

Underwriting Beyond Intuition: Structured Decisions with a Customer Focus

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Introduction

An insurance agency's book of business has produced poor loss ratios and little growth for six straight quarters. Bob, head of underwriting for the agency's territory, orders the agency's contract terminated.

"But, Bob," says the underwriter for the territory. "Isn't this action premature? The agency's performance could be improved with some effort on our part."

Bob responds, "We're in the business of underwriting, not rehabilitating."

The underwriter asks, "What about the fact that it usually costs one-third less to keep a customer than to try to find a new one?"

"That's what marketing dollars are for," Bob responds impatiently. "Terminate 'em!"

Actually, Bob is mistaken. He's in the business of making money, and he does that by serving customers profitably. Because his com-

pany does that by underwriting insurance applications and renewals, he and a multitude of managers like him have been conditioned over their many years in the business to define success as profit and to believe that, as long as a business is profitable, its methods are unimpeachable. In other words, don't mess with success.

Behind this philosophy is the old maxim "You can't teach an old dog new tricks." This saying is both a testament to and a predictor of human behavior. The longer we do something successfully—in this case, turn a profit—the less receptive we are to suggestions for improving our performance. "We make underwriting decisions the old-fashioned way," says Bob, "with sound reasoning and based on years of experience. Our ways have worked in the past, and they'll continue to work in the future. There's nothing wrong with the way we do business."

Abstract

Quality management experts state that customer satisfaction is the most important goal toward which any business can work. This article attempts to improve the reader's ability to make better decisions when underwriting with a focus on customer satisfaction. Underwriting is defined here as the process of gathering risk information, learning stakeholders' expectations, recognizing alternative ways to meet those expectations, and offering risk-management options in an effort to create win-win agreements that meet or exceed customer expectations.

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Editor's note: The views expressed in this article are the responsibility of the authors alone and do not imply an opinion on the part of their employers.

There is no question that time-tested methods work much of the time. By using them, insurers have made and generally continue to make money. But that is not the issue here. The question is whether more money could be made now and in the future if better ways of making underwriting decisions were adopted. When they are basking in the hallowed light of earnings statements showing healthy profits, few managers are eager to ask, "Should profits have been greater?" or "Did we leave money on the table?" To do so suggests failure, a most unwelcome thought at a moment of self-congratulation. (This suggests failure in not realizing higher profits either now or if different ways of making underwriting decisions were to be adopted.)

Competition in today's insurance markets has never been keener or more turbulent. And, while working harder and longer can help to match the competition, insurers must learn to work smarter, or they will lose market share, then profits. The authors have proven that any underwriter who partners with agency teams can increase profits by doing four smart things they are generally reluctant, if not adamantly opposed, to doing:

1. Rely on each other enough to work at building trust through developing rapport, maintaining openness, and earning respect. Many underwriters assume producers will cooperate, and some underwriters become retaliatory when disappointed. Many producers assume underwriters are adversarial and act very guarded when dealing with them.
2. Use structured analytic methods to underwrite applications and renewals (e.g., decision trees). By narrowing the margin for subjective (intuitive) judgment, structured analysis in every case produces less risky decisions that are credible in the eyes of most producers and their clients and prospects. Intuitive decisions, though often profitable, are, in the end, nothing more than educated guess work.
3. When an insured suffers a loss or a prospect does not have a clean loss history, advise producers and customer service representatives how all parties concerned should coordinate their efforts to negotiate a win-win agreement that results in meeting or exceeding the realistic expectations of clients. Negotiate the renewal or issuance of coverage to grow the book of business smartly. There are often a host of remedial measures to consider that will reduce a

policy's exposure to repeat losses or unintended coverage. All that is required to identify these measures is a bit of research and imagination on the part of underwriters. Producers and CSRs bear the burden of representing their clients' interests when considering such measures and then presenting them to their clients so that sales of remedial measures are made. Producers love underwriters who provide realistic alternatives on how to renew existing business and write new business. Few things demoralize producers and CSRs more than having a client or prospect blindly canceled, nonrenewed, or rejected.

