What Every TOLI Trustee Needs To Know About Life Insurance Underwriting

April 29, 2014

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What Every TOLI Trustee Needs To Know About Life Insurance Underwriting

Our Next Three Webinars

Wednesday, May 14th, 1 pm CDT
Mineral, Oil and Gas Assets - Fiduciary Management, with PDS Companies

Tuesday, June 17th, 1 pm CDT
Farm & Ranch - Fiduciary Management, with PDS Companies
Presenter: Phil Olson, BS, PHD Agriculture

Thursday, July 24th, 10 am CDT
Deduction Planning
Randy Pople, CFP®, AEP®

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Today’s Agenda

• Why Should You Care?
• Overview of Underwriting
  • Underwriting Basics
• The Underwriting Process
• Winning the Paramed Exam
• Packaging the Case
• Putting it All Together
• Q&A

Why Should You Care?

• The biggest factor in life insurance pricing can be the underwriting received by your client.
• The difference in underwriting offers among carriers is wide.
• The cost difference over the life of the Insured is dramatic.
  • It can make the difference between a policy making sense and not making sense.
• You can possibly create an “arbitrage” between the actual life expectancy of the client and the underwriting received if the underwriting process is handled well.
Same Carrier/Different Underwriting Offers: From a Spreadsheet

Male Non-Smoker, Age 55, $5M of UL Coverage
Guaranteed to Maturity, Annual Premium

- Super Preferred: $52,555
- Preferred: $58,011
- Standard Plus: $67,146
- Standard: $71,742

The difference in cost over 25 years between Super Preferred and Standard with this carrier is $479,675.

Same Insured/Different Carrier Offers: Actual Case

Male, Non-Smoker, Age 50, 6’5”, 265 pounds, No medical issues noted on application
$5M of 10 Year Term, Annual Premium

- Carrier #1: Rated, $18,586
- Carrier #2: Standard, $13,535
- Carrier #3: Standard Plus: $9,500

The difference in underwriting offers from best to worst was a 96% increase in cost.

The History of Underwriting

When the first insurance contracts were written in the late 1600’s, they were written to insure against shipping risks. Financial backers in London would take on some of the risks in return for a premium. The backers would literally write their name under the information about the risk they were taking on, hence the term underwriting.

Originally, life insurance companies underwrote based primarily with their experience only and obviously, when experience was limited, this was hard. In fact, the first insurer charged the same rates for all and failed. Today life insurance underwriting is very sophisticated.

The Law of Large Numbers

The larger the number exposed to loss, the greater the probability that actual loss experience will equal the expected loss experience. This allows insurers to predict the expected losses of a group with greater accuracy. The larger the group that is insured, the more certain will be the prediction of loss.

Risk Pooling

By using the law of large numbers and probability to determine the chance of an event occurring and insuring a large number of people the carrier can use risk pooling to manage their risk. Risk Pooling: Assuming that the chance of an insured dying is one in 100, the insurer will collect premiums from 100 people. When a person in the pool dies, the death benefit is paid from the premium collected from all insured. The risk is pooled among the large number in the group.

Insurance companies must also evaluate individual risks among the insured to decrease their chances of loss.
How Much Coverage Can Your Client Get? *Approximations*

**Personal Coverage – based on earnings**

<table>
<thead>
<tr>
<th>Age</th>
<th>Factor Times Earned Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>20-25</td>
<td>20</td>
</tr>
<tr>
<td>26-30</td>
<td>30</td>
</tr>
<tr>
<td>31-40</td>
<td>25</td>
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<td>41-50</td>
<td>20</td>
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<tr>
<td>51-55</td>
<td>15</td>
</tr>
<tr>
<td>56-65</td>
<td>10</td>
</tr>
<tr>
<td>66 and up</td>
<td>5</td>
</tr>
</tbody>
</table>

**Estate Conservation – coverage amount growth**

<table>
<thead>
<tr>
<th>Age</th>
<th>Multiply By</th>
</tr>
</thead>
<tbody>
<tr>
<td>Through age 60</td>
<td>1.8</td>
</tr>
<tr>
<td>Ages 61-65</td>
<td>1.6</td>
</tr>
<tr>
<td>Ages 66-70</td>
<td>1.4</td>
</tr>
<tr>
<td>71 and up</td>
<td>1.2</td>
</tr>
</tbody>
</table>

