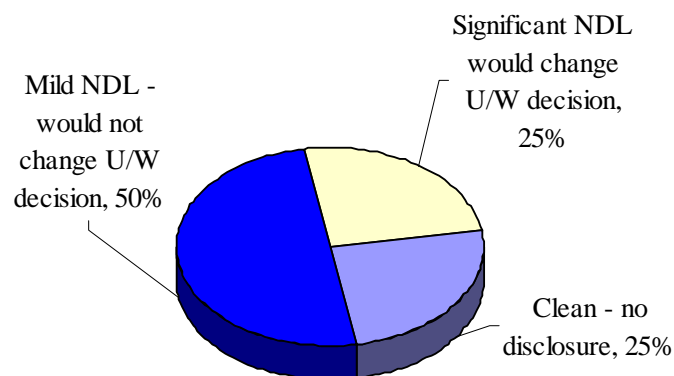


## “Clean” applications! How clean?

In a recent study in the UK carried out by MorganAsh and major providers of life assurance business, non-disclosure was found to be much greater than previously perceived. The study revealed 25% significant non-disclosure on what would previously have been accepted as “clean” applications. Significant non-disclosure was defined as disclosures which an underwriter would not usually allow at standard rates. The study looked at a broad range of protection business including Critical Illness, Income Protection and Term insurance, where the age and sum assured medical limits had triggered a request for a General Practitioners Report (GPR). The ages ranged from 20-60 years old and sums assured from £50,000 to £350,000. Tele-interviews were undertaken with the applicant, covering all aspects of the application. The majority of applicants disclosed additional information during the tele-interview that they had not previously disclosed on the original application form.

### Discovered disclosures



In the same study, in addition to the 25% significant disclosures, a further 50% of applications had minor, yet identifiable, non-disclosure that would not have affected the underwriting decision, but some of which may have led to uncertainty at a future claims stage. The study concluded that a high proportion of so called “clean” applications were not clean at all.

Although this is a single study, a similar trend has been reported from other Tele-underwriting pilots in the UK, revealing a very alarming picture.

#### Examples of mild non disclosure included:

*Female 46, dance teacher. Slightly overweight (but not rateable), has inhalers for asthma and recent prescription of non steroidal anti-inflammatory drug for arthritis. Keeps fit with job*

*Male 53. Smokes 20 cigarettes per day for 30 years. Had back twinge 3 months ago when lifting, took painkillers, had no time off work. No further problem. Was on prescription for depression 7 years ago as both parents died within 3 months of each other. Fine now and no treatment since.*

## BACKGROUND

In the UK, the recent mis-selling scandals of pensions, mortgage endowments and the failure of Equitable Life, have left the consumer feeling cheated, and hence more motivated to make an insurance claim. Recent studies have shown that over 40% of house and travel insurance claims are fraudulent. Additionally over 60% of CV's contain inaccuracies and 1 in 20 cars on the road are uninsured so the non-disclosure rate of over 25% in life insurance applications is not surprising.

Examples of significant disclosure included:

*Female aged 52. Publican, on prescription for arthritis, inhalers for asthma and now on treatment for depression which started 12 weeks previously. She is finding it difficult to cope (problems with daughter who attempted suicide) and GP suggests treatment for 6 months. She has had breathing difficulties when on hormone replacement therapy. She also discloses "lumpy breasts" which she says never caused a problem.*

*Male 47. Family live in Africa. Decided to have HIV test done 2 months ago "of own accord".*

*Male 50. TT for 5 years, personal decision to stop (previously 50-70 units per week). Panic attacks in past and stress for which he takes beta blockers when necessary. Smokes 20 cigarettes per day and feels 2 stone overweight. Stressful job, says he takes prescription for neck pain. Cholesterol was "high" but doesn't know reading. He was put on treatment but stopped as made him feel tired*

*Male 46. Non smoker for 3 weeks. Blood taken for cholesterol "yesterday" He awaits results. Occasional muscle pain in neck and back in last few weeks.*

It seems there is a great imbalance of smokers and non-smokers between the insured population and the general population. Approximately 15% of the insured population declare themselves to smoke compared to more than 25% in the general population. "Smoking amnesia", forgetfulness, call it what you want, the truth of the matter is that a high proportion of the insured population choose not to disclose their smoking habit when faced with the prospect of losing their lucrative discount.

The largest studies on non-disclosure have been undertaken on the smoking status of applicants in North America. These studies consistently show year-on-year non-disclosure rates for smoking ranging from 30% for low ages and low sums assured to 6% for high ages and high sums assured. In the UK non-disclosure data has traditionally been limited to high ages and high sums assured, where non-disclosure of smoking status is typically quoted as 6-8%, matching the North American, Mexican and Canadian experiences. This non-disclosure is clearly the

tip of the iceberg, since actual testing for smoking status in the UK only occurs in the group that is well documented to have the lowest non-disclosure rates.

