

## Balancing Lower Issue Costs and Higher Mortality

**L**IFE AND HEALTH INSURERS HAVE BEEN STEADILY GRAVITATING to the richest end of the market, leaving most of us Americans to make do with whatever we can get from our employers. As a result, the majority of folks carry inadequate levels of insurance to serve their needs. Thus, a much-overlooked and growing mid-market exists for insurers ready, able, and willing to underwrite and issue policies speedily and inexpensively while—and this is the key—maintaining good risk selection. To ensure profits, of course, lower issue costs must be balanced against potentially higher mortality costs.

The revolution in the life/health insurance industry is being fueled by companies that realize the old method of “maximum” underwriting, requiring blood testing and attending physician statements (APSS), has become far too slow and expensive to generate sufficient purchases of typical-sized policies by average-income Americans. Instead, insurers are moving now toward streamlined underwriting for a greater range of policies, believing that lower issue costs—and other business advantages, such as reducing the not-taken rate and better incentives for salespeople—will more than offset any deterioration in mortality.

If underwriting rules are “weakened,” must premium rates rise as a consequence? “Weakened” must be placed in quotation marks because it’s quite possible the new underwriting approaches may prove as good as or better than traditional methods. Advances such as expert underwriting systems and use of prescription drug and motor vehicle databases are affording insurers new, valuable sources of underwriting information. Furthermore, high-volume sales operations should generate a strong mix of insurance risks, thus providing the insurer with a reasonable average claim level.

However, if these new types of underwriting do produce a higher level of claims than would otherwise be the case,

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this wouldn’t automatically mean that premiums would have to be increased. It’s quite possible that “fast” data, from databases, won’t provide as much useful information in many cases as fluids and APSS. However, we can see that instant issue would lead to greater productivity from all types of sales channels and great cost savings as well.

So the question is, “Can the issue cost savings offset any increased mortality that might occur due to chang-



ing underwriting methods?” The answer will vary, depending on specific ages and amounts, as well as what’s learned about the utility of the new underwriting data sources. The following examples, however, demonstrate that issue cost savings can indeed be sufficient to offset a fairly large increase in mortality. These examples are based on males aged 30 with \$100,000-face-amount policies, with all policies issued at standard rates.

### Example 1

Issue cost halved and mortality increased. We begin with

the assumption that normal application fallout is 20 percent; so if 1,250 applications are received, then only 1,000 policies will be put in force. The Slow Issue column in the table (right) demonstrates typical policy-acquisition and claim costs for insurers today. Of the 1,000 policies put in force, we know that on average 6 percent, or 60, will be substandard. According to the Life Office Management Association's 2001 report, "Individual Life Insurance Service Turnaround Time Survey," for the 250 not issued, 62.5 will have been because the insurer declined to accept the risk.

In the "Fast Issue" column, we're also assuming that 4.9 percent of all the applications, 50 percent of those that were previously issued substandard or rejected, will now be accepted as standard, for an overall extra mortality rate of 100 percent for this group. Since half of those that would have been rejected are now issued, there are 31 more policies being placed in force under this scenario.

With instant issue, we could expect acquisition costs, excluding commissions, to drop by more than the 50 percent assumed in the "Fast Issue" column. This is because the mail-handling and issue-area functions would be eliminated, and the underwriting area would be considerably scaled back.

The net result is a substantial improvement of \$115, or 14 percent, in the combined per-policy acquisition and claim cost. But there's more!

### Example 2

Same as Example 1, but including reduced application fallout. In addition to reducing costs, instant issue will reduce app fallout to about the 5 percent that's due to insurer rejection. However, for the sake of argument, we're assuming that rejections are halved to 2.5 percent (consistent with Example 1), due to the insurers' possible inability to screen as effectively using alternative underwriting tools. Table 2 (above right) shows a revised "Fast Issue" column that reflects the improved issue rate of 97.5 percent.

