

The Underwriting Process of Liability Insurance

Sandeep¹, Dr. Manoj Kumara N V²

¹Research Student, Maharaja Institute of Technology-Mysore

²Associate Professor, Department of management sciences, Maharajas Institute of Technology-Mysore

Abstract- Liability risks may embody far-reaching financial consequences for individuals, business enterprises and professional people. This paper focuses on the underwriting process which should be taken into consideration by short-term insurers when they are underwriting the main types of liability insurance, which include employer's, householder's, personal, product, professional and public liability insurance.

The improvement of financial decision-making by short-term insurers when underwriting liability insurance represents the objective of this research. A study of secondary data was done to identify the existing literature, which formed the basis for compiling a questionnaire to obtain primary data. The top 10 short-term insurers which are the market leaders of liability insurance in South Africa and who received more than 85% of the annual gross written premiums for liability insurance in South Africa, represented the sample of the empirical study.

This paper highlights the importance of the underwriting factors concerning liability insurance, how often the stipulations of insurance policies should be adjusted by the short-term insurers to account for the underwriting factors, as well as the problem areas which the underwriters may experience when they are underwriting liability insurance. Possible solutions to solve the problem areas were also addressed.

Index Terms- Employer's Liability Insurance, Householder's Liability Insurance, Personal Liability Insurance, Product Liability Insurance, Professional Liability Insurance, Public Liability Insurance, Underwriting Process.

1. INTRODUCTION AND OBJECTIVE OF RESEARCH

Business enterprises, professionals and individuals are exposed to various types of risks, of which liability risks are important with probable far-reaching detrimental financial consequences. This research focuses on the underwriting factors of the main types of liability insurance, viz. employer's, householder's, personal, product, professional and public liability

insurance. The application of the judicial system towards negligent business operations, professional conduct and individuals has become very strict and a single claim may even lead to the bankruptcy of the defendant. It is, however, a fact that not all risks are avoidable and short-term insurers therefore provide financial assistance to business and professional enterprises as well as individuals. It should however be borne in mind that liability insurance will also have some exclusions which will not be covered by the short-term insurer (Ingram, 2009:123-130). According to Wagner there is a complex interaction between liability insurance and the tort law (2006:277). A tort is a wrongful act which a Risk governance & control: financial markets & institutions / Volume 4, Issue 1, 2014 person has done against another person or against the property of another person (Mehr et al., 1985:65). While mentioning the legal aspect of liability insurance and torts, the reasonable person principle should also be borne in mind (Bajtelsmit & Thistle, 2008:815-823). When applying the reasonable person principle, the faculties and senses as well as the vicinity and circumstances of the insured should amongst others be taken into consideration to determine whether the insured has acted reasonably by doing what he/she did (Dorfman, 1991:149). The purpose of this paper is not to discuss these legal issues, but to emphasise that legal aspects play a very important role in liability insurance. The underwriting process consists of three important steps, focusing on obtaining the relevant information about the risk, deciding whether and to which extent the risk will be covered by the insurer, and thirdly setting the suitable insurance premium which the insured will have to pay. The possibility of a moral hazard, which focuses on the insured's behaviour towards loss prevention, should also be taken into account during the underwriting process of liability insurance, as it may play an important role throughout the entire insurance period

(Parsons,2003:448-471). The objective of this research embodies the improvement of financial decision-making by short-term insurers regarding the underwriting process of liability insurance. Both secondary as well as primary data play a role in this research to ensure that the objective is reached. The empirical survey focused on the top 10 short-term insurers which underwrite liability insurance as they are the market leaders of this class of short-term insurance in South Africa. The paper also highlights the importance of the underwriting factors in liability insurance, how often the stipulations are adjusted by the short-term insurers to take the underwriting factors into account and the problem areas which the short-term insurers experience when underwriting liability insurance.

2. RESEARCH METHODOLOGY

The objective of this research was already defined as the improvement of financial decision-making by short-term insurers when they are underwriting liability insurance. To reach this objective, secondary as well as primary data were necessary. The secondary data of the literature study was already discussed in this paper. The primary data was obtained by means of an empirical survey which focused on the top 10 short-term insurers which are the market leaders of liability insurance in South Africa. These short-term insurers represented more than 85% of the annual gross written premiums for liability insurance in 2010.