Non-disclosure does not stop with smoking. An Association of British Insurers (ABI) survey in 2002 revealed “*nearly half of people surveyed would not rule out making a fraudulent insurance claim*”.

Non-disclosure is an umbrella term for innocent mistakes to blatant and deliberate fraud. To standardise the treatment of claims, the ABI and Financial Ombudsman Service (FOS) have recently defined non-disclosure in four categories:

1. Innocent
2. Inadvertent
3. Clearly Reckless
4. Fraudulent or Deliberate.

Further, how each of these categories is treated in a claims situation is dependent on the onus of proof:

- How the information was gathered
  - How clear and concise the questions were
  - The balance and relevance of questions
  - The warnings given to the applicant
  - The presentation of evidence
- The relevance of a link between the claim and the non-disclosure
- The relevance of the non-disclosure with regard to the underwriting decision

The FOS has clearly stated that the onus of proof is on the insurer. Ombudsman news, November 2004 – “Aspects of insurance fraud”

*“An allegation of fraud should not be made lightly. The burden of proof is on the insurer, if it suspects that fraud has taken place. Strictly speaking, the civil standard of proof ‘on the balance of probabilities’ applies. However, some courts have acknowledged that stronger evidence than this is usually required, which has the practical effect of raising the burden of proof to a degree more akin to the criminal standard of ‘beyond reasonable doubt’.”*

## **THE ISSUES**

There are several systemic problems with the present approach, as continually highlighted by the FOS at claims arbitrations.

### **There is no record of the advice given at the point of sale**

The present approach relies completely on the signed application form, with no recording of the conversation between the advisor/salesman and the applicant. This is inherently flawed, being almost impossible to guarantee that all the questions were asked, explained or clarified. The FOS’s opinion on this is clearly recorded in Ombudsman news July 2002, in the aptly named title “*‘I never said that!’ - the importance of telephone recordings*”

*“... it is obviously far easier to resolve matters if the firm has tape-recorded calls, or followed them up with a clear and agreed written*

*statement of what was discussed. We can otherwise be left to try and resolve the matter by assessing conflicting versions of critical conversations, taking account of the wider circumstances of the case and our knowledge of insurers' procedures. "*

In contrast, every Tele-interview is recorded, and these recordings can be accessed and replayed at the claim stage. Equally, written reports of the Tele-interviews can be provided for retention, consultation and signature by the applicant.

### **The financial advisor/intermediary is not trained on medical matters**

There is no medical knowledge or training required for the financial advisor. Most advisors dislike asking medical questions, as they do not understand them, cannot assist or advise if asked questions, are embarrassed in asking the opposite gender sensitive questions, and are often advising friends or relatives, which further compromises their position. This is more poignant when products are re-brokered, as the intermediary should be advising the applicant on the differences in cover between, the choice of products, and the suitability of the new product to match the applicants medical condition over their previous cover.

It is crucial that, when medical information is being collected for underwriting purposes, the person collecting that information has a good medical background or training. For example, the leading provider of tele-underwriting services in the UK uses almost exclusively RGN nurses for this purpose and to very good effect. These Tele-interviewers can interpret the complex Latin medical terms, drug names and drug brands as well as common and colloquial medical jargon and assist in the level of detail required for specific questions.

It has been shown that when applicants talk with mature, experienced nurses, who have good conversation skills, they are more inclined to "tell the truth". This is for a variety of reasons, not least because they trust and respect the interviewer and believe the information is being handled sensitively and in confidence.

### **The applicants don't understand the questions**

Filling in a 10 page application form on one's health is no easy task. In practice, the applicant and intermediary apply a common sense approach to completing the form, only completing the sections that are applicable for the insurance product. While this may be common sense, it is known that applicants rarely understand the detail of the products they are applying for.

There is a systematic mismanagement of the way the information is collected. The applicant and advisor apply a common sense approach, yet they have no medical or underwriting training, leaving this open for debate at the claim stage. It is unreasonable to expect a sales person to collect detailed and accurate medical information from an applicant when, in most cases, neither are proficient in undertaking this task. Indeed, one of the major flaws of the paper application process is that the applicant and advisor are left to decide what is relevant to disclose and what is not. In this way it may be that information is not disclosed that in fact the insurer would have found relevant.

In Ombudsman news, July 2001 - “*innocent non-disclosure*” the FOS clearly highlights that the Product provider is responsible for collecting the information and can not hide behind the ignorance of the applicants.

*“We occasionally receive cases where a policyholder has failed to disclose a material fact. Previously in such cases, where we were satisfied the policyholder did not intend to mislead the insurer, we have often adopted a ‘proportional’ approach. .... However, we are not entirely satisfied that this is an appropriate approach to take as a general rule.”*

The ABI “Statement of General Insurance Practice” states:

*“So far as is practicable, insurers will avoid asking questions which would require expert knowledge beyond that which the proposer could reasonably be expected to possess or obtain or which would require a value judgement on the part of the proposer.”*

A medical knowledge enables interviewers to cross reference the medication to the condition validating what the applicant is saying, as well as averting inadvertent non-disclosure. The consumer has the opportunity to ask questions at any time, for clarification and assistance in the importance of disclosing what they may perceive to be relatively innocuous conditions.

