providers. I know companies where in-house programs are working marvelously, but developing an in-house program from scratch is very costly. You need work space and you’ve got two kinds of training – underwriting and telephonic. So it’s very difficult to initiate a program internally.

**Underwriting Legalized Marijuana**

**KC: You have researched marijuana and mortality for a few decades now. What do you think the recent movement toward legalization will mean for underwriting?**

**HG:** I think it will finally get us to underwrite recreational use of marijuana by adults in an intelligent manner. I can’t justify taking adverse underwriting action on occasional marijuana use by adults. In fact, I can justify issuing Non-Smoker Preferred in some cases.

There’s no excess mortality in occasional marijuana use by adults. Note that I said “occasional” – one to two times a week, which is your typical upscale user’s pattern by the time they reach age 25. I do not want to insure anybody who uses marijuana under age 18, persons using it heavily or those using other drugs as well.

Many companies treat occasional marijuana users as smokers. But marijuana has not been convincingly tied to cardiovascular disease, chronic lung disease, cancer or all-cause mortality. There’s no justification for saying smoking marijuana and cigarettes confer an equivalent risk.

I would definitely ask anybody who says they use marijuana medicinally why they do so and correlate this usage with other issues in the application.