Busting the Bad-Faith Myth of Adjuster Bonus Incentives

Insurers face significant extracontractual risks from institutional bad-faith claims alleging claims handling deficiencies due to adjuster bonus plans. Bad-faith lawyers often argue that claims professionals should not receive contingent compensation (i.e., bonuses), alleging that such compensation promotes denying and underpaying legitimate claims—thereby boosting insurer profits. This article examines this argument, offers counter themes, and suggests ways management can design incentive compensation that reduces extracontractual bad-faith liability risks.

By Kevin Quinley

Bad-faith myth: "Claims personnel shouldn't get bonuses, especially if they base bonuses on company profits!"

Plaintiff attorneys often trumpet this theme in institutional bad-faith claims. They argue that insurers' bonuses motivate claims handlers to delay or lowball meritorious claims, letting insurers retain funds longer and maximize profit.

Here's a differing perspective: The argument against financial metrics in adjuster incentive pay overreaches.

Granted, the criticism may apply to bonus schemes that reward adjusters *solely* for slashing claim payouts—a practice that invites institutional bad-faith claims. But because some insurers have been stung by adverse judgments, many that previously adopted such schemes have abandoned them. And many others have successfully adopted bonuses practices without conflict.

First, a quick definition. An *institutional bad-faith* claim typically accompanies a breach of contract, bad-faith claim, or both. The latter alleges deficient claims handling. Bad-faith claims allege errors, omissions, mistakes, and deviations from sound claims handling. Plaintiffs want to put the claim file and adjuster on trial.

Institutional bad-faith claims broaden the gunsights. They state that a claim was not only mishandled but that *corporate management* and *financial incentives* create a bad-faith petri dish, perverting the claims process toward anti-consumer outcomes. In fact, many consumers already believe that claims professionals receive commissions, a percentage of the amount they "save" on each claim.

Institutional bad-faith claims weld this to allegations of dysfunctional management. They put the *insurer* on trial.

To this end, not all institutional bad-faith claims are based on compensation plans. Plaintiffs may also allege lax supervision, inadequate training, and miscellaneous deficient management practices.

Examples of Distorted Pay Systems and Discovery Avenues

Illustrative cases highlight bad-faith perils of certain adjuster bonus schemes. A South Dakota federal case, *Torres v. Travelers Insurance Company*, for example, yielded a $12 million punitive damages award.[1] Although the insurer denied setting claim payout targets, discovery ultimately showed bonuses paid to claims handlers and managers, plus cash bonuses tied to trimming claim payments.

At trial, evidence showed that Travelers paid bonuses based on claim payment reductions. The plaintiff only discovered the bonus system when reviewing a fourth-level supervisor's personnel file, which included documents congratulating him on his bonus. This document's disclosure prompted further discovery, revealing a bonus system tied to claim payment reductions.

Plaintiffs and their experts may also cite *Nardelli v. Metropolitan Group Property and Casualty Company et al.* to condemn bonuses as fostering bad-faith practices.[2] In *Nardelli*, Metropolitan's management assigned its claims department a significant role in hitting corporate profit goals. Further, the company's adjusters had aggressive accountability for companywide profit goals. So-called Road Shows reinforced the message to claims staff that they must meet profit goals.

Metropolitan, plaintiffs alleged, threatened adjusters with possible job loss if they missed profit goals and implied that the company might shed certain business units, imperiling job security. Documents also showed Metropolitan aggressively communicating profit goals to its claims department, including sending directives to the office and adjusters handling Nardelli's claim.

Courts have often held that adjuster personnel files are fair game in discovery.

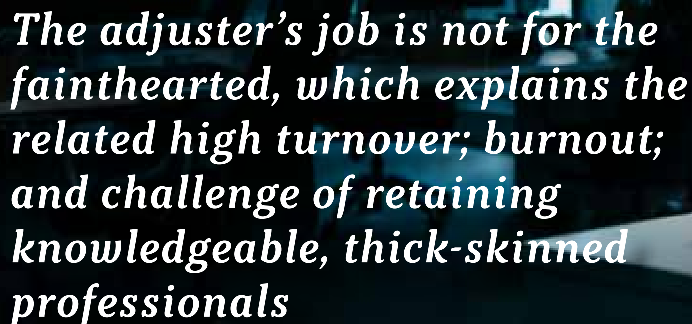
In a Kentucky dispute, a plaintiff alleged that claims representatives' compensation led to lowball settlements, encouraging adjusters to engage in bad faith.[3] Kentucky's Supreme Court granted the plaintiff access to insurer personnel files about bonuses, job performance, wage and salary data, and disciplinary matters, ruling that these were relevant to the plaintiff's bad-faith claim.

