

Chairman's Message

by J. Brian Murphy, CPCU, ARM, ARe, AMIM



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Murphy received his bachelor of arts degree from Central Connecticut State University, and his master of arts from the University of Connecticut, both in economics. He frequently teaches the Insurance Institute of America's General Insurance (INS) course to new members of the insurance community. He serves on the board of the Association of Lloyd's Brokers, which provides information, education, and business contacts to Lloyd's correspondents and coverholders in Illinois.

He also serves on the board of the Elmhurst City Centre in Elmhurst, IL; is a director of the CPCU Society's Chicago Chapter; and is the new chairman of the CPCU Society's Underwriting Section Committee.

We have started a new year, and the Underwriting Section Committee has several activities planned for our members.

On **March 22**, the Underwriting Section will present a free webinar for its members on "Emerging Issues in Insurance Coverage." The webinar will be the CPCU Society's first venture into this new technology, which will enable members to participate in a high-quality educational program via the Internet, without leaving their offices. The webinar is being produced on a trial basis, so the Society can evaluate the results and make improvements.

Since this is the Society's first webinar, attendance will be limited to the first 50 registrants. The Underwriting Section is offering the webinar to its members only, as a benefit of their section membership. The webinar will be held from noon to 1 p.m., Eastern Standard Time. The guest speaker will be **Dom Yezzi, CPCU**, vice president of specialty commercial lines for ISO. Tentative topics include avian influenza, nanotechnology, food litigation/GMOs, electromagnetic fields, and climate changes.

The mid-year Underwriting Section Committee meeting will be held on Saturday, **April 21** at the CPCU Society Leadership Summit in Orlando in conjunction with the National Leadership Institute courses. The meeting will focus on preparations for the Annual Meeting and Seminars. If you are enrolling for the NLI and would like to attend the committee meeting, please contact me and I will handle the arrangements.

The Annual Meeting and Seminars are scheduled for **September 8-11** in Honolulu, Hawaii. The Underwriting Section is developing a seminar on Monday morning, September 10. If you are planning to attend the Annual Meeting, please join us at the seminar.

We still have vacancies on the Underwriting Section Committee and are seeking volunteers. The commitment entails attendance at the mid-year meeting in April and the Annual Meeting and Seminars in September. If you are interested in learning more about this, please contact me at murphyb@brps.com. ■



CPCU SOCIETY Annual Meeting & Seminars

September 8-11, 2007 • Hawaii

Institute Revises the Associate in Risk Management Program

With the recent publication of *Risk Financing*, the Insurance Institute of America has completed a two-year long project to update the ARM program. According to ARM program director **Richard G. Berthelsen, J.D., CPCU, ARM**, "We built upon the program's already strong fundamentals when we updated each chapter. More than one dozen renowned practitioners and professors devoted their considerable expertise to help revise the material. The revision was necessary to address significant concerns that were not emphasized in the existing textbooks, concerns such as terrorism, corporate governance, and cyber risks."

ARM consists of three courses:

- ARM 54—Risk Assessment
- ARM 55—Risk Control
- ARM 56—Risk Financing

ARM 54 was refocused from the "Essentials of Risk Management" to risk assessment. According to Berthelsen, "We felt that risk management could be thought of in two phases—risk assessment and risk treatment. The two approaches to risk treatment—risk control and risk financing—were already the focus of ARM 55 and ARM 56, so it seemed natural to shift the emphasis of ARM 54."

Specifically, ARM 54 now has expanded treatment of liability loss exposures, insurance as a risk financing technique, management liability, and corporate governance.

ARM 55 was extensively updated and expanded in this revision to address the evolving old risks and the emerging new risks for which today's risk management professionals have become responsible. The selection and implementation of risk management control techniques must often be specific to a specific risk. As risks change, so must the techniques used to control them. Consequently, several new chapters have been added, such as those discussing intellectual property and claim management. Many additional concerns were also addressed such as catastrophe modeling, mold, and workplace violence.

The fourth edition of the ARM 56 text is a refinement of the third edition text. The Institutes kept much of the existing structure of the text, but some of the content was consolidated. Consequently, the text went from 16 chapters to 13 chapters. That is despite adding a new chapter on noninsurance contractual transfer of risk. The new text is available now for exams administered beginning in January 2007.

