

INSURANCE FRAUD

© 2010

Barry Zalma

Table of Contents

Introduction	4
Chapter I	Insurance Fraud. 13
Chapter II	Insurance. 21
Chapter III	Construction of Insurance Contracts..... 32
Chapter IV	Ethics & the Insurance Fraud Investigation..... 68
Chapter V	Soft Fraud..... 88
Chapter VI	Hard Fraud..... 95
Chapter VII	Fraud By Professionals 124
Chapter VIII	Third Party Liability Fraud. 152
Chapter IX	Property Insurance Fraud..... 158
Chapter X	Health Insurance Fraud. 164
Chapter XI	Insurance Fraud as A Crime..... 182
Chapter XII	Fraud Created by Legal Professionals. 210
Chapter XIII	Fraud In the Acquisition of Insurance. 217
Chapter XIV	Fraud in The Presentation of a Claim. 255
Chapter XV	Investigation of a Claim for Fortuity. 289
Chapter XVI	Investigating Fraud..... 303
Chapter XVII	The Crime of Insurance Fraud..... 337
Chapter XVIII	Insurance Fraud by Insurers..... 426
Chapter XIX	California SIU Regulations. 445
Chapter XX	The Claims Investigation..... 468
Chapter XXI	The Examination Under Oath. 510
Chapter XXII	Rescission – A Remedy That Stops Insurance Fraud. 582
Chapter XXIII	Insurance Fraud Statutes. 615
Chapter XXIV	Regulatory Response to Insurance Fraud..... 631
Chapter XXV	Investigating the Fraudulent Claim. 636
Appendix I	Insurance Fraud Statutes. 684
Appendix II	Outline for Training of Integral Anti-Fraud Personnel. 702
Appendix III	A Partial Examination Under Oath Transcript 712
The Author	Barry Zalma 718

Dedication

To every claims person, investigator, SIU investigator, police officer, NICB Special Agent, Fraud Bureau investigator, Fraud Division Investigator, Deputy Attorney General, Deputy District Attorney, Deputy States Attorney and Assistant U.S. Attorney involved in the attempt to decrease the extent of insurance fraud of all kinds.

Introduction

Insurance Fraud Is Epidemic

Insurance fraud continually takes more money each year than it did the last from the insurance buying public. Estimates of the extent of insurance fraud in the United States range from \$87 billion to \$300 every year.

In truth no one really knows the extent of insurance fraud because most frauds succeed without the insurer even suspecting that it is being defrauded. Insurers and government backed pseudo-insurers can only estimate the extent they lose to fraudulent claims. No one will ever place an exact number on the amount lost to insurance fraud but everyone who has looked at the issue know – in their heart and gut – that the number is enormous and that when insurers and governments put out effort to reduce the amount of insurance fraud the number of claims presented to insurers and the pseudo-insurers drops logarithmically.

Insurance fraud is not limited to the US. In Britain fraud costs the British economy amounts estimated as at least £14 billion in a report commissioned by the Association of Chief Police Officers (ACPO) published in March 2007.¹

Insurers will often complain that the local district attorneys and police agencies give a low priority to the crime of insurance fraud. Police and prosecutors complain that the insurers do nothing to defeat the crime. It is time that insurers, police and prosecutors stop complaining and do the work necessary to reduce the effectiveness of this metastasizing crime. If not, the logarithmic growth of fraud against insurers and government based programs like Medicare and Medicaid, will eat away any chance insurers – and their shareholders – have of making a profit and will make the tax burden insufferable.

Insurers have good reason to complain. They are universally ignored by police agencies when they report the crime. When insurance criminals are caught in the act they are seldom arrested, even less often prosecuted and almost never punished.

Police and prosecutors have good reason to complain because insurers are not equipped to perform an adequate criminal investigation. If prosecution of insurance fraud is to be successful it is necessary that insurers, prosecutors and police agencies work together as a team dedicated to defeat

¹ <http://www.endfraud.co.uk/>.

insurance fraud.

