

Why Fight Fraud?

By Bill Lundy

We saw in the most recent edition of Awareness some authors extolling the industry to use the services of the Special Investigation Units. Since the very beginning of IASIU, our authors and investigators have prided themselves on the "savings" they have managed to generate for their employers. Since the mid 1980's, we have seen reports telling how beneficial SIU's are to their employers. At the coming IASIU annual seminar, a forum will meet to discuss finding ways to determine just how we can truly measure the success or the "savings" of the SIU's.

The very term, "savings" brings anxiety attacks to most of the legal counsel of the industry. They hate to hear the term because it engenders a fear that at trial, the SIU will be accused of being in the business of generating cash savings for their employer. This is opposed to the SIU being in the business of determining the truth so a claim can be properly handled and paid, denied, subrogated or otherwise adjusted. Plaintiff's counsel always tries to paint the Special Investigation Unit as a hired gun, employed to find evidence favorable to the company. It is almost always a false complaint, but effective.

Instead of using the term savings, let's use the idea of economic benefit. Over the past couple of decades, various insurance industry study groups and researchers have determined and announced that the Return On Investment of most SIU's is about 7 :1. We have heard of course some of the units claim nearly 15 :1 and some as low as 2:1. The average has been about 6.88:1 according to Conning and the IRC in past studies. Why, with that outstanding ROI, has not the insurance industry gone out and mortgaged the proverbial farm to invest in more SIU operations?

Looking at the makeup of the insurance industry, one must be cognizant of the sheer number of accountants and actuaries that are employed there. So, with all the MBA's that are employed by the industry, wouldn't you think that they will have seen the outstanding benefit of really using the SIU's to their economic advantage? Are the SIU's actually more intelligent than all those MBA's? That would

be quite a leap of faith! If the MBA's are all they are cracked up to be and all they are paid to be, then why are many of the SIU's being either down sized, or at the very least limited in size? There must be a reason that the SIU community is not seeing.

There was once a mediaeval philosopher; William Of Occam, (1235 -1349). He is credited with what is now known as Occam's Razor. It's a simple philosophy that says in effect, "one should not increase, beyond what is necessary, the number of entities required to explain anything." In this instance, the question is why are insurance companies not utilizing the economic impact of SIU's to a higher degree?" Perhaps another question should be, "why should they?" Take a look at the math. If General Motors had a problem that cost them 10% to 15% of their after tax dollars, and it was a recurring problem every year, would they not devote one large chunk of money to solve the problem? After all, it would certainly make them less competitive as compared to Toyota, Honda, Mitsubishi to say nothing of Ford or Chrysler. So why then does the insurance industry spend less than 3/10 of 1% of their premium dollar income for their total fraud fighting budget when fraud measurably costs them 10% to 15% of that same income? In fact, some companies spend about 1/10 of 1% and still others spend even less. What kind of economics is that?

We have to shift a paradigm from thinking of the SIU as an economic benefit to one of the SIU being instead an expense. That will require a different perception of how the industry makes a profit. Let's take a look at that and maybe we can see how we can make a better impact.

We need to understand that the primary objective of an insurance company is making a profit for shareholders, or policy holders in the mutual companies. That is why they opened a business in the first place and if they fail to make a profit, the officers will be replaced by those who will. It's business. As far as the industry is concerned, fraud, whether it is auto theft, arson, auto accident fraud, medical fraud, workers comp or anything in between, is all a part and parcel of the cost of doing business. It is calculated into the rate. Eliminate the crime and you eliminate the premium that is to be

invested so as to make a profit. It works something like this:

The average loss ratio of P/C insurers in the US is on the order of 106%. That means that for every \$1,000 they absorb in the form of premium, they pay out \$1,060 in the combination of expenses of doing business and the cost of claims. It is rare that over any significant period of time a company will make what they call an underwriting profit. A few do but they are the exception rather than the rule. The best most companies can hope for is to make a profit on investments of the premium before the premium is paid out for covered perils and business expense. In times when the market is really bad for investments, the companies instead of saving money by asserting fraud defenses actually decrease the size of their claims staffs and SIU's, electing rather to reduce expenses rather than decrease the size of pay-outs for bogus claims.

