

How facultative underwriting develops a market

Facultative life underwriting in reinsurance has become a standard line in many of the more developed markets, although it is still relatively new in emerging markets.

Mr Oscar Smith of **RGA** looks at how facultative underwriting has evolved over the years, and the benefits it can offer.



Over the past half century, facultative life underwriting – a service provided by reinsurers to help life insurers cover a broader range of underwriting risks – has become an important worldwide business and a standard line in many of the more developed markets. In emerging markets however, this concept is still relatively new.

According to Barron's Dictionary of Insurance Terms, "facultative" is defined as a term that denotes a reinsurer exercising its "faculty or prerogative to insure a risk or reject a risk from a ceding company". In other words, it is a form of reinsurance where the reinsurer accepts a risk it is not obligated to accept.

Expanding on this definition, the process also encompasses an insurer seeking to determine if it can underwrite a particular risk by ceding a portion of that risk to a reinsurer. Frequently, the risks in question are either medically impaired lives, individuals applying for a sizable amount of coverage beyond the insurer's maximum automatic underwriting capacity or individuals engaged in high-risk occupations or avocations.

In all these cases, a specialist in facultative underwriting – frequently, a reinsurer – can analyse the application, plus any pertinent medical and (if applicable) financial evidence, and determine whether or not profitable terms can be offered to mitigate the risk. A facultative reinsurer's sizable database of information pertaining to impairments can frequently produce a "yes" where the insurer's own information and processes might result in a "no".

Some history

Facultative underwriting first emerged in the 1960s in the US and South Africa. At that time, the service was very much an informal one: if Insurer A had a relatively large risk, the company's chief underwriter would call his counterpart at Insurer B and request it accept an amount of risk in excess of what Insurer A was able to accept. Each case's terms and conditions would be negotiated personally, chief underwriter to chief underwriter, often during an office visit or, better still, over coffee or a nice lunch.

By later in the decade, life reinsurers had begun to offer special terms for risk such as hypertension, heart attacks and diabetes in the form of an individual facultative facility. From there, the process gained momentum, reinsurers moved to offering a full facultative service, and facultative reinsurance became a structured, formal line of business. Insurers would send policy information on cases for which they wished quotes to multiple reinsurers. If the reinsurers deemed the risks "reinsurable", they would offer special

terms for these applicants. A few years later, reinsurers began to provide facultative quotes for two additional classes of applicants: high-sum-assured individuals as well as individuals bearing avocation and aviation risk.

What needs to be remembered is how communication functioned in those early, pre-internet days. Paper photocopies needed to be made of the full documentation file, and each batch of files needed to be sent by what today is called snail mail to the reinsurers. Reinsurers also employed couriers to make twice-daily rounds of their insurer clients – collecting cases in the morning and in the afternoon delivering what had been underwritten. Some



reinsurers even sent couriers to airports to pick up the files that had been shipped by air for faster underwriting and then to airship the underwritten files back to the insurers.

Since then, facultative underwriting has spread throughout the world with technology improving and speeding its processes. The 1980s saw the introduction of fax machines which enabled insurers and reinsurers to fax paperwork back and forth, removing the need to photocopy and ship large quantities of documents. By the 1990s, computers were further enabling documents to be emailed to insurers.

Today, reinsurers that provide facultative quotes have computerised systems that, with just the touch of a button, enable insurers to electronically submit the financial and medical documentation factors necessary for a facultative quote. Basic information about the applicant, appropriate medical evidence and, if applicable, appropriate financial information, are analysed by the reinsurer's rules engines, and then a decision is produced. Turnaround times are measured in hours or minutes and frequently even in seconds – a huge difference from the many days or even weeks that such quotes would take in the early days.

Benefits of specialist staff

Reinsurers that provide facultative underwriting usually have a fully inclusive unit where this function is performed. Their dynamic underwriting manuals are continuously updated to reflect the most current medical advances and the reinsurer's own mortality and morbidity experience.

These reinsurers also have dedicated staff, including

qualified physicians and actuarial professionals who specialise in assessing and pricing non-standard cases. The broader knowledge means they are able to recommend aggressive decisions and better pricing, which benefits the client and the applicant and will result in increased sales for the insurer.

In situations where the application is for a large sum assured, reducing volatility by reinsuring a portion of a large sum assured is often the way insurers will choose to go. Submitting the case for a facultative assessment often allows companies to write risks that are much larger than their own retentions will permit.

For insurers considering ceding portions of their risk, accessing facultative underwriting can be a way to launch a business relationship with a reinsurer, without either party being obliged to enter into a major commitment. Underwriters at the insurer and reinsurer can get to know one another without pressure, and as the insurer's own business grows and develops and more facultative quote needs emerge, a substantial insurer-reinsurer partnership, based on trust engendered through many quotes, can develop with minimal fuss.

Access to facultative quotes can also help insurers build stronger and more effective client relationships. As life cycles progress, insurance needs increase in complexity, and access to facultative underwriting equals more business underwritten, and stronger, more fruitful client relationships. ■

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Do not follow where the path may lead.
Go instead where there is no path
and **leave a trail.**

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