INSURANCE EXAM · IC-45

IC-45 General Insurance Underwriting

Revision book

12	2	155
chapters	master tables	numbered sections

FREE SAMPLE: Chapter 1 of 12

CHAPTER 1

Introduction To Underwriting

1.1	Meaning and scope	1.2	Importance
1.3	Contracts and underwriting	1.4	Features of insurance
1.5	Road map (23 Sep 2005)	1.6	e-insurance
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1.13	Retention and reinsurance	1.14	Control and audit
1.15	Stages	1.16	Underwriter profile
1.17	Types		

MUST KNOW

1. **Underwriting = process of accepting risks:** whether, and at what price, terms and conditions. Cannot be outsourced.
2. First stage = selection and classification of risks. Selection is the primary step.
3. **Objectives:** business growth; solvency, profitability, liquidity; protect policyholders and shareholders.
4. SCOPE for fire (property); CASE for liability.
5. **Road map circular 23 Sep 2005:** underwriting independent of sales; guide tariff; nominated underwriters; risk inspection team.
6. **Seven functions:** select, classify, rate, terms, issue policy, retention and reinsurance, control and audit.
7. **Insurable risks:** pure and static only.
8. **Decisions:** preferred, standard, substandard, decline.
9. **Two stages:** corporate (nominated underwriters) and line (operating units).
10. **Types:** Fire, Marine, Motor, Miscellaneous, Liability underwriters.

1.1 Meaning and scope

- Selection = accept or reject. Classification = place the accepted risk in its class (decides rate, terms).
- **Includes:** risk peculiarities; loss exposure; frequency and severity; loss prevention; rating; terms and exclusions; retention and transfer.
- Risk management policy + underwriting policy = two sides of one coin.
- **Can be outsourced:** marketing, accounts, claims. Never underwriting.
- Not to broker, corporate agent, auto dealer or bank (bancassurance).

TRAP

3 reasons for no outsourcing: regulatory limits; growth, solvency and profit depend on it; depends on own capability, procedures, controls.

1.2 Importance

To	Points
Insurer	Growth with profit; keep customers; avoid loss, keep solvency; stop fraud; risk-based rating; comply; offer risk services
Insured	See size of risk; risk improvement lowers rate; discounts and deductions; better loss prevention
Intermediaries	Sell with clarity; understand insurer policy; stop mis-selling
Regulator	4 aims: development, market regulation, protect policyholders, solvency and liquidity; Compliance Officer
Society	Growth, safety, less fraud, higher penetration and density

- **Combined ratio:** below **100%** = underwriting profit; above **100%** = loss.
- Losses grow with volume because insurers cut rates to grow.
- Penetration = premium to GDP. Density = premium per person.

1.3 Contracts and underwriting

- **Forms:** fire, marine, motor, engineering, health, PA, liability, misc.
- Contracts differ, so underwriting differs. Insurance Act governs all.

Method	For	Letters
SCOPE	Fire of a business	Construction, Occupation, Protective measures, External exposures
CASE	Liability (public, product, WC)	Circumstances, Activity volume, Security measures, Events

- **Marine cargo:** start with terms of sale and price basis; Incoterms; Marine Insurance Act, Stamp Act, FEMA, Multimodal Act, Customs Act, carriers law; Institute Cargo Clauses and Time Clauses.

1.4 Features of insurance

- **Risk transfer:** insured to insurer, insurer to reinsurer. Oldest, commonest.
- **Definition (ARIA terminology commission):** pooling of fortuitous losses by transfer to insurers.
- Modern insurance about **400 years** old.

Feature	Meaning
Risk transfer	Group shares risk for premium; only few, not all, suffer loss
Pooling	Common fund pays the few who lose
Law of large numbers	Large group; pool pays if premium reflects group risk

- **Classes:** property; project (erection, contractor); loss of income (LOP, BI); personal (PA, health); liability; crop.
- General insurance = all insurance other than life.

1.5 Road map (23 Sep 2005)

- 1 independent of business development.
- 2 not subservient to business development.
- 3 internal guide tariff for small and simple risks.
- 4 staff trained to underwrite by guide tariff.
- 5 risks outside guide tariff go to nominated underwriters at higher offices.
- 6 nominated underwriters report to a senior officer, not to business development; judged on underwriting results.
- 7 own risk inspection team.
- 8 may use outside experts.
- **Rating support:** appointed actuary with senior underwriters lists rating factors per sub-class; data captured for every risk and claim; works with IT staff.
- Claims manager informs underwriting; study Loss Prevention Association of India reports.
- **Governance:** CEO report to Board comments on claims and adequacy of rates, at least every half year; Compliance Officer.

1.6 e-insurance

- eIA = e-Insurance Account, with an insurance repository.
- **e-policy:** digitally signed, issued electronically, directly or through repository.
- e-signature and digital signature as in IT Act **2000**.
- **e-proposal:** proposal in electronic form with e-signature; form must carry space for eIA number.

> **TODAY'S RULE**
>
> Now part of the **2024** policyholder-protection regulations (**2016** e-insurance rules repealed).

1.7 Principles and features

- **5 principles checked:** indemnity, insurable interest, utmost good faith, subrogation, contribution.
- Insurance contracts follow insurance law, common law, statutes, regulation (not only general law).