The Institutes has developed SMART materials for each of these revised courses to assist students in learning the content and passing the national exam. For more information, go to www.aicpcu.org. ■

Thought to Ponder

"Rule No. 1: Never lose money.

Rule No. 2: Never forget Rule No. 1"

—Warren Buffett

2007 CPCU Society Meeting Dates

Leadership Summit

April 18–21, 2007
Orlando, Florida

Annual Meeting and Seminars

September 8–11, 2007
Honolulu, Hawaii

Register Today!
www.cpcusociety.org

The Underwriting Section Committee

We put the YOU in underwriting.

The importance of this slogan is that insurance is still a people and relationship business. People make the difference.

Make sure to put the YOU in the underwriting process.



Sections Strategic Task Force Report Summary

by Kathleen J. Robison, CPCU, CPIW, ARM, AU



Kathleen J. Robison, CPCU, CPIW, ARM, AU, has more than 30 years of experience with leading claims organizations, and possesses a wide range of commercial and personal insurance coverage knowledge and applicability. K. Robi & Associates, LLC, which she founded in 2004, provides customized consultant services in the property and casualty insurance fields, including expert witness testimony, litigation management, claims and underwriting best practices reviews/audits, coverage analysis, and interim claims management. She can be reached at (423) 884-3226 or (423) 404-3538; or at info@krobiconsult.com.

At the CPCU Society's 2005 Annual Meeting and Seminars, the Board of Governors created a Sections Strategic Task Force. The task force developed a strategic vision for sections, and presented it to the board at the CPCU Society's 2006 Annual Meeting and Seminars in Nashville in September. The Board of Governors accepted the report and referred it to the Executive Committee to develop detailed recommendations for consideration by the board at the April 2007 Leadership Summit meeting. This article summarizes the report and recommendations.

David Medvidofsky, CPCU, CIC, chaired the task force. Members of the task force were **Tony L. Cabot, CPCU**; **Matthew J. Chrupcala, CPCU**; **John L. Crandall, CPCU**; **Clint Gillespie**,

CPCU; **Michael J. Highum, CPCU**; **Kelli M. Kukulka, CPCU**; **W. Thomas Mellor, CPCU, CLU, ChFC**; **Kathleen J. Robison, CPCU, CPIW**; **Eli E. Shupe Jr., CPCU**; **Nancy S. Vavra, CPCU**; and **Barry R. Midwood, CPCU**, as CPCU Society liaison.

The task force began its assessment by focusing on issues of strategy and purpose. It developed a series of strategic questions designed to answer "who, what, and why," before addressing the question of "how?"

After task force consensus on the questions, feedback was shared with designated section liaisons. The task force also met with key stakeholders at the mid-year meeting to share findings, to test attributions, and to obtain additional input.

The task force took a qualitative approach relying on member input and interviews to develop findings. Prior survey data were reviewed.

Prior to creating the strategy, the sections' current mission and vision statement were reviewed. The task force recommended the following changes.

Special Note: One of the recommendations is to re-brand the sections into interest groups. Therefore, the reader will note the reference to interest groups rather than sections.

Proposed Mission

The CPCU Society aligns its members within interest groups consistent with the major disciplines of the property and casualty insurance industry. Serving the industry and other stakeholders in an ethical and professional manner, interest groups add value by increasing interest in attaining the CPCU designation and by helping make CPCU the most recognized, valued, and highly respected designation in the property and casualty industry through consistent and valuable technical content.

Proposed Vision

Interest groups offer targeted educational content that make CPCU the most widely recognized, valued, and highly respected professional designation/brand in the property and casualty industry. Instead of being focused toward a value-add for a narrow target, interest groups are at the forefront for name recognition and desirability of the CPCU designation by reaching a broad audience. Although segmented by discipline, interest groups target their consistent and high-quality technical content to anyone in the industry seeking focused information.

Interest group affiliation is provided automatically to CPCU Society members. This enables consistent and ongoing technical content to reach CPCUs affording continuing education and reminding them of the value of CPCU Society membership.

