

Financial Reserves and Reservation of Rights

Disability financial reserves are generally defined as “a monetary estimate of what a claim will cost.” The reserve represents money set aside for the eventual payment of claims and is not otherwise available to pay operating costs such as salaries, expenses and other overhead costs. Since the financial reserve actually represents the future obligations of an insurer to pay the cost of claims, from an accounting perspective, reserves are classified as liabilities on the company’s balance sheet.

Financial claim reserves are clearly important in determining the insurer’s financial health. “Under reserving” suggests the disability insurer may not have sufficient funds on hand to pay future claims and presents a false picture of the company’s financial stability. Investment brokers who set insurance bond ratings as well as federal and state regulators look to insurance financial reserves to determine the financial ability of an insurance company to pay for future claims.

Although financial claim reserves can theoretically be said to be the future value or anticipated cash payout of claims, reserves generally include actuarial and historical experience data kept by each individual company.

It is customary for insurance companies to hold several different reserve amounts. Some insurers include estimates for claim expenses in the reserve amount; others establish a separate reserve for the claim and a separate reserve for anticipated expenses. Therefore, most experts would agree to the following definition of insurance financial reserves:

“Financial reserves are the amount of funds (or assets) necessary for a company to have at any given time to enable it, with interest and premiums paid as they accrue, to meet the financial obligation of all claims on the insurance in force.”

Although financial reserves are theoretically regulated by the state, one can clearly see that it would be in the best interests of the disability insurer to limit or “set aside” *the least* amount of financial reserves, preferring to use available cash to pay operating expenses or to generate portfolio investment income to offset the cost of claims.

Simply put, regulations require all disability insurers to set aside financial reserves to pay future claims creating a potential loss situation, but when disability claims with open reserves are then closed (or reduced), the opposite is true and there is an immediate CONTRIBUTION TO PROFIT.

Regulators, investment bankers, attorneys, even the SEC needs to stop a moment and think about this. If the insurance company has a vested interest in “under reserving” what claims practices could be put into place that would appear credible yet keep total financial reserves at a minimum, or actually produce contributions to profit at certain periods of the year i.e. quarter or year-end profits?

Unfortunately, neither federal nor state regulators know enough about the internal claims review processes of most insurers to identify strategic practices intended to reduce financial reserves when profits are needed. Regulators need to take a better look at the realistic claim reserve figures and determine what internal claims practices are routinely put in place to keep financial reserves at a minimum, potentially under amounts required by federal and state regulators.

Generally, nearly all U.S. disability insurers can understate financial reserves by integrating their benefit pay system with the company’s overall financial claim reserve figures. The financial reserve figure associated with each claim goes up when the claim is approved, and profits are made when the reserve is reduced or eliminated as in the case of a claim denial.

Each disability insurer maintains an electronic “benefit payment system” from which benefits are paid and offsets recorded. Therefore, each insurer can manipulate the amount of financial reserves simply by coding offsets such as primary and family social security, retirement income, worker’s comp etc. Interestingly, certain insurers can also “create” special pay status’ such as reservation of rights and SSDI presumptive that, when coded, will also reduce claims reserves and contribute to profit at any time.

Therefore, if an insurer integrates the following with their internal benefit pay system; financial reserves can be seriously under-reserved:

1. Coding of Reservation of Rights status.
2. Coding of SSDI presumptive such as blindness, end stage renal disease, loss of limbs etc.
3. Coding of estimates for primary and family SSDI.
4. Coding of other expected offsets to benefits prior to realization.
5. Coding of actual SSDI award amounts.
6. Deliberate omissions of contract payment obligations such as revenue income protection provisions.
7. Coding of Advance Pay & Close.

Disability insurance management is very clever. Unfortunately, deliberate attempts at under reserving literally “pulls the wool over” regulator and brokerage houses’ eyes since the company is not as financially sound as reported to these entities. Making matters worse, some states allow the insurance company to recover amounts paid to the insured while on ROR status if it is later determined the company does not have liability for the claim. Presently, most insurers agree only to pursue monetary recovery only in cases of fraud. To do otherwise would be to draw attention to the strategy of “under-reserving” since recovering the benefits would certainly cause financial hardship and complaints to regulators.

For disability claims, Reservation of Rights status is defined as a pay status whereby an insured is notified in writing the disability insurer may not have liability to pay the claim in the future. ROR notification actually allows companies like Unum Group to investigate a claim to determine if it has liability to pay the claim without waiving its right to later deny coverage based on information obtained as a result of the investigation.