Some estimates indicate that more money goes out fighting fraud than is saved. Although insurance fraud is a crime in almost every jurisdiction in the United States, it is the only crime where the victim is required to perform the investigation from its funds and to pay special taxes to support investigation and prosecution by public agencies.

The California Department of Insurance, like similar agencies across the country, continues to add taxes on insurers and the insurance buying public to pay for the state's portion of the fight. Insurers are compelled by statute and Regulation to maintain Special Fraud Investigation Units, a detailed anti-fraud program and train all of their anti-fraud personnel. The Departments of Insurance audit insurers regularly to be sure that each insurer works hard to train its people to investigate and seek prosecution of the crime of insurance fraud. Failure to do so sufficiently allows the state Department of Insurance to fine the insurer for not doing the work traditionally the duty of the state to investigate and prosecute crime. In addition, adding insult to the injury, courts and juries assess punitive and exemplary damages against insurers who accuse their insured's of fraud because the immunity provisions of anti-fraud statutes are anemic.

Similar businesses in the financial sector, which are also regular victims of fraud and other crimes, are not taxed or compelled to investigate crimes committed against them. No one demands that a local or national bank pay for prosecuting embezzlers. No one demands that convenience store owners pay for prosecuting people who hold up 7-11 stores. No Regulator requires stockbrokers to investigate money laundering or fraudulent transactions. The imposition upon the insurance industry – and the attendant cost passed to the insurance consumer – is unique. Insurers are treated differently than all other businesses in the United States. George Orwell was right when, to paraphrase, he had a character in "Animal Farm" say, "all businesses are equal, some are more equal than others." Clearly, insurers are less equal with regard to crimes perpetrated against them than are other businesses.

Do Insurers Get Their Money's Worth From Fighting Fraud?

The simple answer is "yes." The more difficult question to answer is how to quantify the worth of fraud fighting.

The Coalition Against Insurance Fraud reported that:

- More than one of every three bodily-injury claims from car crashes involve fraud.

Insurance Research Council (1996)

- 17-20 cents of every dollar paid for bodily injury claims from auto policies involves fraud or claim buildup. Insurance Research Council (1996).
- Fraud adds \$5.2-\$6.3 billion to the auto premiums that policyholders pay each year. Insurance Research Council (1996)
- Claims for bodily injuries under the Personal Injury Protection portion of New York's no-fault auto coverage rose 79 percent between 1999 and 2000, compared to 25 percent in all no-fault states. Insurance Research Council (2001) Since then reports indicate that New York PIP losses are growing to an insufferable amount.
- Insurers increased auto premiums up to 25 percent for New York City in 2001. Insurance Information Institute (2001)
- The average PIP claim is \$7,950 in New York State — 47 percent higher than the national average. Insurance Information Institute (2001). Fraud costs each insured driver in New York State \$75-\$115 per year. Insurance Information Institute (2001)
- PIP claims in New York State rose nearly one third in 2000, more than twice as fast as second-place Florida. Insurance Information Institute (2001)
- The average PIP claim in New York State jumped 19 percent over the first nine months of 2000, and 64 percent between 1995 and 3Q 2000. This compares to a 33-percent increase for other states. Insurance Information Institute (2001)
- Auto insurers in New York pay out nearly twice as much in PIP claims as they collect in premiums. For every \$100 auto insurers received, they paid \$177 in claims through 3Q 2000. Insurance Information Institute (2001)

It also reports that:

- Criminal convictions increased 31 percent. Coalition Against Insurance Fraud (2004)
- Cases presented for prosecution rose 14 percent. Coalition Against Insurance Fraud (2004)
- Investigations initiated increased by nearly 18 percent. Coalition Against Insurance Fraud (2004)

- Referrals of suspected fraudulent actions were up 4.5 percent. Coalition Against Insurance Fraud (2004)

Arrests and Prosecutions

The Coalition reported that the Fraud Bureaus and Fraud Divisions in the various states are delivering record results in combating swindles, but the positive figures mask deeper weaknesses in some areas of performance. A study of 47 state agencies by the Coalition Against Insurance Fraud revealed that, for the most part, fraud fighters are priming the pipelines with fresh cases that could create a new generation of convictions in the years ahead. Still, the lack of growth in convictions and cases opened is a cause for concern, says the report. The study says arrests and convictions are up but on the downside, 18 fraud bureaus reported declines in convictions even though fraud convictions rose 6.4 percent overall.