The fact is that the more premium a company takes in, the better their opportunity to make a profit on investments, despite the losses that they know they are going to take because of fraudulent claims. Why? Because the cost of fraud is built into every claim dollar and thus into premium. The companies look at it from the position that fraud is not something that they should have to deal with. It is a crime and thus it is up to the society through the police to do something about it. Some companies are benevolent. They put up a good fight and they actually try to reduce the economic damage of fraud. But the result is that they are stung to death by a million mosquitoes. Some fight hard against fraud, some do not. Some say, "It isn't my job. It isn't my problem". Remember your high school physics: All ships rise in a rising sea. If fraud affects all companies equally, then it is no one's problem. It is everyone's, but no responsibility is assigned. Most insurers and indeed many policy holders believe it is not really and insurance industry responsibility. They look at it as a societal problem, one for the police and the courts to control.

It should not be assumed that the insurance companies are evil or malevolent in their actions, or non-actions. The accountants and the executives who think the police are going to launch a battle to eliminate fraud are simply wrong. Many of the SIU personnel are from law enforcement. What do they

think are the odds that a state police agency is going to rise up, particularly in these post- 9-11 days and combat insurance fraud? It hasn't happened in 30 years and it certainly isn't going to happen now. The police are busy addressing other much more important issues. Think Terrorism. Think crimes against people and reduced police budgets.

However, in the end, it will be an industry problem. If the industry does not get a handle on fraud, the states will eventually mandate it. Some states already have but ineffectively. The policies being written and the claims that are quickly paid exacerbate the problem. It is exactly the same as the arson wave that hit the US in the mid 1970's. Some may recall signs in storefront windows proclaiming "America Burning!" Several insurers started Arson Units. Some were purely voluntary and some were born in response to pressure from law enforcement and government suggestions that they do something besides pay claims. Most of those units were quite successful, winning major battles against arsonists. Insurance fraud is the same game with more and different players.

Executives listen to accountant staffs and accountants calculate dollars in vs. dollars out. How are they to know that the police are not riding to the rescue? How do they know how the criminals are thinking or operating? How many accountants or executives do you think ever heard of the "Gypsy," David Bollig and how he told of ripping off the companies for millions of dollars? If there is one failure of IASIU, it is the failure that has affected so many like minded organizations. It is the failure to communicate beyond our own boundaries.

IASIU is and for years has been the preeminent voice in fraud training and education. It has become the loudest voice in anti-fraud matters in the P/C industry. We know the problems. We know the tools of our trade. We know the economic impact. We know the players. What we do not know is how to communicate to the accountants and the upper executive level. For decades we have been talking but we have been talking to ourselves. If we wish to make an impact on fraud, we need to reach out and talk to the right people. The expense of insurance fraud is being paid by the premium payers, not the companies. That would be you and I and the hundreds of millions of people who pay for policies.

In fact, over the 18 years from birth of a child to high school graduation, the average family in the US will have paid enough for fraud alone to send that child to four years of college, tuition and fees paid! NICB calculates the cost is about \$30 billion per year. If you include health, workers comp and life insurance fraud, it is closer to \$130 billion. Sooner or later, the government will have to take a stand and mandate anti-fraud action.

I believe those companies that are honestly active early will see a reduction in fraud and a short term reduction in initial premium. They will also see a reduction in losses and a closer shot at an underwriting profit. A larger investment in SIU operations (at 7:1 ROI) is still a smart bet. Companies that pay serious attention to fighting fraud will be able to draw customers from those who pay and raise prices. In fact, the latest IRC report says the people who pay the premiums are looking harder at what companies do to fight fraud. They too are getting tired of seeing the bogus claims paid. Lower premiums draw larger customer bases and create better retention. And, after all, isn't that the name of the game?

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