Ultimately, the reach of interest groups extends beyond just CPCU Society members. All industry professionals are, therefore, exposed to CPCU through the work of its interest groups. Exposure to the high-quality, technical content of the volunteer interest groups:

1. draws industry professionals to interest groups through exposure to their work; which
2. increases interest in CPCU and other Institute programs as a course of study; which
3. increases Institute participants and program designees; which
4. increases CPCU Society and chapter membership

Special Note: The above is a recommended long-range vision for sections. Included in the recommendations are specific steps to position sections for the proposed mission. The task force believed strongly that attaining the mission would be a staged process.

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Sections Strategic Task Force Report Summary

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The sections' offerings must first be of consistently high value on par with other offerings before extending sections' reach beyond Society members.

Proposed Strategy

The strategy is to position sections as a provider of readily available, high-quality, technical content to stakeholders. The level of content and delivery will vary based on the audience:

- For prospective CPCU candidates, sections offer technical information such as symposia and expertise within the disciplines of the industry.
- For current CPCUs the newsletter and web site are of high value and encourage CPCUs not presently part of the CPCU Society to see the benefits of joining. Retention of current CPCU Society members increases by providing consistent, high-quality, technical content within member disciplines. CPCU Society members are connected to others within a functional discipline offering networking and resource advantages not available through other industry designations or associations.

As the technical content is consistently on par with competitor offerings, "associate memberships" are offered to non-CPCUs working in the industry and to industry providers (e.g., vendors). This provides a new revenue stream for the CPCU Society and further increases name recognition of CPCU. Candidate interest in the Institute's programs increases as well as through the exposure sections create.

Accomplishing this vision requires strategic actions that are presented as a series of strategic initiatives that align with four key perspectives:

- organizational structure
- leadership development
- membership
- value-added services

These strategic initiatives are summarized with a proposed template for reporting on results.

Organizational Structure (OS)

OS1—Re-Brand Sections as Society Interest Groups

Rationale: The term "sections" does not concisely describe their purpose. Other associations with similar structures such as PMI, ABA, etc. use "interest group" terminology. As the vision for sections evolves, re-branding them as interest groups signals something "new and improved." Further, the phrase "sections" carries connotations of silos where "interests" applies whether one works in a discipline or just has "interest" in learning more.

OS2—Create Interest Group Resource and Governance Committee

Rationale: As the interest groups are exposed to a wider audience, the demand for consistent, high-quality content will increase. CPCU Society staff provides excellent support. Interest groups can enhance CPCU Society capacity by forming a rotating four-member committee overseeing standards of content (see Recommendation VA1) and providing a resource for backup, training, and consultative advice. This committee would consist of:

- a former section chairman
- a former section web liaison
- a former section newsletter editor
- an additional member with experience in one of the above tasks

OS3—Assess Current Interest Groups and Align Them with Major Industry Functions

Rationale: The industry has evolved since the creation of sections. For example, many companies no longer have "underwriting" departments—they have moved staff functions to product teams and field functions to production positions. Project management is integrated into most positions but has no discrete focus. As membership is opened, there needs to be a clear alignment

between technical interests and the content focus of interest groups.

OS4—Open Interest Group Membership to all Society Members

Rationale: Open membership will expose all CPCU Society members to the work performed by interest groups. Providing newsletter and web site access will consistently remind CPCU Society members of the value they receive by belonging to the Society. This recommendation also supports the CPCU Society's goal of visibility. Continuing education is provided while leveraging one of CPCU's key differentiators: the ability to connect its members at both the interdisciplinary level (chapters) and the intradisciplinary level (interest groups).

Leadership Development (LD)

LD1—Formalize Standard Interest Group Leader Training and Orientation for the Chairman, Newsletter Editor, and Web Liaison. This training will include an operations manual and continuously updated list of best practices.

Rationale: As membership is opened, interest group offerings will have wider exposure. Content value will become more important. Formalized training and reference materials need to be provided as tools to support the key interest group roles.

LD2—Create a Developmental Scorecard for Interest Group Volunteers and CPCU Society Members

Rationale: As budget and time demands increase, employers and employees will need to understand and demonstrate the value of their commitment. A development scorecard will show employers what their investment provides. It will also enable employees to easily articulate the value they receive. The present CPD qualifier may be promoted or modified to meet this need.