### **One size doesn’t fit all**

The industry has adopted a ‘one size fits all’ approach to insurance applicants that is clearly inappropriate. Applicants vary in multiple ways including:

- different levels of understanding
- different knowledge of their own medical conditions
- different relationships with intermediaries
- differing motivations for taking out life insurance
- different levels of competency and literacy to enable them to complete applications.

However, we expect one application form to match the requirements of all these different scenarios. It is not very surprising that this situation manifests itself in frequent debates on the layout of “The Application Form” at the claims stage.

Insurers have been modifying application forms for many years and yet still there are requirements to change it further. Indeed, the form has become so long and complex it is arguably unreasonable to expect the sales person and/or applicant to complete it accurately or even complete it at all. This one form fits all approach is seriously flawed. Equally, if the insurance industry is to improve the completeness and quality of its underwriting information, then the business acquisition process has to be more flexible and acceptable to the applicant, accommodating a broad range of requirements.

While it is impossible to be interactive and flexible with a printed form, this comes naturally with a Tele-interview. Interactive conversations always provide a fairer system for applicants, they have the opportunity to ask questions, seek clarification and receive feedback.

## **Continuing disclosure**

The problem of continuing disclosure is exacerbated due to the length of time elapsed from application to the applicant being placed on cover. If this period is several weeks or even months in many cases, then the applicant may well develop a medical complaint that they are obliged to report to their insurer. Tele-interviewing accelerates the underwriting process considerably, so applications are turned round in days instead of weeks or months, so this issue is almost eliminated.

## **Conflict of interests – “You don’t smoke do you”**

So long as advisors are remunerated to sell, then we must expect them to behave in a way that will promote the sales process and not hinder it. This is not a criticism of the advisor – more a recognition of the market forces in place.

The collection of medical information on applicants is inherently at odds with trying to sell Life insurance products, since the more information that is collected, the longer the application will take. Furthermore, with more significant disclosures, the more expensive the product becomes and the longer it takes to make the sale. It is therefore imperative that collecting underwriting information is carried out independently of the sales process. The reinsurers, who are carrying typically more than 80% of the risk, will not continue to accept this situation, unless the insurer is prepared to pay a heavy premium for reinsurance rates in the future.

## **Conclusion**

The industry belief, that the vast majority of their applications are “clean”, is flawed. Equally the introduction of “Straight Through Processing” systems may be confusing the issue since many of these applications are never seen by the human eye and never questioned. While the systems are clearly not at fault, the overall process is turning a blind eye to non-disclosure.

It has been shown that Tele-interviewing goes a long way to resolving the issues raised above, significantly improving the application process. Equally, Tele-interviewing is inherently friendlier for the consumer, easier for them to undertake and fairer than traditional application approaches. It is recommended that Tele-interviewing and Straight Through Processing approaches are integrated to maintain efficiency whilst utilising good quality information.

The FOS has been quite clear in its opinions, and the industry must change to reflect these and treat the customer fairly. The FOS opinion is repeated in Ombudsman news – January 2001 “6 non-disclosures”

*“Policyholders frequently assert that they failed to disclose information because they genuinely did not appreciate it was required by the insurer. Alternatively, they may have followed an intermediary’s advice when completing a proposal form. We do not always accept such assertions, but the evidence of the Committee suggests that many intermediaries and insurers fail to comply with the requirements of the Codes. In these circumstances, unless firms can demonstrate having used reasonable endeavours to ensure compliance, we may be rather more inclined to*

*support the policyholder's position in such cases than we have done in the past."*

Non-disclosure is not such a problem, however, if it can be demonstrated irrefutably at the claim stage. Due to Tele-interviewing's inherent interactivity, it ensures that the difficult cases of 'inadvertent' and 'clearly reckless' non-disclosure are teased out during the Tele-interview. Equally, as the applicant has consciously decided to not-disclose, then they are forced to categorically state this, when appropriate direct questions are asked. As all interviews are recorded, such fraud can be reliably refuted at the claims stage.

Life companies are advised to consider Tele-interviewing as an independent information collection process for all applicants.

**Sources:**

ABI "what is dishonest" Facts on Fraud No. 1 February 2003/  
DVLC, 2004  
MorganAsh Tele-interview studies, 2004  
LabOne cotinine positive results for USA and Canada, 2003 results  
Ombudsman news – January 2001 "6 non-disclosures"  
Ombudsman news – November 2004 – "Aspects of insurance fraud"  
Ombudsman news July 2001 - "innocent non-disclosure"  
Ombudsman news July 2002 "'I never said that!' - the importance of telephone recordings"  
Priory healthcare alcohol abuse survey, 2004  
The Risk Advisory Group, survey of CV's, 2004