The average docket of new cases also has stayed flat since 2001, the coalition's study says. New cases increased 6.4 percent overall mainly because two new units started feeding cases into the pipeline. Despite the clear warning signals, fraud bureaus are making progress and may be setting the stage for even stronger results over the next several years. "Convictions — the bottom line for fraud-fighting — thus may spike in the next few years as growing investigations mature into full-blown prosecutions," said Dennis Jay, the coalition's executive director. While the total cases presented for prosecution — 5,467 — rose 6.5 percent, most of the growth appears to come from newer fraud bureaus as their early cases wind through the pipeline. Fraud bureaus with dedicated prosecutors, such as Florida, had the largest growth in cases.

Convictions

California continues to convict more insurance swindlers than any other state — one of every three convictions in the U.S. The Golden State's fraud bureau logged a record 1,546 conviction, well ahead of runners up Florida (493), New York (450) and New Jersey (354). The report concludes "though fraud bureaus show encouraging gains on several important fronts, fraud fighters should be wary of too much celebration. The sobering truth is that America's fraud problem may be much larger than people realize..."

What Do The Results Really Show?

Insurance fraud prosecutions and investigations are anemic. What the reports does not tell is that most of those convicted were sentenced to probation. Few made full restitution and those who served

time were few and far between. Insurance criminals are laughing at the insurance industry, the police agencies, the Fraud Divisions and the prosecutors. If they are one of the few criminally convicted, they face an average sentence of only five years probation and 60 days in jail. Jail time is usually served on weekends so that the convicted fraud perpetrators can still ply their fraudulent trade on weekdays.

Fraud bureaus are not as effective as they want to be or want insurers to believe. Small percentages of those arrested are convicted and only a minuscule number of those reported by insurers are investigated by the prosecutors and police agencies.

Contrary to the belief of many prosecutors, even though people are seldom physically injured by insurance fraud, it is a major crime with a statutory maximum punishment in most of those states where it is a crime, of five years in state prison. In addition, staged auto accidents often result in real injuries and the death of innocent motorists not involved in the fraud. The amount of money is so massive that organized crime figures from every part of the world are joining into the crime with the usual vicious activities that organized crime brings to everything with which it is involved.

Specialists who know insurance and insurance fraud investigate it. It is, at least in California and those states that have a criminal insurance fraud statute, a rather simple crime to prove. It should be the type of case a prosecutor would want to file and try. Instead, as an ex-prosecutor said to me: “insurance fraud is a crime prosecutors run away from because the cases are usually heavy with documentary evidence and are complex.” Consider the public outcry if gangs of bank robbers took \$100 billion a year from banks in the U. S. every year. Would the public stand for groups of criminal stockbrokers looting their 401k and other pension plans? What would happen if a motorcycle gang went across the country and stole \$100 billion every year from convenience stores across the country? There would be a hue and cry for the heads of the police, prosecutors and police who failed to detect it. Yet, when the public is told that a group of criminals steals \$100 billion every year from the insurance industry the response is either a yawn or a cheer for the criminals who make Bernie Madoff, the Ponzi Schemer, seems an amateur.

I have heard the following from prosecutors to whom insurance fraud cases were presented:

“A confession on the record with five corroborating witnesses is not enough to support a fraud prosecution.”

“An insurance company can’t be a victim of a crime.”

“You have a good case but I don’t have time to prepare an indictment or take the case to a grand jury.”