Membership (M)

M1—Create Value Statements and Other Communications Tools to Promote Interest Groups

Rationale: As the sections are re-branded and membership is opened up to all CPCU Society members, value statements and a communications strategy must be created. These efforts must crisply articulate the value of interest group membership, and describe how the value of CPCU Society membership has increased. This highlights the differentiation that interest groups provide CPCU Society members through focused technical content that CPCU Society members will continuously receive.

M2—Establish Affiliations between Interest Groups and Other Industry Organizations (e.g., PLRB, The “Big I,” and RIMS)

Rationale: To promote the technical expertise of CPCU Society interest groups and to support the goal of making CPCU the most widely recognized and highly respected designation, affiliations should be formed with other associations and/or designation programs. By presenting at their conferences and contributing to their newsletters, the CPCU Society increases their reach to potential designees committed to continuous learning.

M3—Refresh the Interest Group Newsletters

Rationale: As the reach of newsletters increases (first to all CPCU Society members and longer term as a revenue-generating product) they must be refreshed. This will support the re-branding efforts. A task force should be formed to finalize recommendations—potential areas of review include electronic versus hard copy delivery (or option for both), the colors, logo, and layout, and the possibility of providing one comprehensive quarterly interest group newsletter with space for each interest group’s contribution (versus publishing 14 separate newsletters).

M4—Designate Liaison(s) to Promote Interest Group Benefits to Chapters, Major Employers, and the Insurance Services Community

Rationale: The value of interest groups may be promoted by expanding the Connections concept. A discussion of the value of the interest groups must be added to the present agenda. Designating special liaisons will expand capacity to extend outreach to chapters and industry service providers.

M5—Strengthen Connection between CPCU Society and Accredited Risk Management and Insurance Degree Programs

Rationale: Students pursuing degree programs in risk management and insurance are future prospects for the Institutes’ programs. Increasing awareness helps capture interested students. Recommendations to strengthen this connection include offering interest group membership to any approved university, offering a pool of guest lecturers, and providing a student forum for web site and newsletter submissions.

Value-Added Services (VA)

VA1—Develop Consistent Format and Content Standards for Core Interest Group Offerings

Rationale: As membership increases to all CPCU Society members, interest groups have an opportunity to promote their value to a wider audience. Longer term the strategy is to broaden interest group reach outside of the CPCU Society. This strategy requires content that compares favorably with alternative offerings. Specific content targets and standards assure the CPCU Society member regularly receive high-quality content. Support and governance for this recommendation is contemplated under recommendation OS3 above.

VA2—Expand Delivery Methods of Technical Content

Rationale: Time and expense dictate member participation. Present delivery methods of the newsletter and the CPCU Society’s Annual Meeting and Seminars for technical content should be expanded by the interest groups to include webinars, more symposia, and chapter-ready presentations through a pool of local speakers. The possibility of on-demand or ability to purchase video of the CPCU Society’s Annual Meeting and Seminars must be considered to meet the needs of our growing international presence and those who cannot attend CPCU Society’s Annual Meeting and Seminars.

VA3—Encourage Interest Groups to Convert Highest-Rated CPCU Society Annual Meeting Technical Seminars into Symposia

Rationale: A great deal of work goes into producing quality technical sessions that are presented at the CPCU Society’s Annual Meeting and Seminars. In their efforts to re-brand themselves and increase awareness of their offerings, interest groups have an opportunity to convert these programs into tested and finalized symposia. Not only does this effort support the strategic goal of industry outreach, but it offers an additional revenue source to the CPCU Society.

VA4—Conduct SWOT Analysis for Each Interest Group; Implement Findings

Rationale: As the interest group expectations change and the prospective members increase to all CPCU Society members, each interest group needs to assure that their offerings align with member needs. Action plans should be developed based on the findings and reported back through the interest group governors. ■

Underwriting Beyond Intuition: Structured Decisions with a Customer Focus

by John T. Gilleland Jr., CPCU, Morgan D. Jones, and Ruth A. Fennell, SPHR



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Ruth A. Fennell, SPHR, worked in corporate training and human resources for several large multinational corporations, including USAA Insurance and Capital One, prior to entering real estate in the Tampa Bay area. In addition to a masters in adult education from the University of South Florida, Fennell has a long list of professional credentials, including the Associate in Management (AIM), Senior Professional in Human Resources (SPHR) and fourteen real estate designations.