Inequities in Exempting Bonuses

More often, adjuster incentive compensation links at least partly to insurer profitability. Is this unjust?

Adjusters get called out of bed at 3 a.m. to investigate tractor-trailer accidents. Management can relocate them to handle post-hurricane CAT losses. The adjuster's job is not for the fainthearted, which explains the related high turnover; burnout; and challenge of retaining knowledgeable, thick-skinned professionals.

Imagine the reactions of those in claims departments if adjusters were the only employees ineligible for bonuses. Underwriters swap high-fives after landing big premium accounts. Even if such accounts become triple-digit loss ratio money losers, underwriters will have long since cashed their bonus checks.



Many marketing folks earn bonuses from new business produced, often regardless of an account's ultimate quality. Assessing an account's quality may take months or years.

Eventually, claims departments would become de facto hazmat teams, cleaning up messes from accounts booked years ago—accounts that yielded bonuses to everyone . . . *but them*. Insurers have a hard enough time preventing adjuster burnout and turnover. And they continually fret over the exodus and brain drain of seasoned claims professionals. Go figure!

Hard-Earned Bonuses

News flash: Handling claims is tough work!

Adjusters deal with people in crisis mode. Understandably, insureds and claimants are in a bad headspace. They've suffered loss. They hear horror stories about adjusters. Personal injury lawyers bombard consumers with TV ads depicting adjusters as shysters who short-change the unwary (more on that soon). Ad blitzes mold jury pool attitudes, a pool with whom institutional bad-faith claims resonate.

Risk management specialist Nancy Germond, in a recent article on occupational hazards facing claims professionals, noted:

> Adjusters have been murdered, robbed, and sexually assaulted on catastrophe assignments ... Adjusting, even in the office, is hard work and can involve long hours. Dealing with angry, disappointed people can be emotionally taxing.[4]

I started my career with Crawford & Company in 1977. Its multivolume *Manual of Procedure* included procedures on managing adjuster hostage situations. Luckily, I was never a hostage. But after I denied a suspicious Lloyd's jewelry loss, the irate claimant threatened to shoot me. While handling a declined longshoreman's workers compensation claim, the upset claimant said he knew my home address and threatened to visit me there and whup my a--.

Adjusters get yelled at, cussed out, and even physically threatened. They get harangued by lawyers, bosses, and vendors who demand ever-faster payments. While these are not everyday occurrences, and while threats may be bluffs, negativity and aggression take a cumulative toll on claims professionals—on whom falls the burden of delivering bad news again and again and again.

Adjusters shoulder substantial caseloads and are stressed, being told to do more with less. A recurring scenario: "Josephine in the next unit just quit, without notice. There's no budget to hire a replacement, so we're reassigning her 279 COVID business interruption claims to you, on top of your current pending workload. Good luck!"

Now try retaining quality staff by announcing pay programs that make claims the only department ineligible for additional compensation. As a tongue-in-cheek management meme states, "Beatings will continue until morale improves!"

Adjuster Motivation and Design Challenges

Depriving claims representatives of bonus eligibility throws the baby out with the bathwater.

The problem is not adjusters earning contingent compensation or bonuses. (If companies are unprofitable, employees share risks by facing layoffs and reductions in force. The sword swings both ways.) The challenge is in program design. Bonus programs dominated by or comprised solely of financial metrics can invite institutional bad-faith claims.

However, I have never known an adjuster who enters the office in the morning thinking, "How can I maximize corporate profitability today?" More likely, claims handlers focus on turning over files, closing cases, and keeping their heads afloat amid large workloads—and the easiest way to do this is to pay claims, not fabricate flimsy reasons to deny them.

Keeping files open with specious denials merely bloats adjusters' pending caseloads. This fact is lost on consumers, who see lawyer ads and drink the plaintiff's Kool-Aid. Attorney marketing from the personal injury bar makes the public largely susceptible to institutional bad-faith arguments rooted in adjuster compensation.