“Juries don’t like insurance companies.”

“Are you bringing this case because you don’t want to pay a legitimate claim?”

“I don’t understand what the claimant did wrong.”

What Can Insurance People Do to Change The Statistics?

It is the obligation of all whose work is to protect insurers against insurance fraud to do something to change the situation. Methods that are available and that should be exercised by every person who wants to reduce the effect of insurance fraud include:

- ▶ Insurers should lobby local, state and federal police agencies to change the system so that:
 - All the insurance tax money must go to all kinds of insurance fraud at the discretion of the Commissioner of Insurance.
 - Prosecutors must be assigned to the Fraud Bureau or Fraud Division whose only job must be to prosecute insurance fraud.
 - When the local D.A. does not file a criminal complaint, the fraud investigator or lawyer for the insurer, must complain, loudly.
- ▶ Insurers and their staff should work within the system to:
 - Report every suspected fraudulent claim to the Fraud Division
 - Follow-up with the Fraud Division after you get the letter saying they won’t investigate.
 - Supplement the Suspected Fraudulent Claim (“SFC”) report with investigation results and transcripts of examinations under oath.
 - Develop a personal relationship with investigators at the Fraud Division.
 - Develop a personal relationship with supervising investigators at the Fraud Division.
 - When The Fraud Division refers a case to a prosecutor, determine the identity of the prosecutor and establish a relationship with the prosecutor.
 - Make it clear to the prosecutor that you represent an interested and proactive victim.
 - Make it clear to the prosecutor that your insurance company is upset that it is the

victim of a crime.

- Make it clear to the prosecutor that you will make available to him or her anything required as required by the law.
- Make it clear to the prosecutor that you, and other employees of the insurance company, will be available to testify at the trial of the insurance criminal.

If you are in California and sixty days go by after the case is referred to the D.A. demand compliance with the requirements of the California Insurance Code. California Insurance Code § 1872.4 that provides, in relevant part, as follows:

“ If prosecution by the district attorney concerned is not begun within 60 days of the receipt of the commissioner's report, the district attorney shall inform the commissioner and the insurer as to the reasons for the lack of prosecution regarding the reported violations.” [Italics added]

If you are not in California look for similar statutes in the state you are in or simply complain to the D.A. or State's Attorney. Remember, a prosecutor is a public servant who is obligated to work with and on behalf of the victim of the crime. As a victim of a crime the insurer has the right to speak with and complain to prosecutorial agencies.

The letter demanding an explanation for why prosecution has not been filed should go to the elected District Attorney and the Commissioner of Insurance. He or she will refer the letter for response to a head deputy. Often they will be ashamed to tell you that the only reason for the failure is that other cases always have priority over insurance fraud. The District Attorney of every county must be made aware that he or she is obligated to inform the insurance company victims why the crime is not being prosecuted. Enough letters, enough complaints, and insurance fraud will be recognized by prosecutors as a serious crime. It often takes the embarrassment of the individual prosecutor before it is possible to increase the number of prosecutions and the speed with which they are brought to trial.

It is also the obligation of everyone involved in the effort to hinder insurance fraud to obtain publicity to make the public at large aware of a problem of insurance fraud. To do so each person involved in the attempt to reduce the extent of insurance fraud can:

1. Write articles for your local newspapers.
2. Telephone local reporters and complain that they don't cover the crime.

3. Call talk-radio and explain the expense of insurance fraud.
4. Volunteer for your company's speaker's bureau and give talks on insurance fraud to every Rotary, Lions, BPOE or other service organization meeting.
5. Appear at the trial of every insurance fraud case.
6. Demand restitution when an insurance fraud perpetrator is convicted.
7. Refuse to pay fraudulent claims regardless of the costs of defense.
8. When sued by people who are believed to have presented fraudulent claims insist that the case be tried to a jury before any payment is made.

Remember Pogo who was reported to have said: "We Have Met The Enemy and They Is Us!" People involved in the business of insurance should do nothing to make the crime easier to succeed and do everything possible to defeat each attempt at insurance fraud.