Morgan D. Jones is co-founder and retired president of Analytic Powess LLC, a Virginia company that conducts workshops for government and industry on the analytic structuring techniques in his book, *The Thinker's Toolkit: 14 Powerful Techniques for Problem Solving*. A former intelligence analyst with CIA, he lives with his wife in Florida.

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.

Editor's note: This article originally appeared in the Fall 1999 issue of the *CPCU Journal*.

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, remembering his sales training, 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 increasing revenues and profit margins, and he can do that by serving more customers profitably this year than he did last year. Because his company 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 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."

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 glowing 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, if/then tables). 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 (CSRs) 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. Advocacy, on the part of clients, should accompany fiduciary agency. 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, non-renewed, 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 others to win. Develop a playbook to help the team learn to win by knowing their plays (e.g., what to do when it is first and goal or third and long). 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.

The fact is, one should not hesitate to negotiate. Producers who are smart deal makers attract more opportunities to sell. Underwriters who are smart deal makers encourage and enable their producers and CSRs to attract more insureds. CPCU should stand for "Creating Production by Creative 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 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."

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Underwriting Beyond Intuition: Structured Decisions with a Customer Focus

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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. Not all are kept in a black box by a monolithic consulting corporation. The need for continuous improvement created by focusing on the consumer encourages innovative thinking in many places.

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 generally 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 as with life in general, 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. Underwriting should be performed as a discipline.

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 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—information exchange—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. However, people tend to pick better routes when their maps are more complete and easier to read. 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 logical and 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 mind. 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.

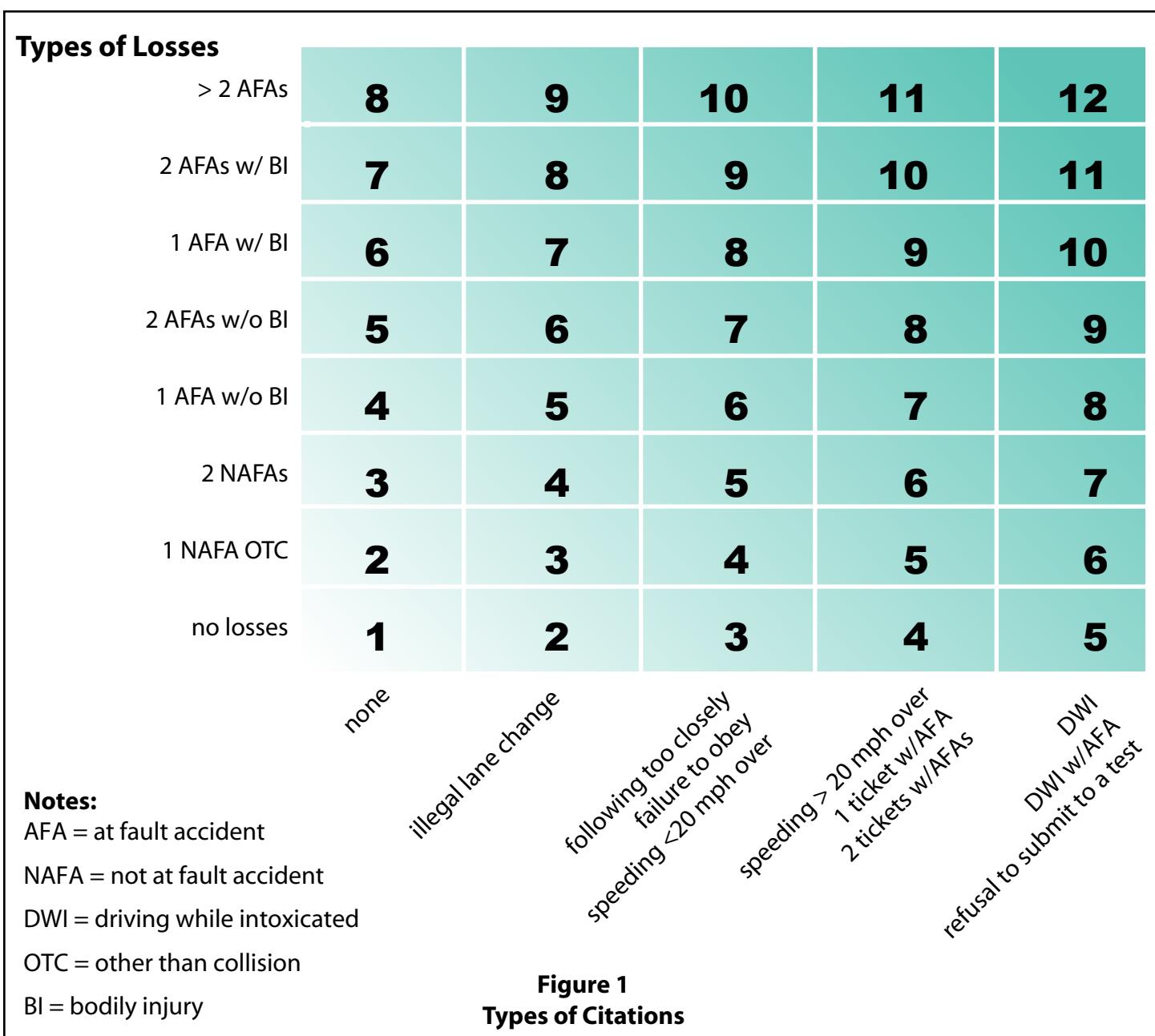
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Table 1

