

### **Educational Objective 2**

Describe what information is needed to make an underwriting decision on a personal umbrella application, and explain how that information is obtained.

## ***The Underwriting Process***

Underwriting an umbrella policy requires great skill because the underwriter must consider the following:

- The underlying exposures and coverages
- Coverage gaps that the umbrella policy might fill
- The likelihood of a large loss that could exceed the limits of underlying policies

The files for the insured's homeowners, auto, and watercraft policies can be reviewed for much of the risk's primary underwriting. If the insurer does not write the underlying coverage, the umbrella policy underwriter should collect equivalent information.

Exposure identification is challenging because exposures can easily be overlooked. Liability loss exposures are also subject to frequent change. Effective exposure identification should be systematic and continuous.

The umbrella policy underwriter's goal is to obtain a complete picture of the exposures of the residence, personal liability (from the insured's lifestyle and activities), autos, and watercraft. A systematic approach to uncovering exposures should also include uncovering less obvious exposures that the insured might overlook, such as personal injury exposures, recreational vehicles, or activity outside the country. Most investigation is done in conjunction with other lines, particularly the homeowners policy. However, an underwriter cannot overlook a potential exposure to loss under an umbrella policy, so an adequate investigation in this regard should also be done.<sup>8</sup>

## ***Gathering Underwriting Information***

An underwriter, a technician, or a producer can be involved in the underwriting process. Regardless of who is involved, however, underwriting follows a consistent thought process and a series of steps, which begin with gathering information.

To systematically identify exposures, an underwriter can use checklists and questionnaires, financial statements, loss analyses, underlying policy file reviews, and personal inspections.

### ***Checklist or Questionnaire***

A checklist is a form listing many of the loss exposures faced by individuals and families. A similar form is a fill-in-the-blanks questionnaire that might allow for descriptive information, amounts, or values.

Insurers and insurance groups publish these checklists and questionnaires. Many published checklists are limited to loss exposures that can be insured, and they overlook other important exposures that also require treatment. If any are so thorough that they list all conceivable exposures, they are probably too long to be practical. The value of a questionnaire varies in direct proportion to the user's skill. An experienced insurance and risk management professional understands the implications of various items on the checklist and uses the checklist to trigger additional questions or ideas.

Some companies use detailed umbrella applications with questions directed toward the liability exposure. For example, questions are asked about any business activities on the premises, any full-time residence employees, and any watercraft excluded by the underlying policy. Questions should also be asked about any other residence premises because umbrella coverage would extend to them, and a proper rate must be charged.

### ***Financial Statement***

Using formal statements to identify exposures has particular appeal to specialists with an accounting or a finance perspective. Each item in an individual's financial statements (such as the balance sheet, income statement, tax return, or budget) and supporting documents are analyzed to determine the loss exposures they reflect. A tax return might show deductions for rental property. The budget could include payments for a boat. Those items should be questioned.

### ***Loss Analysis***

Reviewing an insured's loss history to identify the exposures that have already caused losses and to determine what hazards might have contributed to the losses is helpful. For example, a series of losses under an auto policy could indicate a situation that could lead to an umbrella loss. However, loss analysis is only a review of exposures that have already led to an actual loss, many of which might already have been treated. Loss analysis alone does not reveal exposures that have not yet resulted in a mishap.

### ***Underlying Policy Files Review***

The same sources of information that are reviewed for other coverages are reviewed for umbrella coverage: the application, motor vehicle records (MVRs), inspection reports, and other policy files. Although most insurers do not require that the underlying policies be written by the same insurer, at least some of them commonly are. In such cases, the other policy files are essential sources of information. If the underlying coverage is written by another insurer, the underwriter must be certain of that company's financial stability. Some insurers require that the underlying insurer be rated B+ or better by A.M. Best Company.

### ***Personal Inspections***

Outside inspection reports might be used more often on umbrella policies than on most other policies because of the importance of factors such as financial condition, public exposure, and personal habits. Any hint of possible problems must be examined, because the potential of a large loss is great. Conducting a personal inspection or an on-site visit to help identify loss exposures is wise. Personal inspections often reveal hazards that do not show up on paper. Despite questionnaires and paper investigations, many liability exposures are never revealed until a loss occurs. A careful inspection by the producer might reveal a dangerous playhouse and a trampoline in the backyard that attract the neighborhood children. The cost of individual inspections and loss control activities by the company is often prohibitive compared to the small premium for the coverage. When exposures are indicated, the underwriter uses usual sources to obtain more detail. The producer, the applicant, other files, and inspection reports are all possible sources.<sup>9</sup>

#### **Educational Objective 3**

Identify the exposures that should be considered in the personal umbrella underwriting decision-making process.

### ***Making the Underwriting Decision***

After the information is gathered, the underwriter must carefully evaluate it in order to determine the best underwriting decision. Underwriting guidelines are an important factor in deciding whether a policy can be written. The umbrella policy might be requested of a company in conjunction with the primary policies, so underwriting the entire account must also be considered.

### ***Identifying the Exposures***

Adverse selection is a serious problem in the personal umbrella policy line. Generally, the insureds who want umbrella policy coverage are those with an above-average likelihood of being sued and those who have substantial net worth. Those factors can increase loss frequency and average loss severity.<sup>10</sup>

#### ***Potential for Large Liability Losses***

Estimating what type of exposure can result in a large liability loss is difficult. If an underwriting investigation reveals a landlord who has lead paint exposures in a rental property, or if an insured purchases a high-powered boat and is teaching friends to water-ski, serious injury and large liability suits are possible. However, the extent of injury in an auto accident can be a matter of chance: the difference between a \$10,000 broken leg and a multimillion-dollar paralysis as the result of an accident can be the matter of an extra ten miles per hour of driving speed and the angle of impact. Umbrella policy underwriters view frequent auto accidents negatively (even if the accidents are minor) because each has the potential of being very serious.