**Underwriting - The Basics**

**Factors affecting Risk**

- Gender
- Age
- Body type
- Physical condition
- Health habits
- Non-medical risks
  - Financial status
  - Military service
  - Driving history
  - Travel/foreign residence

**Risk Classifications**

- **Preferred**
  - Reserved for only the healthiest individuals in the general population
  - Must have no adverse medical history
  - Must not be on medication for any condition
  - Has no personal or family history of early onset diseases
  - Is at ideal weight for his or her height
  - Has an acceptable body mass index
  - Has never smoked tobacco or has quit for extended period of time
  - Does not participate in high-risk behaviors
- **Standard**
  - Has an average health and normal life expectancy
  - The lab results are in the normal to slightly abnormal range
  - Can have some negative family health issues
  - Does not participate in dangerous sporting activities or have a hazardous occupation
• **Sub-Standard**
  - Below average life expectancy
  - Height to weight ratio undesirable
  - Being treated or had a chronic illness or major health issue
  - Bad or questionable lab results
    - Table rating
    - Flat extra
    - Rating up in age

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**Sample Height/Weight Chart**

<table>
<thead>
<tr>
<th>Height</th>
<th>Preferred Plus</th>
<th>Preferred</th>
<th>Standard</th>
</tr>
</thead>
<tbody>
<tr>
<td>4'8&quot;</td>
<td>125</td>
<td>145</td>
<td>178</td>
</tr>
<tr>
<td>4'9&quot;</td>
<td>131</td>
<td>150</td>
<td>184</td>
</tr>
<tr>
<td>4'10&quot;</td>
<td>136</td>
<td>156</td>
<td>191</td>
</tr>
<tr>
<td>4'11&quot;</td>
<td>141</td>
<td>162</td>
<td>198</td>
</tr>
<tr>
<td>5'0&quot;</td>
<td>146</td>
<td>168</td>
<td>204</td>
</tr>
<tr>
<td>5'1&quot;</td>
<td>151</td>
<td>174</td>
<td>211</td>
</tr>
<tr>
<td>5'2&quot;</td>
<td>157</td>
<td>180</td>
<td>218</td>
</tr>
<tr>
<td>5'3&quot;</td>
<td>162</td>
<td>186</td>
<td>225</td>
</tr>
<tr>
<td>5'4&quot;</td>
<td>167</td>
<td>192</td>
<td>233</td>
</tr>
<tr>
<td>5'5&quot;</td>
<td>172</td>
<td>198</td>
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<tr>
<td>5'6&quot;</td>
<td>177</td>
<td>204</td>
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<td>5'7&quot;</td>
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<td>294</td>
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<td>212</td>
<td>246</td>
<td>303</td>
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<td>217</td>
<td>252</td>
<td>311</td>
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<td>222</td>
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<td>320</td>
</tr>
<tr>
<td>6'4&quot;</td>
<td>228</td>
<td>264</td>
<td>328</td>
</tr>
</tbody>
</table>

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The height/weight table to the left represents one carrier’s underwriting classification for maximum weight and may not be indicative of other carriers. This particular carrier’s chart is unisex, while many carriers break the tables down to male/female.

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**The Underwriting Process**

- Gather health information
- Informal inquiry
- Market analysis
- Paramed exam
- Formal application
  - Negotiation
- Policy pricing review and design
- Policy placement
HIPAA Regulations: The Health Insurance Portability and Accountability Act of 1996 states that before health information about an individual is obtained there must be a signed disclosure from the individual. This pertains to life insurance underwriting on an Informal or Formal basis.

Underwriting Levels:

**Informal:** A simple signature on an Informal Application is all that is needed to gather the health records. Nothing else is required of the insured. Carriers will review the information and provide an “informal” offer. These offers will be subject to additional information and requirements and carriers will not be held to the offers, they but will provide a gauge of underwriting options.

**Formal:** In order to obtain coverage the applicant would have to submit a carrier specific application. At this point the applicant will also have to submit to other requirements, including a paramed examination.

