Business Quality Control in Issuing Life Insurance

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Fraud investigation and fraud control are entirely different processes. Similarly the auditing of a life insurance company and the issuing of life insurance policies and business quality control are not the same. Business quality control and fraud control have much in common. In this article, these similarities are explored and a case is made that companies issuing life insurance policies should consider the business quality control approach rather than the more traditional investigatory methods.

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Excellent integrity in the business practice of writing life insurance is vital to the financial solvency of any insurer. Business quality control is the conscientious safeguarding and continuous improvement of business practice integrity. Inaccurate data, inappropriate assumptions, fallacious conclusions, and overreaching favoritism are bad business practices at best and at worst may be construed by the public as tantamount to criminal negligence or fraud.

Fraud is a strong term, but I believe that it is correctly used when insurers assert that their products are sound, yet they have not diligently maintained the best possible business practices to keep them that way. This lack of diligence cannot be anything other than intentional, and to assert a sound basis to the public is essentially an act of deception. Hence, the legal definition of fraud as “intentional deception” fits. Those who take a less harsh view may excuse poor business practices as mistakes and pitfalls in the course of doing business.

Although business practice mistakes and pitfalls are commonly found throughout the business world, insurers must be especially careful because of their extraordinary dependence on the public trust. An applicant who denies to the insurer his or her diagnosed chronic medical illness is committing fraud. However, the same result is achieved when an underwriter fails to obtain a critical attending physician statement (APS) that is recommended by requirement guidelines and assigns a preferred class to that applicant. Most often, an underwriter may waive a needed APS under pressure to perform a courtesy to an influential agent or broker. It is possible, and it is hoped more rare, that the underwriter personally knows the applicant and shepherds an application through issue for personal financial gain.

Like fraud, bad business practice is reprehensible and, like fraud, no self-respecting home office manager likes to admit that it could happen on his or her watch. Currently, the majority of systems that are used to monitor the business performance of insurers are designed to show how well these systems
The business practice of writing life insurance involves the following processes: (1) application, which includes the manner in which requests for life insurance are made by the proposed insured. It may be direct or through an agent, broker, or other licensed professional. The application may contain a minimal number of questions or may be an extraordinarily detailed questionnaire; (2) underwriting, which is the process by which an application moves through risk selection and other departments and divisions in the company to become issued or declined; (3) premium, a process in which the premium is set and received from the insured; (4) issue, in which policies are reviewed as a book of business or as multiple books of business; and (5) claims, where review of underwriting criteria and practices occurs.

Ideally, these processes are part of a feedback loop to improve continuously business practice and profitability. When these closely linked processes are monitored, it would be more helpful to see them from a "fraud control" perspective rather than the more typical "fraud investigation" stance from which insurers handle their business oversights. The difference between the 2 approaches is similar to a preventative intent versus a remedial afterthought.

Seven points of common wisdom in fraud control that apply across many different industries can serve as tenets in a business quality control model for insurers. These truisms about structure should be kept in mind whenever one approaches a system of processes that has never been configured to provide explicit business quality control:

1. What you see is never the problem.
2. Available performance indicators are all ambiguous.
3. Business quality control conflicts with productivity and service and competes for resources.
4. Dynamism is the nature of the game.
5. There is overreliance on traditional measurement approaches.
6. The effectiveness of new methods is always overestimated.
7. Traditional audits fail to appreciate the multilevel nature of the business.

The issuing of a life policy is a complex, multilayered process with a long time that may pass before it can be known if the result was a good business decision. Actions taken within each process of issuing a life policy are currently "non-self-revealing," that is, there is no immediate or consistent indication of whether each action taken was the right one. In reference to item 1 in the aforementioned list, in fraud control (as opposed to fraud investigation), what you see is never the problem.

Credit card fraud is generally "self-revealing," for the account holder can discover fairly rapidly from reviews of monthly statements if any theft has taken place. In contrast, bad business practice and fraud in the life insurance industry can persist undetected indefinitely. Auditing typically done for the underwriting of new business considers a narrow range of potential problems on an inconsistent basis. After the initial transactions are completed to issue the policy, as long as the policy remains intact and the premium is paid, only the random policyholder's file is audited. Typically, an audit of underwritten policies is conducted by a reinsurer that satisfies its own interests through the audit and not necessarily its client's interests. Other internal audits, such as those done by the chief financial officer or other financial auditor, may not focus on improving business practice but may only seek to determine that the most egregious financial mishandling did not occur.