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

Underwriting Beyond Intuition: Structured Decisions with a Customer Focus

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Structuring Underwriting

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).

Risk Treatments (Actions)

great risks

good risks

bad risks

terrible risks

1. Make almost any appropriate accommodations so policy will be renewed.
2. Renew the policy if all information is complete, current, and acceptable for the appropriate risk program.
3. Renew if the agent verbally cautions the insureds as a household to take significant actions to operate their vehicles w/o violating traffic laws.
4. Renew if the agent verbally cautions the insureds as a household to take significant actions to operate their vehicles w/o violating traffic laws and liability limits are lowered significantly.
5. Renew the policy if all information is complete, current, and acceptable for the appropriate risk program and OTC & Col deductibles are set above the average loss for at least one year.
6. Renew if (1) the agent verbally cautions the insureds as a household to take significant actions to operate their vehicles w/o violating traffic laws; (2) liability limits are lowered significantly; (3) OTC/Col are raised to be > the average loss amount; and (4) consideration is given concerning whether or not to move the risk to a more appropriate risk program (i.e. from our Preferred program to our Moderate program) for at least one year.
7. Renew if (1) the agent verbally cautions the insureds as a household to take appropriate loss control measures to reduce loss frequency; (2) the deductibles are raised to be > the average loss amounts for OTC & Col; and (3) consideration is given concerning whether or not to move the risk to a more appropriate risk program (i.e. from our Preferred plan . . .) for at least one year.
8. Renew if the (1) agent verbally cautions the insureds as a household to obey traffic rules and take appropriate loss control measures to reduce loss frequency/severity; (2) all information is current, complete, and acceptable; (3) OTC & Col are eliminated; (4) liability coverage limits are reduced to minimums; and (5) the risk is moved to the appropriate risk program (i.e. from our Preferred plan . . .) for at least two years.
9. Renew if the (1) agent verbally cautions the insureds as a household to obey traffic rules and take appropriate loss control measures to reduce loss frequency and severity; (2) all information is current, complete, and acceptable; (3) deductibles are maximized; (4) coverages (limits and types) are reduced significantly; and (5) consideration is given concerning whether or not to move the risk to a more appropriate risk program (i.e. from our Preferred plan . . .) for at least two years.
10. Renew if the (1) agent verbally cautions the insureds as a household to take appropriate loss control measures to reduce loss frequency and severity; (2) all information is current, complete, and acceptable; (3) deductibles are maximized; and (4) the risk is moved to the appropriate risk program (i.e. from our Preferred plan . . .) for at least three years.
11. Renew if (1) the agent verbally cautions the insureds as a household to take significant actions to operate their vehicles w/o violating traffic laws; (2) liability limits are lowered significantly; (3) OTC/Col are removed; and (4) the risk is moved to the appropriate risk program (i.e. from our Preferred plan . . .) for at least two years.
12. Do not renew unless the marketing representative, the agent, and insured insist the policy be renewed and the agent and insured are willing to make every attempt to engineer the risk to reduce the policy's exposure to claims for at least three years.
13. Do not renew unless the driver with the worst record is (1) excluded for up to three years or the renewal after the suspension period has ended (whichever is greater); (2) provides proof of other coverage upon regaining his/her license when the policy is issued; and (3) provides proof that completion of a driver safety course is given to the agent before the exclusion is discontinued, and within 30 days of our policy renewals (agent will monitor adherence to this verbal agreement) any significant deviation will be interpreted as an unacceptable increase in risk and the policy will be canceled within 30 days of notification of MAI for at least three years.
14. Do not renew.