Feature	Idea
a	Find level of risk; accept or not; terms, price
b	Classify by traits; pay in proportion to chance of loss; not all risks equal
c	Sound lines; frequency and severity over liability period

- **Wood burns more than stone:** higher premium. Young drivers, old models, accident history: higher premium or refusal. Anti-theft device: discount. Sprinklers: reduced premium. Earthquake: higher near fault line, brick house.
- Rate = price of one unit. Premium = total paid. Not the same.
- Rate making = price to cover future claims and expenses.

1.8 Seven functions

- 1 selection 2 classification 3 rating 4 terms, conditions, exclusions 5 issue policy 6 retention and reinsurance 7 control and audit.

TRAP

Some questions name only 3 as interdependent: selection, classification, rating.

- Reinsurance decided before policy issued.

1.9 Identification, classification, evaluation

- **Identification methods:** specific inspection; past losses; event analysis; HAZOP; flow or process chart; organisation chart; accounts and annual reports.
- **Experts:** surveyors, engineers, financial and IT experts.
- **Classification:** homogeneous groups so rates can be assigned.

Risk	Meaning	Insurable
Pure	Loss only (fire, storm, flood, breakdown)	Yes
Static	Unchanged in period	Yes
Speculative	Loss or gain (hedging, options, futures)	No
Dynamic	Changes with economy, society, politics	No
Fundamental	Hits whole society; government handles	No

- **Evaluation:** sum insured; PML (Probable Maximum Loss) by statistics. Property: inspection (COPE) and records. Credit: financial ratios.

1.10 Moral hazard and selection of insured

- Moral hazard = main cause of fraud. Bad risk = accidental claims; bad insured = fraud.
- **Criteria:** scrutiny of proposal; risk profile; business line and volume; other business claim ratio; area; insurance and claim history; books of accounts; goodwill and pending cases; cooperation on loss prevention; cost and channels; directors, management, MIS.

1.11 Ratemaking

- Core of underwriting. Rate making, not rate cutting. Rates adequate and reasonable for policyholders and shareholders.
- **3 objectives:** regulatory, business, social (Chapter 3).
- **Steps:** past trends; actuaries validate rates; engineers and surveyors reports; final rate and terms.

1.12 Decisions

Decision	When
Preferred	Lowest risk boundary; lowest rates
Standard	Normal boundary; standard rates
Substandard	High risk within standards
Decline	Outside standards

- **Substandard 3 options:** higher premium (not discriminatory, same for same traits); limited benefits (file and use); exclusions (allowed by rules).

TRAP

Preferred is not a substandard option.

- **Decline reasons:** rates must be adequate; laws bar certain factors; against insurable interest, utmost good faith, indemnity; against public good or law.
- **Monitoring:** at renewal; every 6 or **12 months**; at a claim. Change or non-renewal only if policy terms and rules allow.
- **Issue:** schedule and endorsements; check printed policy (example: reinstatement clause wrongly on stock policy).

1.13 Retention and reinsurance

- Corporate underwriters decide. Reinsurance = insurance for insurers; passes risk above retention.

TODAY'S RULE

Reinsurance is governed by the Re-insurance Regs **2018** (amended to **2023**).

- **Programme objectives:** maximise retention in country; develop capacity; best protection for cost; simple administration.
- Regulator may ask insurer to justify retention (avoid fronting). Cession to Indian reinsurer as fixed by regulator.
- **Reinsurance helps:** expansion; steady results; cat losses; balance sheet; solvency.

1.14 Control and audit

- **3 supports:** underwriting audit; risk governance framework; corporate governance compliance.
- Independent of marketing. Top management.
- **Core team audits nominated underwriters:** trained if weak; authority withdrawn if careless.
- Audit checks adverse selection.

1.15 Stages

Stage	Who	Where
Corporate	Nominated underwriters	Higher offices
Line	Line underwriters	Branch or divisional office

- **Corporate roles:** underwriting policy; product research; revise rating plans; industry-wise analysis; guidelines and reports.
- **Policy considerations (14):** risk management policy; pricing; risk transfer; governance; line for class; add or drop line; new territory; product mix; volume and target; guide rates; philosophy; periodic review; declined risks list; audit policy.
- **Governance considerations (10):** risk classes; risk appetite from capital and reserves; authority and accountability; judgment; independent of marketing; limits at every level; skill mix; regular review; share expertise; internal audit.

1.16 Underwriter profile

- **Three parts:** roles; computers; internet and intranet.
- **15 roles:** analyse proposal; collect background; share with reinsurer; select risks; insurability prerequisites; moral hazard; specialists and brokers; claim experience; cover; rate; conditions (security alarm); reinsurance for large risks; issue policy; records; loss prevention advice.

- Too strict = lose business; too liberal = excess claims.
- **Computers:** analyse against benchmarks; rate on all factors; adjust for deductibles; recommend accept or reject.
- **Access control:** who uses data; who controls; secure; assign ownership; log access.

Network	Meaning
WWAN	Wireless Wide Area Network; radio, satellite, mobile; may suit rural areas
WLAN	Wireless Local Area Network; radio to business network; Wi-Fi hotspot

- CWISS = Centralized Web-based Insurance Software Solution (New India Assurance).
- **Wireless benefits:** convenience, mobility, productivity, easy setup, expandable, security, lower cost.

1.17 Types

- Fire, Marine, Motor, Miscellaneous, Liability underwriters.
- **USA, UK, Canada:** specialise in property, liability or health. India: many lines together.

> **TODAY'S RULE**
>
> Regulator is IRDAI (not IRDA).