Table 2 shows that although *total* ac-

<b>TABLE 1</b>			
	<b>SLOW ISSUE</b>	<b>FAST ISSUE</b>	<b>IMPROVEMENT</b>
Applications	1,250	1,250	—
Policies in force	1,000	1,031	31 more
Acquisition cost	\$283,000	\$141,500	\$141,500 cheaper
Present value of claims for accepted	\$522,000	\$570,024	\$48,024 worse
Total acquisition cost	\$805,000	\$711,524	\$93,476 better
Acquisition cost per	\$805	\$690	\$115 better

<b>TABLE 2</b>			
	<b>SLOW ISSUE</b>	<b>FAST ISSUE</b>	<b>IMPROVEMENT</b>
Applications	1,250	1,250	—
Policies in force	1,000	1,219	219 more
Acquisition cost	\$283,000	\$141,500	\$141,500 cheaper
Present value of claims for accepted	\$522,000	\$668,160	\$146,160 worse
Total acquisition and claim cost	\$805,000	\$809,660	\$4,660 worse
Acquisition cost per	\$805	\$664	\$141 better

quisition plus claim costs are higher for "Fast Issue" than for "Slow Issue," in this example, the "Fast Issue" per-policy costs are even lower than in Example 1. We now have a net \$141, or 17.5 percent, combined acquisition-and-claim-cost-per-policy improvement.

### Reducing the Strain

The benefits go even further, since it's also desirable to shift costs from the front end to the back end. In doing so, less capital is sucked away when a policy is sold, which considerably boosts the return on equity.

While there's great front-end cost-saving potential from accelerating the issue process, sales costs are still the 800-pound gorilla. Sales costs that aren't tied to pre-

mium, such as mailing costs and salaries, will drop as a percent of premium if the volume of premium generated from a salesperson or marketing effort increases. Closing more sales, being able to offer higher premium coverage options, and converting more applications to paid policies will all improve premium volume.

Finally, what about driving those commission rates down? They've grown to ever-higher levels over the years because of the difficulty both in finding likely prospects and in closing the sale. "Platform" salespeople in banks the world over (chiefly lobby personnel such as customer service reps) generally get compensated on a salary-plus-bonus basis. A bank's existing customers are automatic prospects, and overseas the closing rate is high—so

exorbitant commissions aren't necessary! This offers hope that banks can learn to prospect and that U.S. insurers can eventually get banks to accept reduced commissions for their agencies. Commission rates for mid-market agents operating in other leveraged environments may also drop.

### **Sales and Service Create Competitive Advantage**

Competitive premiums are hardly the only ingredient needed to generate high-volume sales in the mid-market. The elements that lead to an effective mid-market sales program—effective sales channels and rapid issue—are far more important than offering the cheapest rates in the country. Internet quote services abound, so everyone can quickly determine what the best rates for term life are. However,

the volume of sales coming from the Internet isn't earthshaking, even for the low-cost carrier. Good sales outreach and removal of the hurdles to getting a policy issued will have a much greater effect on bringing home the bacon.

Since the mid-market is still largely wide open competitively, the refined risk categories that insurers have developed in order to offer the cheapest rates to the healthiest applicants won't be necessary for a while. Yes, I mean that smoker/non-smoker distinctions won't be absolutely necessary, nor will preferred rates. Sales and service will trump cheap rates until the market becomes crowded with insurers that do both well.

Under-insurance is rampant in the mid-market. An insurer can have a simple premium schedule that reflects only gender and age distinctions, building in

a comfortable margin for risk and profit—and sell plenty of policies. Just ask the successful worksite carriers. This is one reason why worksite sales are now the rage.

What does the future bring? I envision the development of a much stronger and more diverse life/health insurance industry, responding to the essential needs of the mid-market with rapidly underwritten and issued products. For the bulk of the population, traditional life, health, and property/casualty insurance products will probably prove to have far more appeal than the investment products that are sold so extensively today—and feed a strong resurgence in the insurance industry. Slashing issue and underwriting costs while dramatically speeding issuance will prove key to this promising future. ●

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