Often, adjuster testimony punctures the plaintiff's narrative that bonus income tied to profitability distorts claim decisions. The

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following adjuster-deposition testimony from a case in which I was involved is an example of the adjuster's mindset:

> Adjuster: There may be an additional check based on the overall – how the company is doing…
>
> Plaintiff's counsel: Meaning the profitability of the company, true?
>
> Adjuster: I don't know if that's exactly accurate. …I don't really think about it.

Here, claims handlers were bonus eligible. This is not unusual. For many, if not most, noninsurance businesses, incentive compensation tied to company performance is common.

Bonuses can flow from factors unrelated to adjuster claim payouts. Instead, they often link to circumstances that adjusters don't control. For example, this claims representative testified that bonuses were available because of below-average storm activity:

> They don't call it a bonus payment. It's something like a profit-sharing, I guess.…A lot of it has to do with how many storms there are during the year, that type of thing… There's a—like a—sort of like a 401(k). So I don't even see some of the money at all. And then the other amount goes into the—you know, into my checking account. But I—it's not a big deal to me.

Weaponizing Corporate Mottoes and Goals

Even seemingly innocuous corporate mottoes can provide fodder for bad-faith attorneys painting a picture of financial goals warping sound judgment. In one case in which a law firm retained me on an insurer's behalf, the insurer had launched a Strive for a Billion campaign. Bad-faith counsel tried to rub the adjuster's nose in the phrase, weaving it into a bad-faith theme.

Still, nothing is inherently wrong with "striving for a billion." (After all, personal injury attorneys seeking "nuclear verdicts" often swing for that monetary fence.) One need not have an MBA to realize that business sustainability requires profitability. But having this awareness does not automatically mean shortchanging customers.

An insurer striving to hit a billion-dollar earnings mark would not achieve it by denying or underpaying meritorious claims. If anything, such a goal would reinforce fair claims handling and foster delivering quality claims service and resisting overstated claims.

A supervisor's testimony related to this case undercut the argument that financial motives and profit consciousness motivated adjusters to deny or underpay meritorious claims:

> Q. And do you know how the Strive for a Billion initiative has affected your employee reviews or your salary raises, if at all?
>
> A. I do not believe that it has affected my salary raises or anything to do with my compensation.

Another plaintiff trope: arguing that informing adjusters of corporate profit is bad and distorts claims handling.

I was retained in a case in which plaintiff's counsel showed that a periodic claims staff meeting topic was company profit and financial performance. However, to the extent that the claims staff were conscious of profit, that awareness flowed from understanding that profitability came from handling claims appropriately, not by slashing expenses arbitrarily.

A deposition exchange between plaintiff's counsel (PC) and a claims handler (CH) unfolded:

> PC: You're not quibbling with me, are you, that the goal is to increase profitability, not decrease profitability, right?
>
> CH: Profitability will come if we do what we're supposed to be doing. Yes, so that would be a goal based on how we all do our work.
>
> PC: And you would agree that the only thing that a claims adjuster can do to improve the combined ratio for [XYZ Insurance] is to reduce the amount that you pay on a claim or reduce the amount that you pay in a claim expense?

CH: No, I disagree completely. ...The things that a claims adjuster can do have a lot more to do with how they handle the claim, how they work with an insured or a claimant, how they work with our agents. That makes a much bigger impact. If you do the right things, the claims process is going to take care of itself.

Claims Profit Centers and Attorney Ads

Plaintiffs' attorneys also ascribe dark motives to claims meetings that mention a company's combined ratio. But addressing key ratios gives employees a big-picture view of company performance and fosters employee engagement. It does not make the Claims Department a profit center.

Combined ratios are a key performance indicator. Further, one way for adjusters to improve a combined ratio is to provide excellent customer service, pay meritorious losses, and resist bogus or inflated claims.[5]

As one Institutes text states:

> Claims managers should be careful when communicating business objectives such as profit and loss ratio targets... Instead of communicating specific financial objectives to their staff, management should communicate claims best practices that guide cost-effective, but fair, claims management. Claims managers should also communicate with the insurer's executives regarding whether objectives are realistic, such as a specific loss ratio.[6]

In the Richmond, Virginia, area, where I live, a local personal injury firm (Marks & Harrison) runs TV ads depicting a mythical insurance claims meeting. A gruff, older claims manager sits at a conference table reviewing documents, his brow furrowed. Then he shakes his head and declares, "There's no way we're paying for all these medical bills!"