4. Develop the ability to "see" how the system works and communicate what you see. Understand how the teams play, how players score, how coaches lead, and how owners enable. Develop a playbook to help the team learn to win by knowing their plays (e.g., paired ranking matrix, workbooks). Producers trying to win at the sales game need to know that their underwriters are willing and able to play ball. Underwriters who enable producers to score by giving them comprehensive and creative play books are revered as great coaches.

These measures, of course, conflict head-on with many stated operating policies and several informal paradigms of insurers. Such insurers prefer to terminate instead of negotiate. Phrases like the following are often spoken or thought:

- The big one is coming.
- Let's cut our losses now.
- Reduce our risk against recurrence.
- Don't throw good money after bad.
- Common sense says this is a bad risk.
- Hire them, tire them, and fire them.

The fact is, one should not hesitate to negotiate. Producers who are smart deal makers attract more opportunities. Underwriters who are smart deal makers encourage and enable their producers and CSRs to attract more insureds. CPCU should stand for Creative Production by Constructive Underwriting. Insurance should be a contract of the utmost good faith, and we should act accordingly. These measures have been applied with demonstrable success because of all stakeholders profited—insureds, producers, CSRs, and insurers.

"Really?" remarks Bob. "Structuring analysis? Counseling agents about their clients and prospects? Renewing risky policies? We don't do that here. Besides, if there were

better, more profitable ways to make money through underwriting, they would have been invented long ago by bright minds among the thousands of intelligent, experienced, successful people in the industry. Remember what the ancient Romans used to say: *Nihil novum sub solum*—There's nothing new under the sun."

Clearly, this Roman maxim is true . . . if one stays in the darkness of sameness, blind to innovations. But the authors, standing in the invigorating light of change, have discovered that there are, indeed, more profitable ways to make underwriting decisions than those currently in use. The need for continuous improvement created by focusing on the consumer encourages innovative thinking.

Oddly enough, these new techniques, which incorporate powerful, practical, proven ways of analyzing problems of every type, have been around for decades. If that's true, then why haven't they found their way into the business of underwriting?

What Is the Problem?

There are actually two problems. The first is that our educational institutions don't teach these techniques as standard analytic approaches, so most underwriters have never heard of them. The quick and easy solution to this predicament is employee training.

The second problem—really the overriding issue—is that the human mind doesn't like to structure its thinking, so on-the-job training alone isn't enough. Just as calculus is a new way of thinking that requires personal mastery, group acceptance, and real-world application, structuring analysis requires personal and team effort.

A voice of reason tells us that an organized, structured approach to analyzing groups of applicants' insurability increases the probability of making profitable decisions. Unfortunately, most underwriters rely on their intuition because it is easier, faster, and it makes them feel good. As when cooking, it helps to follow recipes. But most of us instinctively avoid and resist using an organized approach to decision making. Instead we tend to rely on "gut feeling" or "seat of the pants" guess work—what scientists call intuition. This aversion to structured analysis is simply the way the human mind works. The human mind was not designed to structure its thinking; it has evolved to make decisions intuitively.

Intuition can be relied upon most of the time to lead us to effective solutions when confronted with simple problems. But when

confronted with complex problems, like underwriting insurance applications and renewals, intuition cannot be trusted with the inherent intricacies of coordinating loss histories with driving records, coverages, and such.

