

Guide To...

Underwriting

Why is Underwriting Important?

Underwriting allows you to enter in to a contract with a life company that is both sustainable and equitable in addition to meeting your requirements. Underwriting helps protect both parties of the contract and the underwriter facilitates this.

The role of the underwriter is two-fold:

- i. to assess insurance applications with a view to providing agreeable terms of coverage; and
- ii. to protect the profitability of the life insurer's portfolio of business.

They do this by maintaining a prudent and disciplined approach in offering terms to potential clients, which ensures that a life office has a balanced and sustainable portfolio. This allows:

- the provision of necessary cover to accepted lives insured clients
- confidence on the part of the life insured that the products benefits will be there when needed
- confidence that the cost of the cover will be predictable (within reason) from year to year
- a return of profit to the owners of the life insurance company.

The Role of the Adviser

The adviser plays a pivotal role in the assessment process and can help explain what the underwriter needs and why they need it. The adviser understands the key triggers the underwriter will act on and what information is most meaningful. The adviser's understanding of underwriting can speed up the process significantly and assist in the acceptance of your proposal for insurance.

Medical Underwriting

The most important thing to remember when submitting an application for insurance is, if in doubt, provide too much rather than too little information. If an underwriter is unsure, they will ask for further clarification, which can cause unwanted delays, or they may even deny your application.

Providing full details allows the underwriter to fully investigate all options for cover. Remember, underwriters want to accept your application! However, if they are unsure of your health status, their options are more limited. Items to submit with your application include test results (such as ECG's), X-Rays and doctors reports.

Financial Underwriting

An underwriter will not only look at whether you can medically be offered insurance, they will also look at if the amount of insurance you are applying for is reasonable. Each application for insurance, whether it be life, income protection or trauma, should be associated with a corresponding "need". Life insurance is designed to protect you and your family against unforeseen medically events. The insured or their family is not supposed to be "*financially enriched*" as a result of a medical problem.

Bearing this in mind, the underwriters will look at your income, expenses, assets and liabilities when assessing your application. For example an underwriter would not, in all likelihood, accept an application for a person with an income of \$30,000 no debts and no dependants that is asking for \$2,000,000 in life insurance. The underwriter would quite rightly deny the application on the basis that there is not a “need” that this amount of insurance is covering.

Income is a particularly relevant financial consideration, as it will be the basis of the insurance “need” for income protection insurance, as well as contribute to the overall need for life insurance, trauma insurance and total and permanent disability.

Self Employed People

Accurately defining income for a self-employed person can be challenging. Quite often, tax returns will not tell the full story. To assist the underwriter make a complete assessment and to ensure you receive the full cover to which you are entitled, the underwriter may require;

- Profit and Loss statements
- Cash-flow statements
- Partnership Agreements
- other relevant information, such as income splitting arrangements.

Options for Underwriters

If an applicant has some medical or other issues that affect their proposal for insurance, the underwriter will look at a number of different options at their disposal in an effort to provide an agreeable solution. The most common options are as follows;

Exclusion

Typically relating to an income protection policy, an underwriter may apply what is known as an “exclusion”, primarily in two circumstances;

- i) Where the applicant has a pre-existing medical issue, such as a knee injury, the underwriter may offer cover for all sickness and accidents except those associated with the site of the condition. For example, an applicant who has had two reconstructions on their right knee, may be offered an income protection policy (replacing their income for time off work in the event of illness or injury) *“excluding cover for injuries to the right knee”*.
- ii) Where the applicant engages in a “dangerous pastime”, such as football or motor racing, the underwriter may exclude the applicant from being covered if the illness or injury occurs as a result of their engagement in that pastime.

Loading

The premium that you pay for your insurance is based on the likelihood of the insured event happening to a person with your demographic characteristics. Where the underwriter is able to identify an issue that potentially increases the likelihood of that event occurring for a certain applicant, they may choose to apply a “loading” to that applicants premium.

For example, diabetes sufferers have reduced life expectancy compared to the broader population, so the likelihood of a claim being paid to a person with diabetes is greater. To compensate for the greater amount of claims that they will have to pay, the insurer, through the underwriter, may charge applicants with diabetes (or other conditions) a higher premium.

Depending on the issue, premium loadings can be applied in two different ways;

- i) An amount per \$1,000 sum-insured may be charged. For example a “\$2” loading for a person with a \$200,000 life insurance policy, would equal a total loading of \$400. This means that the insured, regardless of other premium factors, will pay \$400 more for this insurance than someone who does not have this loading (ie the amount of the loading is independent of the amount of the “base” premium).

- ii) The “base” premium will be multiplied by a loading percentage factor. If, in the above example, the “base” premium for the insurance cover is \$1000.00, then a 200% loading would mean that the client will pay \$2000.00 more for the insurance than someone who does not have a loading. Typically, loading factors applied are 50%, 100% and 200%, depending on the reason for the loading being applied.

Limited Term Contracts

A relatively new innovation in the insurance industry is the concept of “limited-term” contracts. Currently, the vast majority of insurance contracts offered are what is known as “guaranteed renewable”. This means that once the insurer accepts the application and the policy is in-force (and while the premiums are paid when due), the insurer cannot cancel the policy due to any decline in the health or financial circumstances of the insured. For example, life insurance contracts are typically “guaranteed renewable” until age 99.

In certain circumstances, this presents the underwriter with a difficult situation. For example, a relatively young applicant of 30 years of age, may present with an illness that will affect their long-term health prospects, however in the short-term they may be no-greater risk than the broader population. An applicant may only need cover for 5 or 10 years (to cover a debt or some other issue) however, in normal circumstances, they will be assessed as though they will be insured until age 99.

A limited-term contract allows the underwriter to provide the cover required by the applicant in the short-term, without taking on undue risk on the part of the insurer. The underwriter will offer the applicant a policy that is cancellable at a certain age or after a certain term with an option to re-apply at that time. Examples of conditions that this may be a useful alternative to “guaranteed renewable” insurance are asthma and moderate cholesterol, where the short-term prognosis is reasonable, but over the long term the likelihood of claims increases significantly.

Deferment

Underwriters typically use this option where an applicant is recovering from a recent medical episode. For example, if an applicant has been recently treated for cancer (and has fully recovered), the underwriter will “defer” the offer of insurance until the applicant has been symptom free for 10 years.

Rejection

An underwriter will obviously not accept all applications for insurance. However, the underwriters will exhaust all the above options before rejecting an application. In most cases, where one insurer has rejected an application, other insurers will be unlikely to make an offer.

Your Duty of Disclosure

The most important thing to remember when applying for insurance is that you must fully disclose all information that is requested and *any other information that you should be reasonably expected to know is relevant*. Unless you do this, any offer that an underwriter may make could be invalidated and put at risk your insurance even for circumstances that are not associated to the issue that was not disclosed.

If you have any queries in relation to the content of this material, please do not hesitate to contact Kate Kimmorley the Principal Financial Adviser at Kimmorley Financial Management on (07) 5591 1725.

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