Figure 2
The Range of Risks and Their Corresponding Treatments

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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, consistently acceptable decision rather than simply an educated guess.

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 Results

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 an insurer's 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 insurer 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). Structured, standardized processes give company management teams, for the first time, real hands-on control over underwriting decisions and profitability. The same type of standardized procedures can be used to improve the performance of insurance agencies under contract.

Naturally, people will resist changing the way they have been doing their jobs for many years. And resistance is greater when communication is weaker. 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.
6. "Underwriting Discipline Evolved From Art to Science," by John Gilleland, CPCU, and Joseph Wiest, CPCU, *Best's Review*, February 2006.



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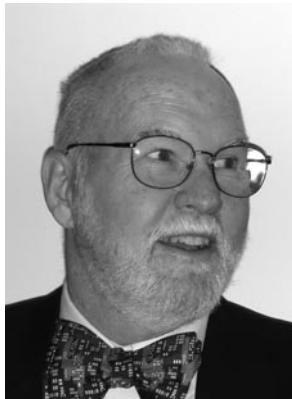
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Insurance for Emerging Technologies Entrepreneurs: A Challenge Not To Be Ignored

by Gregory V. Serio, J.D. and Edward W.S. Neff, CPCU, ARM



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Abstract

Emerging technology businesses face many challenges as they grow through the development stages into successful operations. Adequate and appropriate risk management policies and coverages are often among the significant but overlooked challenges that can contribute to their failure rate. The risk management and insurance communities, companies, and brokers alike should be working with these developing businesses in their earliest incubator stages to understand their unique risks, and develop programs and new coverage forms that will address their needs not only in their earliest days but also as they develop into mature businesses. Home-based businesses face the same challenges, as was reported last year in a little noticed Independent Insurance Agents and Brokers of New York report.

The Independent Insurance Agents and Brokers of New York released to little notice last year a report raising a critical issue for many home-based businesses: the (in)adequacy of insurance coverages for the business operations within residences. This study, which showed that many home-based businesses are exposed to potential financial peril because of inappropriate or insufficient coverages for business-related activities, should direct our attention to another unspoken and potentially critical problem: the (in)adequacy of insurance coverages for New York's emerging technologies businesses.

Just as home-based enterprises, comprising a healthy portion of the state's small business community, provide structural strength to the backbone of the state's economy, the new technologies sectors—bio, nano, and other emerging areas—represent the most positive business development trends that our region has seen in generations. The Sematech initiative that has become the cornerstone of the Capital District's

nanotechnology boom, the recent announcement of AMD's decision to build a chip-fabrication facility in Saratoga County, and the seemingly unstoppable forces behind the Tech Valley movement have all contributed to the strong foundation upon which upstate New York's economy will rest for the foreseeable future.

Key to the progress of this economic expansion, of course, will be the proliferation of smaller companies either spawned to support the larger developments or to start mapping the next generation of technological breakthroughs. Small business in the Capital Region, including a new crop of home-based businesses, will take on a decidedly high-tech flair.

While the grander initiatives like Sematech and AMD most likely have adequate and tailored insurance programs, the many smaller technology and software companies that are cultivated from this tremendous economic wave may well not be sufficiently covered. Failing to adequately cover them (in types of or breadth of coverages) for the eventualities that come to confront all businesses, large and small, will have profound effects beyond the four walls of those enterprises, and will directly impact the regional economy and its ability to sustain the technology-based business boom it is now enjoying.

