

Issue Brief

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Insurance Fraud Most States Take Action to Curb Abuses *Vermont One of the Last States to Act*

By Kenneth R. Marshall
State Affairs Information Manager

Executive Summary

While insurance fraud is hardly a new problem, not a great deal was known about its impact until fairly recently. In the past, states lacked basic laws even to define insurance fraud, let alone to establish authority for investigating, prosecuting, and punishing those responsible. As a result, fraudulent activities, whether highly organized or simple acts of misrepresentation, were undetected and unreported, thus making it difficult to quantify the cost of insurance fraud and to determine its toll on the marketplace. This, in turn, made it difficult for those concerned about the problem to build support for state laws aimed at controlling it.

In 1993, an organization was created to increase awareness of insurance fraud, and to develop strategies to combat it. The Coalition Against Insurance Fraud (CAIF) has performed a valuable service for consumers and insurers alike by shining a spotlight on this insidious and costly crime. Its efforts have led lawmakers in dozens of states to enact legislation designed to identify and ultimately deter acts of insurance fraud.

While most states have passed laws to curb the problem, a couple have yet to follow suit. In one such state – Vermont – there are encouraging signs lawmakers are beginning to appreciate the magnitude of the costs associated with insurance fraud. In 2004, the Vermont General Assembly debated an anti-insurance fraud bill that would have brought the Green Mountain State into line with nearly all other states in the nation. Unfortunately, the legislative session ended before lawmakers could act on the bill.

In 2005, however, NAMIC has joined forces with CAIF, the National Insurance Crime Bureau (NICB), the Vermont Association of Domestic Property/Casualty Insurance Companies, and other members of the insurance industry to support similar legislation introduced this year (HB 150 – An Act Relating to Insurance Fraud). The bill establishes penalties and requires fraud-warning statements on insurance applications and claim forms. Key sponsors of HB 150 include Rep. Kathleen Keenan (D-St. Albans City), who chairs the Commerce Committee, and Rep. Mark Young (R-Orwell).

Background

Insurance fraud is insidious. Its escalating costs are borne by insurers and consumers alike. Historically, insurance fraud has been difficult to quantify, let alone deter. States have often lacked adequate resources and expertise to conduct proper investigations or even the necessary legal authority to effectively prosecute cases. These obstacles have made insurance fraud difficult not only to identify and control, but also to accurately quantify in terms of its overall societal costs.

Insurance fraud can take the form of “hard fraud,” which describes well-planned and organized acts such as submitting claims for accidents and injuries that did not occur. At worst, it involves the actual staging of automobile accidents, which can put innocent drivers at risk of serious injury. Media attention has begun to spotlight the proliferation of fraud claims related to staged automobile accidents perpetrated by organized crime rings.

Lower-profile but more common “soft fraud” involves deliberate acts that are not as organized or significant in scope individually. Examples include intentionally inflating claims or providing false information on insurance applications.

In the Property/Casualty industry alone, the cost of insurance fraud is estimated at nearly \$30 billion annually, which costs the average U.S. household roughly \$200-\$300 in additional premiums each year. And these are conservative estimates, since not all fraud is even identified let alone investigated, quantified, or prosecuted in the courts.

In order to prove insurance fraud, three elements must be established:

- intentional/deliberate acts of deception occurred;
- records, such as claim forms, were clearly falsified; and
- payments were received in excess of what would otherwise have been paid.

Given the limited resources that are typically dedicated to fraud detection and prosecution, proving these elements is a formidable challenge.

Enter CAIF

Against the backdrop of escalating insurance fraud costs, the insurance industry, in conjunction with other private and public sector interests, created an insurance fraud watchdog organization – the Coalition Against Insurance Fraud. CAIF was formed to educate and alert the public about insurance fraud, develop deterrence strategies, and to protect insurer and consumer interests by controlling the cost of insurance fraud. CAIF has become a clearinghouse for data about insurance fraud as well as an effective champion

of tough state insurance fraud laws.

CAIF created a series of model acts to help states develop their own insurance fraud laws. A noteworthy example is the Model Fraud Bureau Act, which encourages states to create independent fraud bureaus to lead investigative reporting, prosecution, and other deterrence efforts. The model identifies the elements needed for an effective state fraud bureau: statutory definitions, immunity provisions, funding mechanisms, civil remedies, and criminal penalties.

