

Underwriting

Underwriting is the process of classifying the potential insureds into the appropriate risk classification in order to charge the appropriate rate. An **underwriter** decides whether or not to insure exposures on which applications for insurance are submitted. There are separate procedures for group underwriting and individual underwriting. For group underwriting, the group characteristics, demographics, and past

losses are judged. Because individual insurability is not examined, even very sick people such as AIDS patients can obtain life insurance through a group policy. For individual underwriting, the insured has to provide evidence of insurability in areas of life and health insurance or specific details about the property and automobiles for property/casualty lines of business. An individual applicant for life insurance must be approved by the life insurance company underwriter, a process that is sometimes very lengthy. It is not uncommon for the application to include a questionnaire about lifestyle, smoking habits, medical status, and the medical status of close family members. For large amounts of life insurance, the applicant is usually required to undergo a medical examination.

Once the underwriter determines that insurance can be issued, the next decision is to apply the proper premium rate. Premium rates are determined for classes of insureds by the actuarial department. An underwriter's role is to decide which class is appropriate for each insured. The business of insurance inherently involves discrimination; otherwise, adverse selection would make insurance unavailable.

Some people believe that any characteristic over which we have no control, such as gender, race, and age, should be excluded from insurance underwriting and rating practices (although in life and annuity contracts, consideration of age seems to be acceptable). Their argument is that if insurance is intended in part to encourage safety, then its operation ought to be based on behavior, not on qualities with which we are born. Others argue that some of these factors are the best predictors of losses and expenses, and without them, insurance can function only extremely inefficiently. Additionally, some argument could be made that almost no factor is truly voluntary or controllable. Is a poor resident of Chicago, for instance, able to move out of the inner city? A *National Underwriter* article provided an interesting suggestion for mitigating negative characteristics: enclosing a personalized letter with an application to explain special circumstances.^[5] For example, according to the article, "If your client is overweight, and his family is overweight, but living a long and healthy life, note both details on the record. This will give the underwriters more to go on." The article continues, "Sending letters with applications is long overdue. They will often shorten the underwriting cycle and get special risks—many of whom have been given a clean bill of health by their doctor or are well on their way to recovery—the coverage they need and deserve."

Over the years, insurers have used a variety of factors in their underwriting decisions. A number of these have become taboo from a public policy standpoint. Their use may be considered unfair discrimination. In automobile insurance, for instance, factors such as marital status and living arrangements have played a significant underwriting role, with divorced applicants considered less stable than never-married applicants. In property insurance, concern over redlining receives public attention periodically. **Redlining** occurs when an insurer designates a geographical area in which it chooses not to provide insurance, or to provide it only at substantially higher prices. These decisions are made without considering individual insurance applicants. Most often, the redlining is in poor urban areas, placing low-income inner-city dwellers at great disadvantage. A new controversy in the underwriting field is the use of genetic testing. In Great Britain, insurers use genetic testing to screen for Huntington's disease,^[6] but U.S. companies are not yet using such tests. As genetic testing continues to improve, look for U.S. insurance companies to request access to that information as part of an applicant's medical history.