To defeat insurance fraud it must be prosecuted. To get it prosecuted the insurer must do the work to complete a thorough investigation that can be presented to a prosecutor. Every person involved in the business of insurance must understand that insurance fraud is the orphan child of the criminal justice system. Insurance fraud will never be totally defeated. It will be reduced and be unprofitable to the perpetrators when the public and prosecutors recognize that insurance fraud is a serious problem that effects their own financial condition.

Everyone involved in the business of insurance and everyone who buys insurance must make it clear that they are angry with what is happening to their insurance premium dollar. When I, and everyone who has ever purchased a policy of insurance, hear that \$300 out of every \$1,000 we pay in premium goes to a criminal we should all want to scream out the window, as did the character in "Network" — "I'm mad as Hell, and I'm not going to take this any more!"

Knowledge of Insurance is Required to Adequately Investigate Insurance Fraud

Before insurance fraud can be understood, it is important to understand what insurance is and how it works. Politicians continue to misunderstand insurance. Insurance is not a right awarded by the Constitution to every resident of the United States. It is a contract between an insurer and a person or corporation called the insured. "Insurance is a contract whereby one undertakes to indemnify

another against loss, damage, or liability arising from a contingent or unknown event.”²

That is all insurance is: a contract.

It is a special type of contract where the insurer agrees to indemnify the insured against a loss, damage to property or liability as long as the event for which indemnity is ought is contingent or unknown at the time the insurance is acquired. A condition pre-existing the contract is not contingent or unknown. One should not be able to buy insurance against the fire loss of a home after it burns down. A person should not be able to buy medical care insurance to treat a cancer only after the cancer is diagnosed. Auto liability insurance purchased after an accident is not insurance and should not indemnify the insured for injuries caused.

Insurance fraud exists because its perpetrators wish to profit by failing to comply with the definition quoted above. Those who perpetrate insurance fraud intend to create the loss, damage or liability rather than join the pool of those who have no losses but wish to protect themselves against contingent or unknown events.

Because politicians and the public they serve do not understand what insurance is and what promises the insurers and insureds make to each other insurers are not liked. As a result, insurance fraud in North America and Europe is rampant and almost universally unpunished. Insurance fraud professionals who are engaged in the attempt to reduce insurance fraud have estimated that insurance fraud takes between \$87 billion and \$200 billion from the insurance buying public every year. Every year an additional \$100 to \$200 billion is stolen from Medicare and Medicaid programs across the United States.

It is the purpose of this book to provide information to those who are engaged in the effort to reduce insurance fraud. It will provide information for the lawyers representing insurers so that they can adequately advise their clients who are victims of the crime of insurance fraud. By including the full text of decisions from courts of appeal and supreme courts across the country the reader can understand what happens after the investigation is completed in order to better complete the investigation. The full text of appellate opinions dealing with insurance fraud and weapons available to insurers to defeat insurance fraud will give each person involved with information not available elsewhere. This book will also provide information for insurance claims investigators, special insurance fraud investigators working at insurance company Special Investigation Units (SIU), Fraud

² California Insurance Code § 22.

Bureau Investigators, and Prosecutors will have the information needed to allow prosecution of insurance criminals to proceed. Prosecutors will also have sufficient information to understand the importance of the crime and the need to reduce the crime by effective prosecution and punishment of the insurance fraud perpetrators.

Since the effort to reduce insurance fraud requires the assistance of courts – both civil and criminal – the prudent fraud investigator, insurance adjuster, insurance attorney or insurance Special Investigation Units, and insurance management will have the information to deal with state investigators and prosecutors. It is also necessary to read the full text of decisions of the courts of appeal to fully understand the facts gathered by the investigators and prosecutors.

This book includes the full text of important or informative decisions that should be read in full so that those involved in trying to defeat fraudulent claims can be aware of what courts look at after a suspected fraudulent claim is denied.