Underwriting Requirements: In most cases, besides a formal application, the applicant will have to submit to a Paramed Exam, including blood profile and urine sample. For most of your clients there will have to be a resting EKG as part of the paramed exam. For ages above 50 and coverage above $10M a stress test may well be needed.

The Paramed Exam: Typically takes place at client’s house, though can take place at an office, either a paramed firm or even a doctor’s office. It should be understood that the client does not have to be “super healthy” as average people get life insurance every day. The most important thing is to have the client relax and follow some simple guidelines:

- Get a good night’s sleep.
- Be ready for exam.
  - Have a photo ID on hand.
  - Have a list available of names, addresses and phone numbers of any doctors or clinics visited in the last five years.
    - They should not try to hide any medical history since this tends to make it look worse than it probably is. It is a good idea to prepare this information in advance of the examiner’s visit so that it is ready and accurate.
    - In addition, providing a list of all doctors will speed up the underwriting process.
  - Have a list of all prescription medications, dosages and who prescribed. Over-the-counter medications including mega dose vitamins, Tylenol or diet supplements should be noted as these can affect blood results.
    - It is probably a good idea to fast for 12 hours prior to having your blood drawn. Results of non-fasting blood work can produce abnormal results on certain studies.
      - If your client must eat prior to an examination, sugar, butter, cream and fatty foods are discouraged.
    - A urine specimen will be taken as part of the examination. Your client may wish to encourage the examiner to allow the urine to be done first before the exam begins. The elimination of fluids tends to lower blood pressure.
- Caffeine is best avoided prior to examinations.
  - Caffeine can elevate blood pressure and increase your pulse rate.
- Alcoholic beverages should not be ingested for at least 24 hours prior to the exam.
  - Alcohol does affect exam results and can increase fat in blood and liver functions.
- Salt intake should be minimized for several days prior to the exam.
  - Salt causes fluid retention which in turn raises blood pressure.
- If a smoker, trying to reduce or not smoke prior to the exam is recommended. Smoking cigarettes raises your blood pressure. Nicotine testing will occur during the exam.
- It is recommended that exercise be limited for 48 hours prior to examination. Workouts, jogging, or weightlifting can adversely affect both blood and urine results.
  - Protein in the urine is the most common abnormal finding. This is usually the result of exercising prior to lab testing.
- Avoiding the use of nasal decongestants for 24 hours prior to the exam is recommended.
  - Nasal decongestants can increase blood pressure readings.

**Other Notes:**
- Several tubes of blood will be drawn and sent to a clearing house laboratory. These results are available and will be sent to your client’s Attending Physician upon written request to do so.
- Your client should allow at least 30 minutes for a full examination. Perhaps a little more if EKGs are involved.
- If your client is driving to an examination location, they should plan to arrive early as a period of relaxation after traffic tension will be beneficial.
- The underwriting process includes the insurance exam, medical records and letters from attending physicians involved in your care. Your client is advised to assist wherever possible in the underwriting process.
- Your client should be advised to provide information about additional doctor’s visits that might occur during the underwriting process.

**Medical Information Bureau (MIB)** is a data base containing medical and some non-medical information pertaining to avocation on individuals who have applied for insurance coverage. It was formed almost 100 years ago by a group of physicians representing insurance companies who had suffered fraudulent claims. They agreed to share information about prospective clients, assuring them that significant information one insurer was aware of was available to other. The information is shared in a coded fashion to protect the privacy of the prospective proposed insured. A member company has the responsibility of providing the MIB with information which is then input into the data base. Member companies input information of a positive (good) nature, such as negative tests and current normal findings where previous abnormal findings had been coded. The MIB also alerts member companies whether that client has applied to other member companies within the recent past. While the other member companies are not specifically identified, this does alert the member companies of multiple application submissions and the possibility of over insurance or the attempt to avoid certain age and amount underwriting requirements. The MIB conducts audits of its member companies to assure that proper reporting practices and rules of confidentiality are being closely adhered to. Member companies are also required by MIB rules of membership to conduct ongoing self audit programs to assure they are adhering to all rules and procedures.
An MIB report does not indicate the underwriting action that was taken with regard to any application for insurance. In other words, it does not indicate whether an application for insurance was issued, rated, or declined. An MIB report will be used only as a starting point to begin an investigation which will help protect insurers and policy holders from losses due to fraud or omission. The member company receiving the MIB report compares the information to that provided by the client. In the event the MIB codes are inconsistent with the information provided by the proposed insured, the insurer then must seek further information about the proposed insured from some other source. As a matter of law (NAIC Act, Privacy Protection Model Act, etc.) decisions based solely on MIB codes are prohibited. The MIB allows companies to minimize their exposure to the possibility of anti-selection and fraudulent claims. This in turn improves the companies experience and allows for better product pricing and dividends.