States Act to Curb the Problem

To date, no fewer than 40 states have created their own fraud bureaus. Ten states – Alabama, Colorado, Illinois, Indiana, Maine, Michigan, Oregon, Vermont, Wisconsin and Wyoming – have not. However, it is important to note that most of these states have at least taken action to statutorily identify insurance fraud, as well as to establish appropriate penalties. Many state fraud bureaus were created by legislation and are administered by state insurance departments, but a few are organizationally tied to other units of state government. Most of these state fraud bureaus address all types of insurance fraud activities; a few focus exclusively on workers’ compensation issues (Georgia, Kansas, Louisiana, Minnesota, Missouri, Nevada, North Dakota, Oklahoma, Rhode Island, Tennessee, Texas, and Washington).

In addition to its advocacy supporting the creation of state fraud bureaus, CAIF also champions state adoption of anti- insurance fraud model laws to:

- identify acts that constitute claims, underwriting, and insurer fraud;
- classify fraud as a felony offense;
- encourage insurers to develop anti-insurance fraud plans and develop Special Investigative Units;
- establish annual fraud statistical reporting requirements;
- grant immunity to individuals who report suspected fraudulent activities;
- require the placement of fraud warnings on insurance applications and claim forms.

To date, six states (Arkansas, California, Colorado, Kentucky, Maine, and Tennessee) have adopted all but one of the CAIF recommended measures referenced above. Five other states (Florida, Minnesota, New Jersey, New Mexico, and New York) have approved laws addressing all but two of these standards.

The fact that many state governments have implemented the CAIF standards indicates a growing consensus that states must act forcefully and decisively to curb the alarming societal costs of insurance fraud.

While the actual substance of the laws adopted in each state vary, they all embody those same CAIF recommendations and at this point nearly every state has approved at least some of these key provisions. However, one state stands out as a conspicuous exception: Vermont lawmakers have yet to approve any of these important anti-insurance fraud measures.

Getting Ahead of the Curve in Vermont

Presently, Vermont is not considered a haven for insurance fraud, and there is a perception among some that no immediate threat exists. However, the potential for major insurance fraud problems to develop in Vermont should not be discounted. Two bordering states, New York and Massachusetts, are currently plagued with significant “hard” insurance fraud problems in the form of organized crime rings. As these states step up their efforts to close the remaining windows of opportunity on insurance fraud, there is ample reason to believe that these lucrative organized fraud rackets will move their operations into Vermont.

Because existing Vermont law neither defines acts of insurance fraud, nor provides for civil remedies or criminal penalties, the state is likely to become an irresistible target for those organized fraud rackets that have prospered for years in neighboring states. Moreover, Vermont’s international border could further entice organized crime activity from outside the country.

Encouraging Legislative Developments

The General Assembly of Vermont recently demonstrated serious recognition of insurance fraud

and the potential threat it represents for consumers and insurers who live and work in the state. In 2004, Vermont lawmakers considered a substantial insurance fraud proposal, HB 742. The bill contained several of the key substantive provisions contained in the CAIF model laws. It set forth a clear definition of insurance fraud, and establishes civil remedies for victims and criminal penalties for those who commit the crime – including restitution and recovery of fraudulently obtained funds.

Noting that its member companies comprise roughly half of the private and commercial automobile insurance market and two-thirds of the homeowners insurance market in Vermont, NAMIC strongly supported HB 742. Its failure to pass last year, however, has not dampened the industry’s collective will to pursue this important legislative objective. In fact, this year NAMIC has joined with the Vermont Association of Domestic Property and Casualty Insurance Companies, the National Crime Insurance Bureau, and the CAIF to urge passage of a similar proposal (HB 150).

This year’s legislation incorporates the basic framework of several CAIF model provisions by statutorily defining insurance fraud, and by identifying the specific acts that constitute insurance fraud. It establishes criminal penalties, civil remedies, and administrative procedures, and grants immunity to individuals who cooperate with investigations or report suspected instances of insurance fraud. The bill also sets forth a comprehensive plan for combating insurance fraud, including fraud-warning requirements for insurers to follow. In addition, this legislation targets inflated homeowners and business loss claims, as well as fraudulent workers’ compensation claims.

NAMIC has already joined with these other organizations in offering testimony before the House Commerce Committee in support of HB 150, and has accepted an invitation from the bill’s key sponsors to return later this session to continue to assist in moving this fundamentally important legislation forward.