Although ROR status protects the interests of the insurer, it should be regarded as an alert to the claimant that some fact or element of the claim has been brought into question which could be used at a later time to deny the claim. But, that's not the entire story.

Once a claim has been coded on the benefit payment system as "paid under reservation of rights", the system automatically adjusts the financial claim reserve downward (referred to as a financial reserve gain) producing an immediate contribution to profit. This is why a large percentage of claimants are notified of ROR status just prior to year-end – 2008 was no exception.

This would suggest that something "changed" in the claim challenging the future payment of benefits. Not so. Claimants are placed on ROR status for no other reason than the say-so of a manager or consultant who simply says, "I think we can deny this claim in the future."

Theoretically, insurance companies have an obligation to produce actual claim documentation (or lack of it) proving it is likely the company will not have liability to pay the claim in the future. This is why DCS, Inc. challenges the assignment of ROR status by asking the company to produce file documentation or specific cause for ROR status.

In the absence of documentation challenging future liability for the claim, the assignment of ROR status has no other value than to reduce the financial reserve causing an immediate realization of profit to the company.

For example, here are some of the inappropriate reasons Unum places claimants on ROR status:

1. Any occupation investigation. Regulators should really pay attention to this. Unum begins "any occupation" investigations between 9-18 months of paid benefits. Updated medical information needs to be obtained and reviewed, vocational reports should be completed, and "gainful" needs to be documented. There is absolutely no proof 9-18 months before the results of the "any occupation" investigation is completed, that Unum will NOT have future liability for the claim. However, if Unum codes a "ROR" status on the pay system for the claim, it receives a premature "contribution to profit" when the outcome of the investigation has not even been received! In a sense, to record ROR status before receiving a TSA identifying alternative occupations, is actually pre-determining the outcome of a claim, or put another way, targeting a claim for the certainty of denial. Unum receives approximately 450,000 group claims per year.
2. If all of the claims were to be placed on ROR status between 9-18 months, can you guess how under reserved the company is?
3. Our medical opinion doesn't agree with your medical opinion. I think we can all agree insurance companies generally buy physicians who "rubber stamp" denial decisions.

Insurance physicians who have been in the business for a while learn the lingo of claim denial very quickly. Of course, it is very easy and convenient to deny disability claims when the only opinions considered are its own. If the medical opinions of Unum's physicians differ from that of the primary care physicians, a manager may place the claim on ROR status particularly at the end of a quarter or year. This is was the case for 2008.

4. Any manager say-so. Managers and Directors have a great deal of responsibility to “roll out” certain levels of profit for the corporation. This is what they get the big monetary incentives for. Since the multistate settlement agreement Unum has no doubt “bumped up” reserve accountability to senior management such as vice presidents and other top executive personnel. However, managers are aware of claims reserves and how the denial of claims produces profit. A manager would have to be the dullest knife in the drawer not to know that.
5. Insufficient medical evidence to support payment. Of course, the insurance company is the entity who decides what is “sufficient evidence” to support a claim (discretionary authority), which is having the fox in charge of the hen house so to speak. The insurance company can, at any time, arbitrarily decide there is NEVER enough evidence to support a payable claim.

Reservation of Rights status is supposed to be a relatively short-lived pay status, however, getting a disability insurer to remove the ROR status after having benefitted from it by reducing the financial reserve, is very difficult since claims reserves increase again (reserve loss) reducing profit once the status removed. Therefore, most disability insurers will delay removing the ROR status, or at best, procrastinate removing it to avoid the inevitable reserve loss.

Bottom line, if a claimant receives a letter from their disability insurer informing a pay status of Reservation of Rights, please note the following:

1. It means the insurance company is notifying you it has begun an investigation of your claim because they either do not have sufficient proof of claim, or there is evidence to suggest the company will NOT have liability for your claim in the future.
2. The insurance company is nearing the end of a quarter (March, June, and September) or yearend (December) and needs to reduce the amount of financial reserves to show targeted or expected profits.
3. If the insurance company has not told you in writing it will only attempt to recover amounts paid for cases of fraud, it can attempt to recover any monies it has paid you as of the date of the letter. (Actually, paid benefits from the date of ROR notification to the date of the denial letter.)
4. The insurance company made a profit from your claim even though it actually paid you while the investigation was going on.
5. The insurance company may have pre-determined to deny your claim at a later date.
6. If the investigation is favorable to the insured and the claim is approved and paid, the insurance company understated its liability for the claim for the period of time it took to obtain what it felt was lacking.