Packaging the Case:

- Have a good Underwriter
- Understand the clients’ health situation
  - Make sure information is complete
- Understand the carriers
- Put together a great cover letter
- Provide great follow up when requested
- Make sure client is ready to purchase and what objective is

Cover Letter

Underwriters read cover letters because they provide an insight to the case and make the case much easier to understand. The content of the letter should provide a full and balanced view of the case to help the underwriter gain a better understanding of your client and what the goals of the case are. Information you provide up front can speed the process by alleviating many of the why’s asked by underwriting along the way.

The key to a good cover letter is to answer these questions before they are asked. Include in the letter:

- What do you know personally about the Applicant, with any key personal and business facts?
- Be open about underwriting risks, but put in the best light.
- Review non-medical underwriting risks such as adverse driving, foreign travel, aviation, hazardous activities, etc.
- If there are any unique issues about the case that needs explanation and any information that can benefit your case?
- Focus on the goals for the case:
  - What is the coverage amount to be applied for?
    - How was this determined?
    - Were other professionals involved in making this determination such as attorneys, accountants, financial advisors.
  - What is the premium tolerance?
- How is premium to be paid?
- Who is the beneficiary and why?

Underwriting Nomenclature

Reinsurance is “insurance for insurance companies,” who use this process to cede a percentage of their financial risk to other insurance companies for diversification or to “lay off” a portion of a large death benefit. Typically, these transactions occur behind the scenes and your client will be unaware of them. Reinsurance
may affect underwriting:

- When a client has or is applying for a large amount of life insurance.
- When a client is involved in aviation or has a special avocation.
- When a client is older (70+) and/or represents a substandard risk/rating.

Two types of Reinsurance

- **Automatic reinsurance** refers to an agreement insurance companies have with their reinsurers on applications that exceed their capacity. Agreements vary, but in general, automatic reinsurance allows individual insurance companies to offer death benefits as high as $50 million by automatically sharing the risk with their reinsurers at a specified face amount. Cases that fall within “auto limits” do not need to be sent to the reinsurers for review. Contractually, reinsurers accept the underwriting decision made by the writing company and the risk is shared based upon the reinsurance agreement. Automatic reinsurance agreements only pertain to coverage applied for or placed with an individual carrier – they do not include coverage in-force or applied for with other carriers. Auto reinsurance capacity, as is with individual carrier capacity, is generally reduced at older ages and for individuals who represent a substandard risk.

- **Facultative reinsurance** refers to applications that are not acceptable by the writing company or are not included in the reinsurance agreement and therefore must be sent to the reinsurers for review. In these instances, the reinsurers are not obligated to accept the risk or even make an offer. They have the option to decline or rate the case as per their guidelines. Examples of cases that generally require facultative review include individuals who are a higher risk due to aviation activity, a specific avocation, or high-profile individuals such as professional athletes. If the risk is acceptable by the reinsurance company, the death benefit may be limited, depending on the capacity of the reinsurer. The policy is issued on the writing carrier’s paper, but the entire death benefit is the liability of the reinsurer at claim time. Facultative reinsurance can be a very good opportunity, especially on cases that ordinarily would be declined by the writing carrier. Facultative reinsurance must be used once the amount of insurance in-force and applied-for exceeds the carrier’s jumbo limit.

- **Retention** refers to the maximum amount of coverage that a carrier can accept on a single life without contractually involving its reinsurers. A carrier’s retention ranges from as low as $500,000 to as high as $20 million. Carrier retention typically falls within the $1 million to $5 million range. Retention also varies on older applicants; after a certain age (often 70), the retention may be reduced, and above a particular age (80 to 90+), carriers do not have retention at all and must work with their reinsurers in order to issue a policy. Further, carriers often have a lower retention on rated individuals or individuals who represent a substandard risk.