Those who suffer most from bad business practice in the life insurance industry are the life insurers themselves, and no one can really help them except themselves. Examples of problems that are amenable to business quality control include the following: a worse than estimated health or financial profile of the policyholder; receipt of inappropriately low premium; and payment of inappropriate claims.
Each life insurer has to balance its expenses and losses against premium and investment income. It is relatively easy to assess the expenses and monitor them month by month, but the losses from claims that have generally been on the books for several years are another matter. Matching the losses to actions taken several years ago requires a dedicated system that is appropriately targeted to present actions and that is constructively informative.

The following illustrations of each of the 7 tenets of business quality control refer to the underwriting process. These may serve as a starting point for examining the other processes for integrating business quality control into their structure.

WHAT YOU SEE IS NEVER THE PROBLEM

If one never sees any problems, one does not feel the need to create a detection apparatus. However, if there is no detection apparatus, no problems are seen. If the overriding of medical decisions by business judgment is perceived as the normal course of business, then one may not capture the information needed to review this practice and assess an adequate premium for the inevitable change in mortality rate.

Does the physician who supplies the APS keep multiple sets of records designed specifically for different purposes? This may include a record sent to insurers that is materially different than records kept for treatment or reimbursement. Are the records sent to a life insurer, which show how healthy the applicant is, consistent with the records of the same patient that are sent to the disability company or workers' compensation carrier claiming that the patient is 100% disabled?

Is the physician truly a licensed MD? Probably about 5% are not!

AVAILABLE PERFORMANCE INDICATORS ARE ALL AMBIGUOUS

As audits increase in frequency and scope for particular processes in the life insurance operation, the number of problems detected will also increase. This can be due to the increased effectiveness of the audits or due to a real increase in problems. It may be difficult to tell which is the underlying reason.

As another example, a review of contestable claims can show that the underwriting procedure was correct 98% of the time. If the company standard is 95% correctness, this finding would be credible and acceptable. However, if the 2% error rate reflects the number of claims that were paid for the wrong deaths, such a performance indicator is not helpful.

BUSINESS QUALITY CONTROL CONFLICTS WITH PRODUCTIVITY AND SERVICE AND COMPETES FOR RESOURCES

Although business quality control is a vital aspect of doing business effectively, it is usually treated as an expense and bundled with other expenses charged to the area they serve. Some enlightened health care firms designate a fixed percentage of revenue (usually approximately 0.5%) to the quality measurement side of their business. In a life insurance company with an earned annual premium of $100 million, a similar proportional amount would be $500,000, a sum that is much higher than most insurers currently commit to their business quality control.

An area that should be particularly monitored is the development of mortality ratios used for underwriting impairments. Departures from reinsurance manual guidelines must be based on valid science rather than on the latest news from the popular press. The experience from impaired lives must be evaluated continuously, for their contribution to the bottom line is ultimately more important than market share.

DYNAMISM IS THE NATURE OF THE GAME

The term life insurance business is aggressive and very competitive. Not only do in-
urers compete regarding price, but the company that can process an application and issue the policy in the shortest time will often prevail over others. Currently, some insurers can issue a policy through their own Internet Web site to the agent for delivery or even directly to the insured. How many companies have the technical skill to identify a word or phrase, a number, or a dollar amount that has been altered on the way through cyberspace to the insured? Can insurers protect their own Web sites from attempts at piracy or plagiarism?

OVERRELIANCE ON TRADITIONAL APPROACHES

Because of the dynamism of term life insurance underwriting methods and delivery, old ways to establish business quality controls must give way to creative and innovative methods of review.

NEW METHODS ARE NEVER AS EFFECTIVE AS PREDICTED

The development of new underwriting tools, such as oral fluid assessment and tele-underwriting, may be subjected to underwriting quality control to answer the same questions asked of old tools. These questions may include the following: Is there underwriting inconsistency among underwriters on different teams? Are the preferred reinsurance underwriting manual guidelines being followed? This, however, does not answer the question as to whether the underwriting manual guidelines are correct in the first place and if they take into account the quality and type of information provided by new underwriting tools.

TRADITIONAL AUDITS FAIL TO APPRECIATE THE MULTILEVEL NATURE OF THE BUSINESS

Although underwriting and policy issue are considered to be a tight loop, the process has far more levels that are integral to its success. Marketing and new product development are critical functions to underwriting that are traditionally outside the organizational group that performs underwriting. From a higher perspective, investors, shareholders, agents, brokers, and management all have a vested interest in seeing that underwriting and issue work well all of the time. Business quality control measures that do not account for these multiple levels are inherently flawed but commonly found.

