

A GUIDE TO SIMPLIFIED UNDERWRITING



Sophie Clement
Director and Product Manager, Living Benefits
RGA Life Reinsurance Company of Canada
Toronto, ON
sclement@rgare.ca

An individual insurance policy application form, whether for life, critical illness or disability, can be challenging for both applicant and advisor. Most are more than 30 pages long even before they are filled out, and contain numerous medical and non-medical questions. Supplemental underwriting evidence is also frequently required, such as blood profiles, urinalyses, paramedical exams, electrocardiograms, medical reports, motor vehicle reports and financial records.

The entire underwriting process, from submission of the application through the case assessment to the underwriting decision, can easily take 3 to 8 weeks or even more, depending on the applicant's history and on how much additional information is requested by the underwriter.

In the Canadian market, simplified issue products have long been popular in the context of bancassurance or credit insurance. However, in recent years, Canadian insurers have amplified efforts to reach the middle market by developing simplified underwriting and issuance frameworks for individual life and living benefits products. Generally speaking, Canadian insurers currently offer simplified issue products either as adjuncts to their regular product portfolio or as "plan B" offerings for situations where fully underwritten products might not be available to clients. Simplified issue products can also be a perfect fit for advisors who find traditional life insurance products complicated, cumbersome or too labor-intensive to sell. They can also be more accessible and easier to understand, making them a strong option for direct channel consumers.

Key Many approaches to simplified underwriting

What today's simplified underwriting approaches have in common is a limited number of questions and no automatic age and amount requirements.

Executive Summary *Over the years, insurance carriers have sought to underwrite and issue more policies in less time and at lower costs. Many insurance advisors might also say that today's full underwriting process is not only long, but can be daunting—for the advisor as well as the applicant. In order to improve customer (and seller) experience quality and attract more business, many insurance carriers have been developing products with simplified underwriting, which is making the process speedier and easier and raising the quality of customer experience. This article will discuss the main approaches to simplified underwriting, their advantages and associated risks, and how insurers can mitigate these risks.*

One approach keeps the application and underwriting processes as simple as possible. Only three to five questions are asked, and decisions are based on answers to those questions, with any "yes" answers meaning coverage is declined.

In a second approach, one all-encompassing question is asked. Such a question could read: "In the last 5 years, have you ever had any symptoms, consulted or been treated for any disease or disorder of the cardiovascular system, the heart, the blood vessels, the endocrine system, the respiratory system, the lungs, the musculoskeletal system, the neurological system, or have you ever had symptoms, consulted or been treated for cancer, a tumor, diabetes, anemia, any other blood disorder, depression, anxiety or any other nervous disorder?" Again, if that question is answered "yes," coverage is declined.

These two approaches are known as "pass-fail," and both require very limited (if any) underwriter involvement.

A third approach, disclosure-based underwriting, requires an applicant to answer approximately 10 to 15 questions. Unlike the two approaches outlined above, an applicant can opt to provide details to questions answered “yes.” The completed application form is then reviewed by an underwriter. Some insurers only permit the underwriter to use the information obtained at the time of application, and do not allow requests for additional evidence such as a blood profile or a medical report.

A fourth approach is a limited form of full underwriting. In it, the question framework is the same as for disclosure-based underwriting, but the underwriter also has the option of obtaining certain types of additional evidence if needed to reach a decision. Some insurance carriers allow the underwriter to obtain only medical reports, while others will allow the underwriter to obtain any additional evidence deemed necessary.

Simplification: advantages and risks

Simplified underwriting has significant advantages for consumers, advisors and insurers, which is why it is becoming increasingly popular.

OTT For insurance carriers, simplified underwriting improves operational efficiency by reducing evidence requirements, touch points and service time. It also allows insurers to issue more policies at less cost, while still mitigating risk. It is also expected to attract more business because of the simplicity of the process.

For the consumer and the advisor, simplified underwriting facilitates a faster, simpler and less invasive application process. In this age of smart phones, Internet shopping and streaming of favorite television shows, most people want their purchases immediately (or at least very fast!), and are certainly not eager to wait 8 weeks to obtain a life or critical illness policy.