Other Things Your Client Needs to Be Aware of During Underwriting:

**Inspection Report:** Sometimes referred to as Personal History Investigations, it is contact with the Applicant over the phone. It is typically required on cases with larger face amounts or for older age individuals. Most inspection reports are handled by a third party company contracted with the life insurance carrier. Once the application is set up at the carrier, the inspection report company is triggered to contact the client using the phone number listed on the application. If the client is difficult to reach, the inspector will leave a call-back number. The phone interview takes approximately 10 to 20 minutes. In rare instances, at larger face amounts or in the older ages, an actual face-to-face interview may be required. Individuals that are ages 70 or above may also be required to complete cognitive testing or senior supplement exam as a part of their inspection report.
The inspection company has limited access to the information on the client’s application. It is important to discuss the inspection report ahead of time with your client and explain that the inspector does not have a copy of the application; therefore, questions may seem redundant. It is also essential that all questions are answered completely and honestly. An Inspection Report will include health questions, as well as financial questions and can include questions about business or other topics depending on the insurance need.

**Senior Supplement Exam:** Many insurers require a “senior supplement” exam for applicants age 70 and older. There are different types of exams, though most of the questions and activities are similar. The exam may be given in person by the paramed or medical doctor who is doing the regular physical exam. In other instances, the exam is completed with a phone interview by the insurance company or a contracted vendor of the insurance company. Typical questions and activities:

- Clock Draw: The examiner says a time, for example, 10 after 10, and your client is asked to draw a clock with the hands pointing to the proper numbers.
- Math: Simple math questions may be asked.
- Exercise: Questions on types of exercise and how often.
- Delayed Word Recall: The examiner will say 3 to 10 words and ask clients to recall them several minutes later.

**Other Things Your Client Needs to Be Aware of During Policy Placement:**

**Insurable Interest:** The person or entity taking out the coverage must have some sort of “insurable interest” in the insured. For example, there must be some sort of financial hardship if the insured should die. By law an individual has an insurable interest in his or her own life. In addition, insurable interest exists between an insured and spouse and children, and others related to the insured by blood or by law. The concept of insurable interest is also recognized in business situations. Employers often purchase policies insuring the lives of key employees if the company would suffer financial loss at the employee’s death. However, regulations have grown up around this process.

**Suicide Clause:** Under the terms of a suicide clause, policy benefits will not be paid to the beneficiary if the insured commits suicide within a specified period of time after the inception of the policy, usually two years. If an insured dies within the stated time, the insurance company will typically investigate to determine whether the death was caused by what is referred to as “self-inflicted injury.” If the death is determined to be self-inflicted, the policy will be voided, and all premiums paid will be returned to the beneficiary.

**Incontestability Period:** All life insurance policies contain a incontestability period, which is typically two years. Under the incontestability provision, the insurer has the right to contest a claim during the first two years after the policy’s inception date. The company will investigate the representations made in the application to learn if any misrepresentations were “material.” A material misrepresentation is one that, if the company had known about it at the time of underwriting, it would not have issued the policy. The burden of proving a material misrepresentation, or outright fraud, rests on the insurance company.
Putting It All Together:

Getting the Best Offer for Your Client

1. Partner with someone you trust
   a. Access to the marketplace is broad
2. Work with someone who can underwrite well
3. Prepare your client for the process
   a. In a period of health
   b. Thoroughness
   c. Honesty
   d. Complete
   e. Understanding
4. Have clear goals
5. Communicate the goals well
6. Once offers are made, be able to move quickly
7. Understand product types, funding methods, etc.
8. Once policy offered bound, make sure it is funded correctly
9. Manage the policy going forward

Questions?

Michael Brohawn, CFP®, CLU

Email: mbrohawn@youritm.com
I attended the Webinar on April 29th, 2014 provided by Insurance Trust Monitor, entitled, *What Every TOLI Trustee Needs To Know About Life Insurance Underwriting*, and wish to receive Continuing Education Credit.

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  - CFP License Number: _______________________
  - Last 4 numbers of SS Number: _______________
- CTFA – Certified Trust Financial Advisor

Name: __________________________________________

Email Address: ___________________________________

______________________________________________

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