A younger claims rep at the table cautions, "We might want to think about that."

Claims manager (exasperated): "Look—just get them to sign. This offer is more than fair!"

Young claims rep: "Sir, it's the law firm of . . . [drum roll, please] Marks & Harrison..."

The camera zooms in close, showing the claims manager's bulging eyes and apoplectic expression, his face frozen in a horrified rictus. He scoots his wheeled chair out of the conference room, terrified of the prospect of testing his evaluation against the personal injury firm.

Watch daytime, or even evening rush hour, TV. You'll see similar ads, variations on a theme: Insurers will cheat you—they only care about profit. Come hire us!

Insurance marketing provides little help. With few exceptions, most ads tout cheap prices, lower premiums, and saving money. They rarely promote concierge-level claims service.

More common are pitches that might as well say: "Have a loss? Call a 1-800-number three states away, only to become trapped within an automated phone system. Look forward to hearing messaging gems such as, 'Your call is important to us.' 'Due to unusually high call volume...' 'Your estimated wait time is...' 'For faster service, visit our website.' 'Download our app.' 'Send us smartphone photos of your damage.' And so much more!"

Yes, by all means, let me become an unpaid DIY claims investigator for you!

Insurer ads do little to burnish a brand image of claims handling prowess. Geckos, LiMu emus, Gronk, Flo, and Mayhem are notable insurance ad icons. Few to no ads, however, tout white-glove claims service.

You Might be Facing an Institutional Bad-Faith Claim If ...

Comedian Jeff Foxworthy achieved fame with his "You might be a redneck if ..." routine. My adaptation highlights seven red light flashing signs that you may be facing an institutional bad-faith claim rooted in adjuster pay:

1. The Plaintiff's Request for Production seeks personnel files, including performance appraisals and pay information on the adjusters who handled the claim.
2. The Plaintiff's Request for Production seeks documents pertaining to bonus/contingent compensation, not just on claims handlers, but also supervisors and managers.
3. When deposing claims staff, plaintiffs' counsel asks about their base pay, whether they received bonuses, the amount of those bonuses, etc.
4. The Plaintiff's Request for Production seeks copies of Claims Department meeting agendas, PowerPoints and "best practices" documents.
5. When deposing corporate representatives (i.e., 30(b)6, "persons most knowledgeable"), plaintiffs' counsel asks about company payment systems and how the payments relate to company profitability or combined ratio.
6. The Plaintiff's Request for Production seeks any and all materials related to departmental or individual adjuster goals for the specific years in which they were handling the plaintiff's claim.
7. For publicly held (i.e., stock) insurance companies, plaintiffs' counsel seeks records related to quarterly CEO/CFO calls, webinars, or podcasts with institutional investors.

To be sure, bonus schemes that feature financial benchmarks can foster bad-faith conduct. However, other incentive bonus plans that include financial benchmarks can safeguard against bad faith by including nonfinancial criteria that foster good faith and fair dealings. Those nonfinancial criteria bring us to the remedy of balanced scorecards.[7]

Balanced Scorecards: A Holistic Bonus Option

Bonus programs tied to balanced scorecards, which include but are not limited to financial metrics, neutralize incentives to underpay legitimate claims. Claims management must collaborate with human resources professionals to design contingent pay criteria that include yardsticks such as:

- Customer growth
- Overall profitability
- Customer service and satisfaction benchmarks
- File quality
- Continuing education and professional development

These yardsticks are legitimate factors to weigh when apportioning bonuses. That some are subjective doesn't make them useless: Not everything that counts can be measured, and not everything measurable counts.

Let's shed the notion of claims professionals as the insurance industry's Rodney Dangerfields and instead give them the respect they deserve. Do not marginalize them for doing one of the hardest jobs on the insurer's task list. Don't relegate adjusters to second-class citizenship by exempting them from sharing in a company's success—when their efforts and hard work helped make the success possible.

Double-Standard Financial Incentives

Some plaintiff attorneys and experts condemning financial carrots cite a 2009 article, "Goals Gone Wild: The Systematic Side Effects of Over-Prescribing Goal Setting," in which the authors argue that "the beneficial effects of goal setting have been overstated and that systematic harm caused by goal setting has been largely ignored."[8]

Goals, of course, can have positive or negative effects, depending on how they are used—or misused. A hammer can be used to build a beautiful building. It can also be a murder weapon. The problem is not the hammer, but rather its use or misuse. Same with financial and nonfinancial goals.