OTT On the risk side, companies must be aware that when developing a simplified underwriting framework, antiselection is a real risk. Simplification of the application process must be balanced in ways that will mitigate this risk. Think about it carefully: if an application only has five questions instead of 25, it would be substantially more difficult to blame an applicant for withholding information. Applicants are not obligated to disclose specific aspects of their histories if the insurer does not ask about them.

In addition, because simplified underwriting generally requires no screening tests or supporting evidence, insurers have fewer opportunities to discover

undisclosed risks during the application process. This includes risks the applicant might have chosen to withhold, risks not picked up in the brief application, and risks of which the applicant might not be aware.

In fact, a simplified product might have been chosen because of questions not asked. For example, a question about prior insurance history might be worded “In the last 5 years, have you ...” instead of “Have you ever ...” Or, if applicants are not asked about the previous times coverage has been declined or whether a policy has been issued to them with modifications and/or exclusions, there would be no impetus to disclose that history. Also, if an applicant was treated for colon cancer 6 years ago and the simplified application wording only asked about cancer history “in the last 5 years,” the applicant would not be obliged to disclose that history, which would be very antiselective.

If the product uses the second “pass-fail” framework—i.e., asking only one all-encompassing question—that question frequently risks being so long and complex (as in the example above) that an applicant might not understand it and answer “no” in error. This risk is especially high in situations where the applicant has limited insurance and/or medical knowledge. If the insurance company decides later to rescind coverage due to lack of disclosure, it might be difficult, should the case end up in litigation, for the insurer to prove that a “reasonable person” would have understood the question and answered it appropriately.

Question wordings that include too many medical conditions can also leave applicants confused and unable to understand the question’s intent. It also might be confusing to group questions about neurological disorders with questions about nervous disorders. An applicant might not understand the difference between the two types of disorders, or might not realize that by nervous disorder, the insurer means adjustment disorder, anxiety and depression. When an applicant answers “no” to a question regarding nervous disorders, but discloses antidepressant use when asked about current medications, one could possibly determine the question on the application form was misunderstood. This type of situation shows applicants are willing to disclose their medical histories, but might misunderstand a specific question’s intent.

This brings us to the reputational risk issue. This is of especial concern for those insurance companies that use a simplified underwriting process and then undertake a more thorough contestability review when a claim is filed. Although such an approach enables

policies to be issued faster and reduces costs, it risks negatively affecting the reputation of the insurance company. No company wants to be known as one that doesn't pay its claims, or one that underwrites at claim time.

Finally, most applicants are not familiar with the underwriting process, which brings its own set of risks to an insurer. Depending on the distribution channel used to sell a particular product, especially in the direct market where the applicant does not benefit from the educated advice of an insurance advisor, an applicant may not completely understand the consequences of not fully disclosing one's medical history when completing an application. If many policies are rescinded due to non-disclosure or if many claims are denied, even if rightfully so, the reputation of the insurer might be affected.

Pricing and claims issues

In general, claims experience for simplified issue policies tends to be worse than for fully underwritten policies. This should not be surprising. If fewer questions are asked and less evidence is gathered, the likelihood is greater that certain important risks will not be detected during the application process. Also, some substandard and even unacceptable risks are accepted at standard rates under certain simplified underwriting processes, as what is considered "standard" in a simplified issue product can encompass up to eight tables (200% of mortality). In some markets, therefore, advisors might steer applicants who have been declined or rated for a fully underwritten product to a simplified product.

Most insurers will charge higher premiums for simplified products, given the acceptance of certain substandard cases at standard rates, which means more claims will be paid. Charging too high a premium, however, might encourage better risks to apply for cheaper fully underwritten product, which could concentrate unfavorable risks in the simplified product's portfolio. This risks causing a spiral of worsening experience, increasing prices and more concentration of poor risks.

The converse is also true: if a simplified product is priced too low, more favorable risks who might normally have purchased the fully underwritten product might buy the simplified product, which would in turn affect experience in the fully underwritten pool.

Mitigating the risks

While insurance carriers are right to embrace the opportunities presented by simplified underwriting,

it is vital that product managers, actuaries and underwriters recognize and understand the risks as well. There needs to be a team-based approach to tackling these risks in order to create a profitable and sustainable product.