(Among those "eventualities" are shortcomings in the operational security and continuity of the Internet, and other information pathways that have become critical for many emerging businesses and crucial for small businesses in particular. The Business Roundtable recently released a report, "Essential Steps to Strengthen America's Cyber Terrorism Preparedness," which highlighted many deficiencies in the protective mechanisms that would prevent or mitigate the effects

of some cyber interruption. While it did not even address the gaps in the financial safety net for high-tech and emerging market companies, i.e. insurance, the report did concentrate on the need for fixing the operational defects in our preparedness strategy.)

The new and emerging technologies businesses need protections unlike any other components of the small-business sector. And, these new entrepreneurs need to focus as much on protecting the businesses they create as on growing them. The efforts to protect and develop these fledgling businesses, however, are made difficult given that current, off-the-shelf policy offerings don't fit their needs. Economic advances in emerging technologies will be short-lived if the insurance professionals serving these new businesses do not challenge the status quo in terms of the coverages that are typically furnished to the small businesses that do and will populate the sector. As the Independent Agents' study indicated, agents and brokers need to educate insureds and prospective clients as to how available coverages fit or do not fit the operating realities of their businesses. The question is: are existing coverages suitable (or affordable, for that matter) for the businesses seeking coverage?

The forces behind the tech sector boom in the Capital Region will need to instigate this discussion. While they share, together with insurers, agents, and public policy makers, the duty to make sure that our new economic base is properly protected, it is the visionary element of the Tech Valley concept that can best articulate the needs of this marketplace. The growing economic force of the business entities that are deciding to call this area home can best persuade insurance agents and brokers (who may have their own errors and omission exposure for mismatching coverages to risks) to seek appropriate

coverages more aggressively and compel insurers to provide such coverages.

Some within the insurance community will see this as a challenge they are not willing to take on. Inserting new and perhaps unknown risks into an insurance industry that has become increasingly risk averse—asbestos liabilities, for example, have mushroomed far beyond the known science at the time that the applicable liability policies were written—will of itself be a difficult task. For many insurers, it may well be more advantageous to ride the far slower path of letting legal interpretations of traditional policy language, shoehorned into these new business contexts, determine the breadth of coverage. This track may well be preferable to venturing out with new policy coverage concepts and language that have no interpretive track records.

The traditional insurance carriers may pass on the opportunity to play a role in the maturation of this branch of the economy. If so, then the emerging technology sectors and the businesses within them, from the incubated to the established, will have to take matters into their own hands. The same entrepreneurial spirit that has fueled the rejuvenation of this segment of upstate New York's economy will be necessary for the creation of a whole new insurance sector, catering to the emerging technology fields, merging the dynamism of venture capital with the security of insurance capital, and delivering for these companies coverages that work for them in terms of quality, breadth, and affordability. But this will not be your father's insurance sector, as they say, for it will be built upon contemporary notions of alternative risk financing and risk pooling, underscored by an attentiveness to risk management and loss control that does not exist in many traditional insurance relationships.

As with every other step of the way for the tech-sector entrepreneur, this won't be easy. Arcane laws will have to be revisited, and the flexibility in assembling coverages currently enjoyed by only the largest corporate entities will have to be offered to all the members of the new economy as well. Just as our technology-sector leaders could not play the role of bystander when it came time to figure a way to reinvigorate the local economy—creating the opportunities for their enterprises as well—they certainly cannot be mere observers as it relates to the changes will have to be made to allow for enhancements in insurance coverages for the market and their own insurance programs. Like their non-technology home-business colleagues in our economy, they have as much a duty to educate themselves to the insurance program they choose or have chosen for them as any agent or broker, and they need to know, in detail, how these coverages either protect or do not protect their enterprises.

When more than half of the home-based businesses in the Independent Agents' study are found to be without business coverage, and fully two-thirds of those studied lack adequate coverage, the challenge of properly covering the most vulnerable elements of our economy is already daunting. But when one considers that our present and future economies are similarly situated, the task does not simply become exponentially more difficult; rather, it takes on the proportion of a mission for everyone concerned or connected to this economy to make the moves necessary to marshal the resources, tear down the blockades, and do what has to be done to make these businesses more secure because, after all, they will one day make us all more secure. ■

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