

# *Underwriting as Decision Making*

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Underwriters help insurers select and maintain growing and profitable books of business by making decisions about which risks to accept, and under what conditions. This chapter examines the process underwriters use to make these decisions. Later chapters will apply this process to a variety of underwriting situations.

## THE UNDERWRITING DECISION-MAKING PROCESS

For years, sound underwriting decisions were considered the result of judgment, experience, and “gut feelings.” The only way for a new or young underwriter to gain “judgment” was by working under the guidance of a successful senior underwriter and gradually gaining experience.

This approach to underwriter training was similar to the apprentice system still used in many trades. The advantage of such a system was that senior underwriters gradually passed their knowledge and experience to a younger generation, who could then do the same for the next generation.

Developments since World War II in the study of decision making and the development of multiple-line insurers serving a mass and growing market, however, seemed to render the apprentice system obsolete on a number of counts:

- A “scientific” approach to business decision making downplayed the importance of “judgment,” placing it in the same category as luck or hunches.

A **line** of insurance is a major segment of insurance. A **multi-line insurer** (short for multiple-line insurer) writes coverage for more than one line of insurance.

- The insurance business's growing need for personnel demanded that training be streamlined and consistent. Insurers needed trained underwriters quickly and could not afford the five, ten, or even fifteen years required to develop an underwriter through the apprentice system.
- Specialization and the development of relatively straightforward products designed to meet the insurance needs of a mass market, especially in personal lines, meant that some underwriters could be productive in much less time. (A **line of business**, or a **line**, is a major segment of insurance. The term originally referred to a type of insurance that was reported on a single line of the Annual Statement form; every insurer is required to file an Annual Statement with state insurance regulators. This form is changed annually by the National Association of Insurance Commissioners. A **multi-line insurer**, short for multiple-line insurer, is an insurer that writes coverage for more than one line of insurance. This term originally referred to insurers writing both property and liability insurance coverages.)
- Insurers began to learn that experience is not necessarily the best or most efficient teacher—it is both time-consuming and expensive. Bad habits as well as good habits could be passed on through the apprentice system.
- Changing employment patterns decreased the availability of veteran underwriters and increased the need to train or cross-train underwriters quickly.

## STEPS IN THE UNDERWRITING DECISION-MAKING PROCESS

One way used to improve underwriting training in the past fifty years was to analyze in detail the steps in the underwriting decision-making process. Thinking of underwriting as an application of the steps in the decision-making process clarified its nature. This analysis and clarification allowed underwriting training to be more structured. Experience and good judgment are important attributes of underwriters, and analyzing the underwriting decision-making process increased the efficiency of trainers in developing these attributes in underwriters.

**Underwriting by exception** is the screening of applications by computer or by an underwriting assistant. In this process, the underwriter does not handle clearly acceptable and clearly unacceptable applications.

Another benefit of the analysis of underwriting decision making has been the increasing use of automation in underwriting. Computers do not underwrite, but they can be programmed to screen routine submissions or renewals. Computers can compare underwriting criteria with information provided on applications and select those risks which are clearly acceptable and reject those which are clearly unacceptable. Such procedures enable underwriters to use their ingenuity on

applications for insurance that require modification. This process is known as **underwriting by exception**.

The steps in the underwriting decision-making process generally include the following:

1. Gathering, organizing, and analyzing information pertinent to the decision
2. Identifying and developing alternative courses of action
3. Evaluating the alternatives
4. Selecting one of the alternatives
5. Implementing and monitoring the selected course of action

The underwriting process does not have an “official” number of steps. Some persons prefer to separate implementation and monitoring, for example. The important thing to remember is the process itself, regardless of whether it is in four, five, or six steps. Explanations of the steps follow.

### Gathering, Organizing, and Analyzing the Information

To a large extent, the quality of an underwriting decision reflects the quality, quantity, and relevance of information gathered before the decision is made. (The value gained from information gathered must, of course, be compared to the expected time, effort, and cost involved in gathering information.) Information is vital to making good underwriting decisions.

All of the information the underwriter sees is not necessarily the result of a disinterested inquiry. The underwriter must realize that the source of subjective information is not merely a provider of information, but, to a greater or lesser extent, an interpreter of it. An underwriter receiving a piece of information stating that a building is in “excellent” condition must know the source of that information. What is excellent to one person might not be excellent to another. Underwriters must not only gather information, but also reinterpret it from the point of view of the insurance company, which is in the business of accepting risks in order to generate premiums that exceed losses and expenses in the long run.

Underwriting information can be classified as either objective or subjective. **Objective information** consists of facts that can be verified and that have been recorded in some manner, such as date of birth, type of construction, and so on. The underwriter only needs to verify the objective information.

Underwriting information can be classified as either objective or subjective information. **Objective information** consists of verifiable facts that have been recorded. **Subjective information** consists of relevant opinions or impressions of various characteristics of the risk.