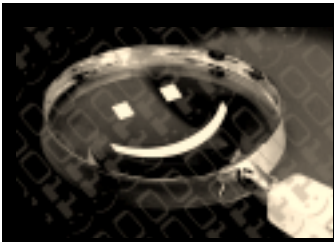
Instead of following a structured format or recipe that addresses the system's requirements, our minds tend instinctively to favor the first solution that seems satisfactory, which leads to a trial-and-error process. But in underwriting, cause and effect are generally not closely related. Therefore, few underwriters are aware of how shooting from the hip amounts to shooting themselves in the foot. Economists call this phenomenon "satisficing" (the merging of "satisfying" and "sufficing"). It refers to the fact that we would rather accept a quick satisfactory solution than pursue a more time-consuming, optimum solution. What makes satisficing especially insidious is that we are disinclined to resist intuitive decisions because we feel comfortable and confident with our impulses. In the case of underwriting, the defects in a solution do not become apparent until data are thoroughly measured or a customer complains.

Unfortunately, intuition's reliability is limited and guided by a host of unconscious mental traits that defeat creative, objective, comprehensive, and accurate analysis. Seven of these traits have especially adverse influences on our ability to analyze problems and make effective decisions:

- 1. Emotion** is perhaps the most troublesome trait, for we are emotional creatures. There is an emotional dimension to every thought we have and every decision we make. Whether this emotion is subtle or mind-capturing, it influences choice in any decision we make.
- 2. Mental shortcuts** taken by our unconscious mind continuously and drastically influence our conscious thinking. Therefore, those who seek to be objective struggle against such shortcuts.
- 3. Patterning** is how our mind relates to the world around us. We often reflexively recognize patterns in situations and in sequences of events that we have seen before. Stereotyping and cause-and-effect relationships are forms of patterning. Unfortunately, such mental activity causes us to misidentify things and corrupt our problem-solving and decision-making efforts.
- 4. Biases** are unconscious beliefs that condition, govern, and compel our thoughts



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and behaviors. Regrettably, we tend to give high value to information that is consistent with our biases, thus reinforcing them, while devaluing or rejecting information that is inconsistent with our biases, thus preserving them.

5. Compulsive explaining helps us make sense of and lessen the uncertainty in the world around us. Unfortunately, the explanations that result don't have to be true to satisfy this compulsion. And being satisfied, we move on without seriously questioning the validity of our explanation.

6. Focusing makes us view problems and decisions one-dimensionally without probing for deeper meanings and causes. Focusing can severely cheapen the value of our efforts to be objective.

7. Clinging to false beliefs when faced with contradictory evidence weakens our ability and credibility as professionals. We prefer to believe what we prefer to be true.

As a consequence of these and other mental traits, producers, CSRs, and, especially, underwriters habitually and unwittingly commit a variety of analytic sins:

- They begin their analysis of a problem by formulating their conclusions. Thus they start at what should be the end of the process.
- They focus their analysis initially on the solution they intuitively favor.
- They look for and find evidence that is supportive of their gut feelings.
- They confuse "gathering information" about a problem with having a real dialogue with customers.
- They focus on the substance (evidence, arguments, and conclusions) and neglect the process of their analysis.

The overall effect of intuition and the unconscious mental traits that govern it is to close the mind to alternatives and better decisions. The quickest, most effective way to open the mind—that is, to overcome the instinctive mental traits that defeat objectivity—is to structure one's analysis.

Structuring Analysis

Structuring one's analysis means working to see and learn the constituent elements of a problem in an organized way that enables—compels—the analyst to consider each element separately, systematically, systemically, and sufficiently. Conducting analysis within a rational framework helps the mind make sense

out of complex problems by systematically focusing on all key issues and all alternative scenarios, one at a time, allowing each alternative scenario its moment in the center stage of our mental processes.

"Structuring" should not be confused with "analyzing." Structuring is like mapping a trip or charting a course. Structures (the road maps) show that trips are systems having a single beginning and many alternative endings. Where you end up, which alternative path you take, is not determined by the road map but by your analysis—what you do along the way. These systems are best learned and used as cycles or reoccurring models instead of linear cause-and-effect relationships with definite beginnings and ends.

