

What do Personal Finances have to do with Life Insurance Underwriting?

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Chris Hooper, FALU, FLMI
Chief Underwriter at BUI

The process for purchasing most goods and services sold today is simple: The sale is approved if the buyer has enough money or credit to purchase the goods. However, the process to purchase life insurance is more complicated than most purchases due to underwriting requirements. While most buyers are not surprised about the medical underwriting, financial underwriting is frequently misunderstood.

Generally, the goal of financial underwriting is to confirm insurable interest. In other words, the life insurance policy cannot place the Insured in the dangerous position of being worth more dead than alive.

How is this determined? The insurance company requires financial data for all applications. The more coverage applied for, the more financial data requested. This is where the rubber meets the road. Finances are often extremely private and clients tend to find it frustrating and confusing why this information is required to obtain a life insurance policy.

Why do insurance companies financially underwrite?

To ensure the applied for coverage makes a beneficiary whole: The financial impact of a person passing away should bear a reasonable correlation to the amount of insurance. Just as one cannot insure a home valued at \$250,000 with a home owner's policy for \$1,000,000, one cannot obtain a life insurance policy that would improve his/her financial position through the death of the insured.

It's the law: While the source and provisions vary widely from state to state, it is universally adopted a murderer cannot inherit the estate of the person he/she murdered. This may remind you of a late night murder mystery (Spoiler Alert: It was the spouse that did it for the insurance money). The last thing an insurance company wants is to be accused of accessory before the fact in a murder trial.

It protects the insurance company's profitability: Historically, there was no such thing as financial underwriting in the USA before the 1929 stock market crash. During the Great Depression, insurance companies experienced a significant increase in claims for devious reasons. Further analysis displayed higher mortality when a large chunk of an Insured's income was spent on life insurance. When claims go up, the insurance company's profitability goes down.

How to prevent financial justification derailing your client's underwriting process?

Identify the purpose of coverage: Guidelines vary based on the purpose of coverage. Understand the purpose of coverage and confirm the desired amount of death benefit is acceptable within the carrier's parameters.

Set appropriate expectations: Explain why insurance companies financially underwrite, and set the expectation that the insurance company may require documentation similar to applying for a bank loan. We deal with the discomfort because the value of the policy makes it well worth it.

Gather and communicate information: Providing a cover letter with the application is an excellent way to avoid financial underwriting problems. It allows for you to set the stage, and provides the underwriter with an overall higher level of comfort with the application.

Dear Underwriter,

Thank you for underwriting this \$2,000,000 application on the life of Mrs. Smith. The purpose of this coverage is income replacement. According to your income multiple guidelines, we determined this coverage is financially justified utilizing the following formula:

- Gross annual income = \$150,000
- Age 45 income multiple = x20
- Total line of income replacement coverage with all carriers will be \$2,500,000, noting the existing \$500,000 In Force policy is not being replaced.
- $\$150,000 \times 20 = \$3,000,000 > \$2,500,000$

Mrs. Smith's pay stubs or tax returns to document her gross compensation are available upon your request....

A Final Thought:

Preparing for the underwriting process and setting appropriate expectations will set you up for success. **BUI's Financial Underwriting Criteria** document provides an inside-out view of how an applicant will be examined from a financial perspective and outlines what information insurance companies typically require based on the specific purpose of coverage. Contact your BUI Relationship Manager or Underwriter to obtain proactive underwriting tools or to discuss the underwriting process.