What business quality control activities are needed to be successful? Unlike the typical internal audits performed from the office of the chief financial officer, the money trail is only one component of a very complex system. The team that establishes business quality control functions must have an overall understanding of the business and the environment in which it exists. This includes the insurance industry's best practice and competitive information. It is helpful for the team to have multicompany experience in life insurance. A knowledge of medicine, underwriting, and the business of insurance is essential. Equally important is familiarity with mortality statistics, risk selection, calculation of risk, scientific study analysis, statistics, and quality control.

One decision of importance is whether the activities establishing business quality control are to be kept in-house or performed through outside contractors. If business quality control is to be performed by in-house staff, there must be considerable commitment of human resources, expenditures, and senior management support. This would most likely be the case even if the business quality control plan is performed by a contractor. Difficult realities must be faced and decisions made after the initial business quality control investigation exposes practices considered poor or questionable.

If the resources of an insurer are large or committed enough to support an internal unit, there must be a succinct business plan that is approved by top management. Day-to-day reporting may probably be directed to the chief operating officer. Since business quality control would involve underwriting, new business operations, and claims, obviously one cannot have the unit reporting to
the head of new business, underwriting, or claims; the level of report therefore must be higher. Just as the quality assurance unit of a health plan reports directly to the board of directors or at least to a committee of the board of directors, so should the business quality control unit for life insurers have a similar access to that level of management.

Serious problems have occurred frequently in health plans when both the quality control function and daily operation functions report to a single person significantly lower than the chief executive officer. In California, the Department of Corporations, which regulates most of the health maintenance organizations in the state, regularly checks the minutes of board meetings for evidence that the quality assurance function of the plan reports directly to the board.

Frequently, in a small company several functions must be performed by the same person. Generally this is appropriate, but the job of fraud control and running the operations of the company are roles with an inherent conflict of interest. Similarly, the business quality control of a life insurance company and normal business operation conflict. For example, if a particular manager is rewarded for productivity, it is a conflict of interest to require him or her to reassign productive workers or commit part of the budget to business quality control and risk a fall in production.

In the same way, it is a conflict of interest to give a manager responsibility to assess whether an underwriter has complied with the company underwriting rules in the medical aspects of a claim and to have the same person review the death claim regarding whether it is contestable on medical grounds. The 2 roles are very different. In the first situation, if the underwriter had done something that was not appropriate, some of the blame must fall on the manager. In the second case, it is only the company that pays!

An even stronger conflict of interest may occur when an in-house manager decides to use external sources for business quality control. It is likely that the cost of the external resources will come out of that manager's budget. Therefore, there is an inherent bias to get something considered "free." One must analyze the motives of the vendor of these services. Perhaps the external resource, as a primary business, sells laboratory tests to the life insurance industry. There can be many different motives for them to offer a free audit service, and it would come as no surprise if they concluded that the life insurance company could use specific laboratory tests more frequently in a protective way. As a result, it would be exceedingly unlikely that the audit would reveal that the insurer performed too many laboratory tests or that the accuracy or timeliness of the results was substandard. This applies to operational software vendors and paramedical or reinsurance companies offering audit services. The motives and objectives must be understood and aligned so that there is little risk of conflict of interest.

In conclusion, a business quality control operation in a home office life insurance environment needs to be aggressive, flexible, innovative, and creative to be able to improve the continued financial well-being of the company. An approach using fraud control methods is desirable. Whether the function of business quality control is performed in-house or with outside contractors, the parties performing the procedures and monitoring of business quality control need to be carefully considered and positioned so that they are effective and unbiased.

REFERENCE
The *Journal of Insurance Medicine* published a new section in 1996, the Case Study section, which is edited by associate editor Dr Robert Frank of Nationwide Insurance Enterprise, Columbus, Ohio. He has been ably assisted by assistant editors James Harris of American United Life Insurance Company, Indianapolis, Ind; James Bilyeu of Country Life Insurance Company, Bloomington, Ill; and Keith Clark of Western-Southern Life Insurance Company, Cincinnati, Ohio. Readers may submit a particularly interesting case report with discussion that would be of interest to the readership and to the industry. These reports will undergo peer review anonymously by Dr Frank and his team. This issue marks the resignation of Keith Clark from this important journal section, and the editor thanks Dr Clark for the time, effort, and industry experience that he has shared so generously with his colleagues through the *Journal of Insurance Medicine*.

Dr Frank is pleased to announce that Jack Cotlar has become a case study assistant editor of the *Journal of Insurance Medicine*. Dr Cotlar is the medical director of Indianapolis Life, Indianapolis, Ind. Dr Frank also encourages the readership to submit case reports and their discussion for the benefit of the readership specifically and for the industry in general.

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