All structuring techniques are visual processes that involve writing or depicting elements of a problem so we can see them. By enabling the brain to actually see the words or numbers or other depictions of the problem, we engage more brain power and, thus, gain added insights. Indeed, when elements of a problem are seen visually, we often discover correlations we missed when we simply thought about them using only intuition. We sometimes perceive solutions that would otherwise not have occurred to us. Finally, structuring allows us to analyze alternative decisions and solutions in an organized way not controlled by the unconscious mind, but by the conscious. That is why the visual nature of structuring techniques is important, enabling the conscious mind to better focus on, and exercise control over, the analysis. The effect is to force our intuition into the open, so to speak, where we can consciously cross-examine it and, in the process, protect ourselves against the workings of those troublesome intuitive mental traits.

The striking differences between the intuitive and the structured approach in analyzing a problem or decision are portrayed in Table 1.

The message of Table 1 and previous discussion is: *Structuring analysis and decision making will produce better underwriting results.*

How Can We Structure Underwriting Decisions?

There are, of course, many different ways. We recommend a three-phase process that incorporates two basic analytic structuring techniques—one called "paired ranking" and the other a simple matrix. These result in a structure that reflects the decision maker's preferences based upon his/her knowledge and

experience. Therefore, it is neither prescriptive nor restrictive, just structured. This process unscrambles and systematizes analysis of the most common types of information used in evaluating applications for and renewals of insurance coverage. Because the steps involved are relatively simple and logical, they are easily mastered and can be repeated in many situations.

Using automobile policy renewals as the example, we rank the different kinds of driving record losses from most to least severe from the standpoint of approving the renewal of a policy. We then separately rank the different kinds of driving record citations, from most to least offensive or alarming. We align these two rankings on the X and Y axes of a matrix and enter a number or letter in each of its cells (see Figure 1). We will then plot on the matrix the intersection of an insured's worst loss and worst citation (see Figure 2). For each cell in the matrix, we create a risk treatment. We list these treatments in order of their severity (least to most) assigning them numbers or letters corresponding to those of the cells in the matrix described above.

The process of combining these two analytic devices is straightforward:

1. Obtain the applicant's driving-record losses and citations.
2. Locate on the X and Y axes of the matrix the most severe loss and citation.
3. Plot their intersection on the matrix.
4. Note the number of the intersection cell.
5. Find the risk treatment that corresponds to the number or letter of the matrix's cell.
6. Modify the treatment, as appropriate, to accommodate the particulars of the renewal.

Both the matrix and the list of treatments can be easily revised, based upon the decision maker's knowledge and experience, to maximize the profitability of the resulting underwriting decisions. Structuring the decision process in this way may seem mechanistic and inflexible, but it really isn't. The underwriter's judgment plays a determining role at every stage. The effect is to narrow the range of decision choices by breaking down the underwriting decision process, step by step, into its constituent elements. This enables the underwriter to focus analysis on only one or two elements at a time—instead of trying to juggle all of them at once—and to make an informed, soundly constructed and, therefore, acceptable decision rather than simply an educated guess.