The data of the literature study was used to compile a questionnaire. Copies of an invitation letter and the questionnaire were mailed to the executive managers of the top 10 short-term insurers who were involved in underwriting liability insurance. After following up, 10 completed questionnaires were available. Some of the questions of the questionnaire used a five point Likert interval scale. It was explicitly stated on the questionnaire that the five point Likert interval scale forms a continuum which enabled the weighting of the answers. The answers of the respondents, which appear in Section 4, were weighted by assigning the following weights.

3. LITERATURE REVIEW

Sharma and Kalyani (2006), conducted a study titled, "CRM. in LIC : Some Reflections." For the purpose of study Warangal division was selected, since its performance in offering services to the customer was remarkable in the past few years. It was based on secondary data obtained from the records of divisional office of Warangal. The results showed that the LIC adopted the CRM philosophy at all levels and initiated necessary measures for providing better services to policyholders. Computerization and networking of operating units was also taken up for better access. New methods like single window and customer service centres had received wide recognition and acceptance among users.

Banerjee and Parhi (2007), revealed that competition was yet to reach the pricing arena in health insurance. The oligopoly nature of market has turned to restrict the free play of market forces through product differentials. Post-detariffing, the upcoming probable price war in other fields of insurance, may create a momentum in this section. In future, health insurance premium goes up by another 40per cent to factor the increased claim ratio of 130per cent in health insurance, which obviously is unacceptable.

Gupta (2003), in his paper, highlighted the need of branding in insurance, because the changing scenario is forcing the players to differentiate themselves from others; hence, they are now examining the possibility of branding their product and services to fuel growth. The study revealed that settlement of claims is the most important factor in the mind of customers followed by quality services and security of investments. The other expectations included nine other types desired by the customer. It, therefore, logically follows that the expectations of the customers, especially the claim factor, should be strategically incorporated in the brand strategies of the insurance players.

4.THE IMPORTANCE OF UNDERWRITING FACTORS IN LIABILITY INSURANCE

The empirical results concerning the importance of the underwriting factors in liability insurance appear. The preceding answers of the respondents based on the five point Likert interval scale were weighted by applying the weights discussed in Section 3 of this

paper. The total weighted scores calculated are depicted, where the scores appear in a declining order of importance. It is interesting to note that the nature and scope of the risk linked to the applicant and the members of his/her household or business, as well as the indemnity limit of liability insurance which the applicant needs from the respondent's company, are the underwriting factors which received the highest total weighted scores calculated. According to Table 2 these two underwriting factors received an almost unanimous vote of "extremely important" from the respondents, as only one respondent indicated a slightly lower vote of "highly important" for each underwriting factor.

5. CONCLUSION

The objective of this research was already formulated as the improvement of financial decision-making by short-term insurers regarding the underwriting process of liability insurance. This paper is based on a literature study, as well as an empirical survey which involved the leaders of the short-term insurance market in South Africa, which is classified as a developing country with an emerging market economy. This study leads to the following important conclusions which should also be valuable to short term insurers in other developing countries.

BIBLIOGRAPHY:

www.liabilityinsurance.com

www.google.com

- [1] Arora, M.N. (1987), "The Life Insurance Corporation of India (Financial & Organizational Aspects: 1956 to 1986)," Ph.D. Thesis, Submitted to Faculty of Commerce, Banaras Hindu University, Varanasi.
- [2] Arora, S. (1988), "The GIC of India – An Appraisal", M.Phil. Thesis, Submitted to Department of Commerce, Delhi School of Economics, University of Delhi, Delhi.
- [3] Azam, M.S. (2005), "Customers' Attitude towards General Insurance Service: Contrasting the Public and Private Sectors in Bangladesh", *Insurance Journal*, July, pp. 91-109.
- [4] Baltelsmit, V.L.; and Bouzouita, R. (1998), "Market Structure and Performance in Private Passenger Automobile Insurance", *The Journal*

of Risk and Insurance, Vol.65, No.3, Sept., pp. 503-514.

- [5] Banerjee, P.; and Parhi, C.K. (2007), "Health Insurance: Competition Among the Players is yet to Touch the Prizing Arena," *Insurance Chronicle*, Feb., pp.45-56.