Successful simplified underwriting requires that the questions on the application form be developed with the utmost care, to allow insurance carriers to approve as many acceptable risks as possible while capturing and declining unfavorable risks. 

Careful design also means that, in addition to being brief and simple, the application and the policy contract should:

- Use language appropriate for its target market(s).
- Be comprehensive enough to capture all relevant risks.
- Limit legitimate opportunities for applicants to withhold information.
- Give adequate instructions, including information about the duty to disclose.
- Include restrictive clauses such as a pre-existing condition exclusion, as well as other exclusions or limitations, to mitigate risks. Such clauses should be clearly spelled out. For example:
 - Specific risks such as aviation or alcohol or drug abuse could be excluded.
 - Limitations could be applied, such as changing the benefit period from 5 years to a lifetime maximum benefit period of 180 days for soft tissue injuries on disability benefits.

Conclusion

Simplified underwriting is becoming more popular because of its significant advantages. It allows for a faster, simpler and less invasive purchase process for applicants, while allowing insurance companies to issue more policies and improve operational efficiency. There are, however, risks associated with simplified underwriting, namely, antiselection risk, reputation risk, and the risk of attracting and concentrating less favorable risks while steering more favorable ones to cheaper, fully underwritten products.

The good news is that it is possible to mitigate these risks by developing strong underwriting questions and by designing products which can reduce undesirable risks and avoid having to underwrite at time of claim. Product managers, underwriters and pricing actuaries should work closely together to ensure the simplified underwriting process will attract the expected risks and provide a positive experience for clients.

DEVELOPING A SIMPLIFIED PRODUCT? HERE ARE SOME IMPORTANT CONSIDERATIONS ...

What product(s) will be sold using this process?

The type of product being designed will significantly influence the application form questions. For example, if the product is critical illness insurance, application questions would have to consider which illnesses the policy might cover and would have to address very specific risks (e.g., cancer, multiple sclerosis, etc.).

What is the target market?

Understanding several basic aspects of the product's target market is essential. For example, a product intended for a specific group of individuals such as, say, physicians or nurses who are part of a medical association or insurance brokers, all of whom would be expected to have a certain level of educational achievement as well as knowledge of medicine and insurance, might be quite different from one intended for the general public.

Intended age cohort and gender are also important considerations. Young or middle-aged adults will clearly have different considerations from pre-retirees or retirees.

This information will have a significant impact on the design of the simplified product. It will influence both the questions to be asked and the most appropriate language to use in framing the questions in order to ensure clarity.

How will the product be distributed?

The distribution channel (or channels) for a simplified product, whether that of intermediaries such as insurance agents or financial advisers or directly to consumers via the Internet or direct mail, will impact the product's structure in several ways.

If the sale is intended to be direct, with no one advising the applicant, instructions for completion of the application must be clear, concise and self-explanatory. Language must also be incorporated that explains clearly the importance of answering each question as accurately as possible. It would also be advisable to write the questions using layman's language instead of medical jargon, to ensure applicants clearly understand the intent of each question. For example, when asking about neurological disorders, the words "numbness and tingling" or "a feeling of pins and needles" are preferable to the term "paresthesia."

Any restrictive clauses, such as pre-existing conditions exclusions or limitations, also need to be expressed in clear and simple language, to ensure the applicant understands the product being bought.

How much business is anticipated?

Can it be assumed that the greater the volume of business for a simplified product, the less will be the impact of antiselection? Not necessarily. Although this might be true, it is still imperative to remember that in order for the business to be profitable, insurers need to make sure that no gaps exist in wordings used for application questions. Such gaps could allow unwanted risks to slip through, which would adversely affect expected claims experience.

About the Author

Sophie Clement, FALU, graduated in 1994 from McGill University with a bachelor's degree in Social Work. She obtained her FALU in July 2012. Sophie has been underwriting living benefits products for close to 20 years and is very passionate about her work. She has been with RGA since 2010, first as Director and Chief Underwriter for Living Benefits, and more recently as Director and Product Manager, Living Benefits. In her role, based on a deep understanding of the market, Sophie is responsible for managing and contributing to the development of innovative living benefits solutions, including product design, underwriting and claims.