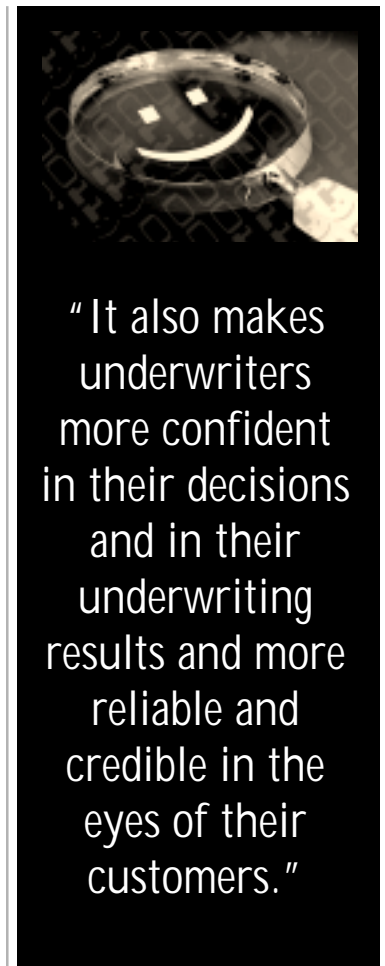
Table 1

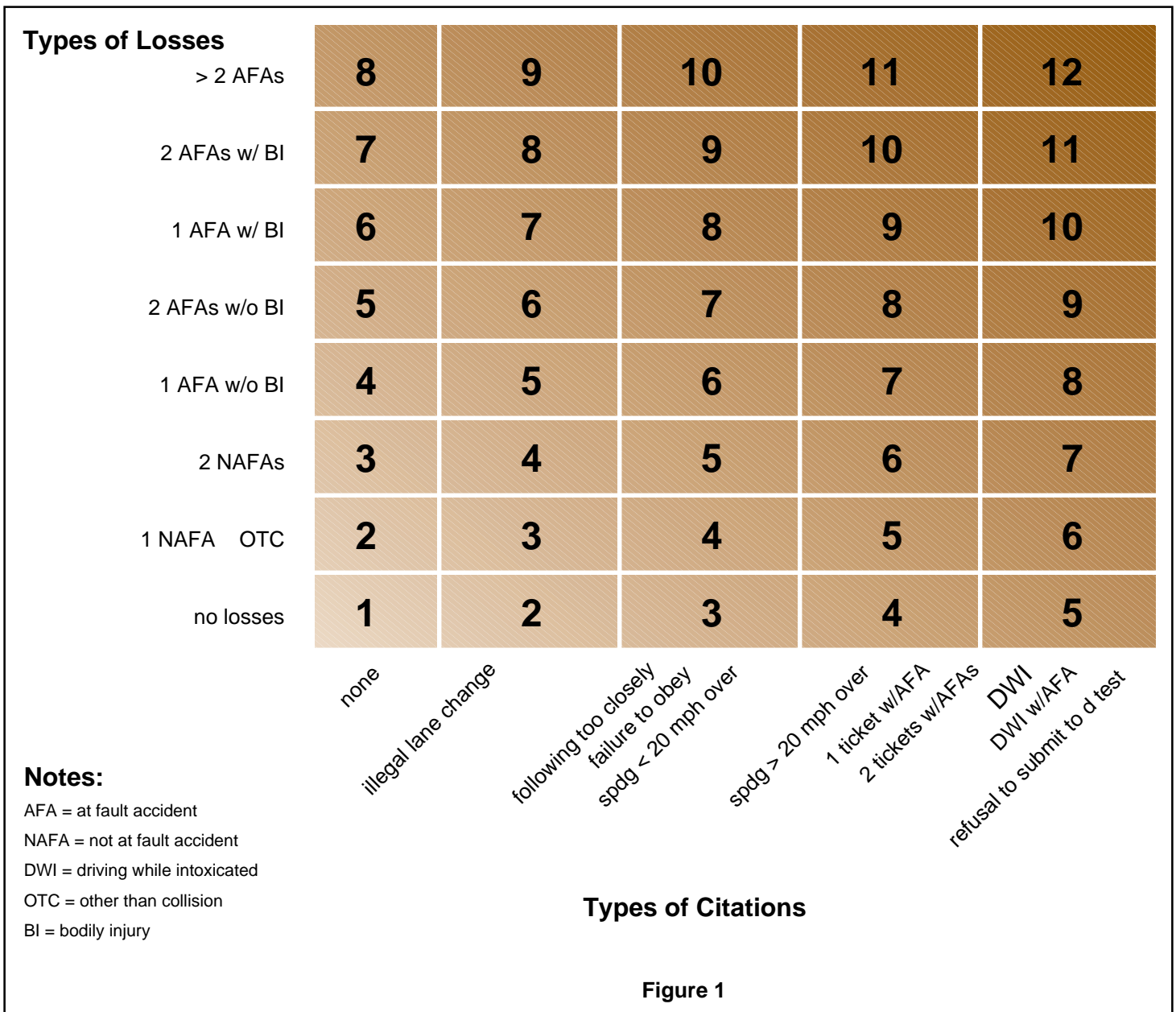
Comparisons	Instinctive Analysis	Structured Analysis
Method:	Satisfice	Separate, Systematic, and Sufficient
Mindset:	Closed	Open
Alternatives:	All Not Fully Considered	All Considered Fully
Decision/Solution:	Frequently Flawed and Less Effective	More Comprehensive and Effective

