Understanding the Life Insurance Underwriting Process

Knowing which pitfalls to avoid can increase insurability

By Ken Smith, CLU, ChFC

Recently, at the onset of the underwriting process, a prospective client disclosed he had been declined for coverage 18 months prior through another firm. The agent had taken a formal application, forwarded it to the carrier, and a declination of insurance was issued. Unfortunately, the fact that another agent did not complete the proper due diligence prior to beginning the underwriting process will likely have a long-term adverse impact on this individual’s chances of receiving future life insurance coverage – and if coverage is available, the pricing of that coverage.

The following offers an overview of how carriers determine insurability and how IPS Advisors helps our clients avoid pitfalls that can oftentimes accompany the application and underwriting process.

The Importance of Informal Inquiries

The Medical Information Bureau (MIB) is an organization that shares data from prior life and health insurance applications with its member firms (comprised of almost all domestic insurance companies). Similar to a bad credit score, your MIB code can influence the decisions made by an underwriter regarding the availability and pricing of life insurance.

When applying for insurance, any health or lifestyle conditions (such as adverse driving records or hazardous hobbies) are reported and coded into the MIB system where they remain for seven years. Although MIB information is not the determining factor in the issuance of new coverage, it does influence the underwriter’s thought process. More importantly, actual codes exist for “suspicion” of a medical or non-medical condition. Unfortunately, your ability to secure coverage in the future could be influenced by a coded “suspicion” on your application.

Correspondingly, prior to the formal application of life insurance, IPS Advisors completes an “informal inquiry” on behalf of our clients and when necessary, gathers medical records from their respective physicians. Dan Stanley, our Chief Underwriter, reviews this information and if we feel there is a possibility coverage could be modified, rated or declined, we send the initial application to the carrier on an “informal inquiry” basis. By doing so, we discover if coverage would be issued other than at a standard risk class or better, and we are able to assist our client in making a determination that is in their best interest. If they decide not to pursue coverage we simply withdraw the informal inquiry. Nothing is reported to the MIB and the client can state on future applications they have not been formally offered coverage that was modified, rated or declined; subsequently, no coding occurs with the MIB.
The informal inquiry process described above also gives both the IPS underwriting team and client the chance to review any issues in the underwriting file that might have an adverse impact on their risk class. It is not uncommon for our staff to uncover incorrect MIB codes or notes scribbled by an attending physician on a patient’s record that may impact the underwriting process if not addressed early on. Additionally, due to the Electronic Medical Records Mandate, our team commonly identifies issues with inaccurate transfer of patient records.

A Closer Look at Reinsurance

Another advantage of having our Chief Underwriter review medical records prior to any formal application submission has to deal with carriers and their reinsurers. In order to make this concept more understandable, we will refer to a life insurance company that offers and issues coverage to an individual or group as a retail carrier. Retail life insurance carriers generally carry a small portion of the risk they insure on their books; coverage above that amount is moved to a single reinsurer or a pool of reinsurers. The amount of the risk the retail carrier retains is referred to as their in-house retention, or Autobind Limit, which the carrier can issue using reinsurance agreements they have in place based upon their underwriting guidelines. If the application is for an amount above the Autobind Limit the underwriting file must be forwarded to their reinsurer for review. For example, if an individual applied for a $15mm policy the issuing carrier might retain 10% of that risk on their books and forward the additional 90% (or $13.5mm in this example) to their reinsurer or reinsurance pool.

At any given time there can be three to five reinsurance carriers that take on the additional risk on large or higher risk life insurance contracts (knowledge of carriers and their specific retention limit is also useful when packaging coverage across multiple carriers). And beyond – or behind – the reinsurers there are “retrocessionaires” – oftentimes referred to as reinsurers of reinsurers.

Treaties and Testing

As previously mentioned, each retail carrier has negotiated a treaty or covenant with one or more reinsurers. In each of those covenants many items are negotiated between the retail carrier and the reinsurer. An important item includes the tests to be performed in the underwriting process. For example, the reinsurance company might typically offer coverage for $X per thousand of coverage. However, if the retail carrier agrees to include an A1c test (which provides information about a person’s average levels of blood glucose, and can diagnosis a person with diabetes or who may be pre-diabetic), then they may offer coverage to the carrier for $X - 5%. The testing costs for the retail carrier may be higher; conversely, the demographics of their book of business may indicate the discount offered by the reinsurer is great enough to offset the additional lab costs. Other tests that may be negotiated in reinsurance treaties include a CDT test to detect heavy alcohol use (and often has false positives) and a reflex test which detects markers that indicate if a person is positive for hepatitis.

“Knowledge of testing and the treaties that dictate them are often important components in our decision as to which carrier may be our best option for underwriting a specific client.”
~Dan Stanley, Chief Underwriter
Tapping our Perspective
IPS Advisors’ Chief Underwriter, Dan Stanley, has access to the reinsurer’s guidelines as well as insurance carrier underwriters, and maintains intimate knowledge of the underwriting process having served on risk management boards for several national insurance carriers. With his understanding of how underwriters work, as well as the insurers themselves and how they view adding risk to their books, Dan offers our clients a unique insight not typically found in other firms. The IPS Advisors underwriting staff, coupled with our access and knowledge of the domestic life insurance carrier universe, gives our clients the highest possibility of securing coverage at the best pricing.

Insuring the Un-insurable
Often we are told by prospective clients that they are uninsurable. In some cases people are truly uninsurable on an individual basis. However joint and survivor coverage can be secured on a husband and wife, or business partners, if one of the individuals is insurable. Usually the addition of the second life, even if deemed uninsurable, will lower the cost of coverage below that available on the healthy individual alone.

In business situations we are also regularly able to secure coverage on individuals who are truly uninsurable. We accomplish this by pooling the risk of a class of employees, for example anyone at or above the level of Executive Vice President. We have secured as much as $1.5mm of coverage per employee on a group as small as 15 employees. Even down to eight employees we can secure some level of coverage. The insurance issued is term; however, it is convertible to permanent coverage. Coverage occurs on a simplified issue basis, such that the underwriting only requires the individuals to answer one question: “Have you been at work full-time and not hospitalized for five or more days in the last three months?” If the individual can answer “Yes” then some level of coverage can be issued.

Summary
There are many ways for individuals to purchase life insurance in today’s market. At IPS Advisors, we leverage our working knowledge of the underwriting process to deliver optimal results to our clients. Coupled with our independence and experienced team of professionals, we carefully navigate the carrier universe of products and pricings, understanding the associated risks and helping our clients take the necessary precautions to avoid potential difficulties in obtaining coverage in the future.
About the Author

Ken Smith has over 25 years of experience in the insurance industry. He joined IPS Advisors in 1997 and currently assists high net worth clients and their advisors in the design and implementation of highly customized life insurance strategies. Ken holds a BSBA in Finance from the University of Arkansas and the Chartered Life Underwriter (CLU) and Chartered Financial Consultant (ChFC) designations from the American College in Bryn Mawr. He is an avid fisherman and when not working can be found tossing lines into the local lakes.

About IPS Advisors

Since 1978, IPS Advisors has offered multi-disciplined insurance planning and consulting services to public and private companies, closely-held business owners, governmental sector clients, family offices and individuals. We advocate proudly on behalf of our clients to help ensure value-driven plans that are cost effective and easy to administer. Specializing in Corporate Benefits Consulting, Insurance Planning Services, and Retirement Plan Consulting, our high-service approach and boutique-style infrastructure has earned IPS Advisors the trust of hundreds of clients around the world.