When law firms have profitable years, though, partners and associates share the bounty. When businesses have good years, part of the financial success made possible by the employees' hard work flows back to the workers. Fair, right?

Claims handling exists within a financially incentive-oriented system. It is impossible to have an adversarial tort system without incentives. Consider the claims process from the claimant's or claimant attorney's standpoint. Claimants and their lawyers have built-in carrots to maximize their recoveries.

When insureds or claimants hire lawyers, financial incentives are clear. Personal injury lawyers represent claimants on a contingency basis. The attorney receives a percentage (usually one-third, maybe 40 percent if a case goes to trial) of the ultimate recovery. This contingency system *incentivizes* plaintiffs' attorneys to demand and recover as much money as possible. Lawyers' stratospheric settlement demands start high, with a tacit expectation they will trend downward, to reach a mutually agreeable number with the adjuster or defense counsel.

While plaintiffs pillory insurers for having financial incentives, they are oddly silent about their incentives. Financial incentives are fine for them, but adjuster incentives are evil. The Twitter Age could label this #hypocrisy.

This isn't to say that claims handlers should be financially incented to deny or lowball legitimate claims. They should not.

Rather, claims and human resources managers can design contingent pay in ways that don't motivate dysfunctional claims practices. Well-crafted, balanced scorecards for incentive compensation promote the twin goals of profitability and good-faith claims practices.

Closing Caveats

First, I am not an attorney. Observations and suggestions made here are not legal advice.

Second, while this article mentions bad faith as if it were a uniformly defined phenomenon, what constitutes "bad faith" varies by state and can have significant jurisdictional nuances, depending on a claim's venue.

Third, insurers can adopt all the advice offered here and still face lawsuits alleging institutional bad faith rooted in dysfunctional pay systems. No titanium shield exists.

That said, thoughtful adoption of bonus systems incorporating checks and balances—financial and nonfinancial criteria—enable insurers to deter and successfully defend institutional bad-faith claims rooted in claims representatives' pay.

Bad-faith counsel may throw rocks from the front yard of their glass houses, but these tips will help insurers build their proverbial houses out of good faith Teflon. ■

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1. *Alice Torres v. Travelers Insurance Co.*; U.S. District Court for the District of South Dakota; No. 01-5056, SDS, Judge Karen E. Schreier. Case cited in http://www.abourezklaw.com/headlines-04.html.

2. *Kenneth John Nardelli and Tammy M. Nardelli, husband and wife, Plaintiffs/Appellants/Cross-Appellees, v. Metropolitan Group Property and Casualty Insurance Company, a Rhode Island corporation, Defendants/Appellees/ Cross-Appellants*, No. 1 CA-CV 10-0350, Court of Appeals of Arizona, First Division, Department C, May 1, 2012.

3. *Grange Mutual Insurance Company v. Trude*, 151 S.W.3d 803, 815 (Kentucky 2004).

4. Nancy Germond, "Keeping Adjusters Out of Harm's Way," *Insights*, Winter 2021, pp. 16 and 17. (See also, Kevin Quinley, "Adjuster Safety: The Darker Side of Investigative Risk," *Claims Magazine*, May 1991, pp. 40-41, 75-77.)

5. Successful subrogation offsets claim payouts and thereby indirectly facilitates profit. In this light, there is nothing nefarious about viewing a claims department as a "profit center."

6. Martin Frappolli and Ann Myhr, *Claims Leadership and Organizational Alignment*, First Edition (Malvern, Pa.: The Institutes, 2013), p. 9.4.

7. Kevin Quinley, "Slouching to Gomorrah: Adjuster Pay Plans and Bad Faith," *Claims Magazine*, October 2004, pp. 18-19.

8. Lisa D. Ordóñez, Maurice E. Schweitzer, Adam D. Galinsky, and Max H. Bazerman, "Goals Gone Wild: The Systematic Side Effects of Over-Prescribing Goal Setting," *Academy of Management Perspectives*, vol. 23, no. 1, February 1, 2009, https://journals.aom.org/doi/abs/10.5465/amp.2009.37007999 (accessed March 25, 2022).