The Benefits of Structuring

A structured approach ensures that an underwriter makes decisions by rigorously following the same analytic steps, not by improvising a makeshift, haphazard process each time based on intuition. Reinventing the wheel each time an application is considered for issuance or a policy is considered for renewal is unnecessary. Because the process is systematic and repeatable, it is consistently reliable, and its results can, therefore, be measured and revisions made to increase its profitability.

It increases profitability by empowering agencies and underwriters to approve more new policies and renew more existing business while simultaneously reducing risks. It prescribes reasonable and consistent treatments for different risk situations that can be explained in clear, simple language and illustrations to an insurer's agencies and to insureds. And these treatments can be effectively defended before insurance commissioners and in courts of law. Communication between underwriters and agents is enhanced significantly when underwriting structures are shared and demonstrated. This is true because structuring, by design, reveals biases and assumptions, illuminates alternatives, and stimulates ideas. This is the creative beauty and power of structuring; it is multidimensional. It also makes underwriters more confident in their decisions and in their underwriting results and more reliable and credible in the eyes of their customers.





Standardizing Underwriting Procedures

Consistency is the Achilles' heel of the underwriting profession. The Underwriting Cycle is a formally recognized model illustrating how underwriting is inconsistent and cyclical. As in every avenue of human endeavor, there is a standard distribution curve with respect to underwriters' success. At one end, underwriters perform very profitably; at the other, very unprofitably. Most underwriters, in the middle of these extremes, make decisions that, when averaged, are moderately profitable. If the average of all three groups is profitable, an underwriting company does well and considers its underwriting philosophy successful. If the average is not sufficiently profitable,

the company revises its underwriting procedures, terminates the most unprofitable underwriters and/or agencies, and looks for promising replacements. This produces unnecessary turnover costs associated with replacing employees and agencies.

This revolving-door approach to managing underwriting may be a time-tested way to ensure a profit, but it is clearly wasteful in its management of resources and in its profitability. What is worse, this approach endlessly reinvents itself, never coming close to maximizing the underwriters' profit-earning potential.

It would make more sense and be more profitable to formulate a standard, structured decision-making process that teams of underwriters would follow, partnering with their





agencies, based on the insights of the company's most profitable underwriters (those in the uppermost tier of the distribution curve). A structured, standardized process would give company management, for the first time, real hands-on control over underwriting decisions and profitability. The same type of standardized procedure can be used to evaluate the performance of insurance agencies under contract.

Naturally, people will resist changing the

way they have been doing their jobs for many years. But if underwriters apply and practice the principles embodied in structured analysis, they will quickly discover how these principles organize and focus analysis, produce sounder, more profitable underwriting, and enhance management's confidence in those decisions. The authors promise that, once the structuring threshold has been crossed, underwriters will prefer structured decision making, which reduces but does not eliminate intuitive analysis.

Appendix

For further information on structuring techniques, see the following:

1. *The Thinker's Toolkit: 14 Powerful Techniques for Problem Solving*, by Morgan D. Jones, Times Books, 1998.
2. *Project Planning, Scheduling and Control*, by James P. Lewis, Probus Publishing Co., 1991.
3. *The Memory Jogger II: A Pocket Guide of Tools for Continuous Improvement*, GOAL/QPC & Compact Training Co., 1994.
4. *Thinkertoys*, by Michael R. Michalko, 10 Speed Press, 1991.
5. Insurance Institute of America's AIS 25 course material.