7. ROR status for “any occupation investigations” presumes (incorrectly) what the outcome of the Transferable Skills Analysis will be for longer periods of times perhaps as long as 18 months. If it was later determined the insured met the definition of disability after 24 months, then the claim was under-reserved for as long as 18 months, assuming the company removed the status promptly, which may or may not happen.

Regulators should exercise more oversight into the manipulation of financial claim reserves by using the actual claims process and pay system to adjust claim reserves. It is very likely the indiscriminate use of ROR pay status by disability insurers could cause disability insurers to be under-reserved to the point of not being able to cover future claims. Remember, Reservation of Rights is only one of several ways in which disability insurers manipulate financial reserves.

Prior to June of 1999 it was alleged Provident’s management integrated Expected Recovery Dates (ERDs) with Unum’s benefit payment system to reduce and increase financial reserves based on “anticipated”(informed guesses) recovery dates. We know ERDs were coded into BAS (Benefit Administration System) and these “expected recovery dates” could not be changed without manager approval. ERDs were initially determined by RNs and other medical staff, but once it became apparent financial reserves could easily be manipulated via the ERDs, consultants and managers also determined expected recovery dates by review even though they were not medically trained to do so.

It is also alleged the more conservative financial reserve achieved prior to June of 1999 may have contributed to the attractiveness of the merger between Unum Life Insurance Company and the Provident Companies.

Integrating varying expected dates of recovery to ERDs did NOT work and caused several problems:

“Expected dates of recovery” are not certain. Human beings do NOT recover by planned, textbook definition of impairments, symptoms and recovery. Unum tried to use an online MDA (Medical Dictionary of Recovery), but still claimants blew the established ERDs into the water causing frequent fluctuations in financial reserves as ERDs had to be changed. Income and profit reporting was not consistent.

ERDs caused Unum to be grossly under-reserved. Subsequent to the Multi-State Settlement Agreement and introspection of regulators at the time, Unum subsequently contributed to its reserve figures to bring it more in line with regulation and investment requirements.

Since the ERD experiment failed miserably, sometime in 2001, it is believed Unum disconnected ERDs from financial reserves and allowed senior claims handlers to make adjustments to the dates of recovery. Eventually, ERDs were done away with, or at least in the context they were previously used.

Clearly, federal and state regulators look only at the big picture, or macro view, of financial reserve compliance. If Unum, for example, reports \$X dollars for financial reserves and the figure is within the required limit, very little inspection is given to the company's internal processes to determine how deductions in reserves are actually accomplished and **whether the reserve amounts actually equate with realized liability**. In other words, the bottom line isn't always the bottom line.

This consultant has been recommending to federal and state regulators since 2002 that a more micro inspection of actual claims processes and pay system integrations with offsets and reserve deductions be undertaken to reconcile actual liability for claims with financial reserve figures. It is likely further investigation may discover all disability insurers are under-reserved.

From an accounting and investment perspective, recording under-valued liabilities (financial reserves) is actually engaging in "off-balance sheet financing" since the true liability for future claims does not appear on the statement. Those investment brokerages who public bond ratings etc. should take particular interest in whether or not financial claim reserves are under reported on the financial statements.

Audits are performed; but the problem is in not comparing the full realized value of what financial claim reserves "should be" vs. "what they are", and not investigating the extent to which disability insurers manipulate reserves by integrating reserve gains (and losses) with the benefit payment system and strategic processes deliberately put in place to indiscriminately place claims on ROR status.

As long as comparisons are not made by regulators and auditors between reported financial reserves and the ability to manipulate reserves by engaging in "off-balance sheet financing" *via the benefit payment system*, disability insurers will continue to grossly under-reserve future liability of claims and report profits which are largely Aesop's Fables.

If anyone has any questions concerning Reservation of Rights status and what it means to you as an insured, please contact us by email at: lindanee@metrocast.net

Linda Nee is a former claims specialist trained by Unum Life Insurance Company on the significance and use of claim financial reserves. From 1994-1999 Unum Life used financial reserve gains (claim denials) as performance measurements for their claims specialists. Ms. Nee also received training (Settlement Specialist I & II) from Unum Life Insurance which involves the use of financial claim reserves.

In addition, Ms. Nee's DIA credential (Disability Income Associate) added additional training on the use of financial claim reserves.