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Book Review

Tackling Insurance Fraud: Law and Practice, by Dexter Morse and Lynne Skajaa, Informa Professional, London, UK.

Reviewed by Richard A. Derrig,[1] OPAL Consulting LLC

This volume bills itself as one of a series of *Practical Insurance Guides*, along with others such as *Insurance Disputes*, *Good Faith and Insurance*, and *Marine Insurance* all with an emphasis on law. Informa Professional is the publisher of a London insurance daily *Insurance Day* and a purveyor of conferences (Reinsurance Summit 2006), training courses (none listed yet), and distance learning (masters degrees in various law fields, such as EU law, food law and employment law, and with various universities) as shown on their Website (www.informalaw.com). Informa's interests appear to be principally legal (247 products, 27 in insurance and banking, and 73 in maritime law). This volume fits into the insurance and banking law category.

The authors are both accomplished lawyers in the UK, Dexter Morse with a reinsurer and Lynne Skajaa with several law firms dealing with maritime issues and with the University of Southampton. As you would suspect the book deals with insurance fraud with a decidedly legalistic point of view. Although the fraud coverage is primarily from a UK perspective, the authors present some universal concepts such as "What is insurance fraud?" and "Who is the typical fraudster?" and contrast the UK experience with the United States, Canada, Australia, New Zealand, South Africa, and European efforts in some 34 of the book's 158 pages.

You will not find theoretical models of behavior, with underlying subjective probabilistic models of outcomes favorable to the fraudsters, but you will find a discussion of both the problem of insurance fraud and details about the means of detection, deterrence, and prosecution, all in a readable and well sequenced set of chapters.

Chapter 1 begins by exposing a worldwide problem for combating insurance fraud found also in the UK, namely, the absence of specific statutes that deal explicitly with insurance fraud. The authors cite relevant sections of the Theft Act of 1968, and subsequent case law that cover deception and dishonesty in obtaining property (claim settlement), in gaining a pecuniary advantage (policy coverage) and in falsifying accounts (large scale fraud). The Theft Act, updated in 1996 to include banking but not insurance transactions, provides the analogs to the use in the United States of larceny and mail fraud statutes to prosecute insurance fraud prior to recent state-by-state adoption of laws, some by line of insurance, specifying penalties for insurance fraud per se. Case law and the Perjury Act of 1911 are also cited for their usefulness in rounding out the legal environment in the UK.

[1] Richard A. Derrig Ph.D., CFE was instrumental in establishing the Insurance Fraud Bureau of Massachusetts in 1990, served as Vice President for Research until his retirement in 2004, and continues to serve as a Senior Consultant. Current activities can be found at www.derrig.com.

Typical fraudsters are categorized in Chapter 2 into three categories: The average insured succumbing to what we call "opportunistic fraud," the full or part-time criminal, and organized gangs, all motivated by greed, financial difficulty, or a sense of recovering premiums not paid out in claims. There does not seem to be a category that covers professional providers such as doctors and lawyers who facilitate fraud in the guise of legitimate claims[2] or a category for those who create phony insurers or loot existing companies of their assets. Thus the focus of the book is the retail aspect of application and claim fraud. Chapter 3 reviews so-called fraud indicators, those yes–no objective and subjective statements about the circumstances surrounding the filing of a claim such as "The insured is very knowledgeable about insurance terms and claims procedures." Such indicators may be specific to line of business, especially property or motor lines.[3] Chapter 4 confronts the problem of separating criminal fraud from civil "fraud," the latter being unethical practices, at least in someone's eyes, known colloquially as "soft" fraud. The authors properly view the distinction in terms of contract law and resolution of contract disputes. Chapters 5 and 6 apply the general legal analysis to their specific interests in marine and reinsurance lines of insurance.

Chapter 7 is devoted to the UK industry's response in general to the problem of insurance fraud. After discussing a sequence of studies that report large amounts of claims and pounds that are deemed fraud of one sort or another, the authors list some of the more important developments by UK insurers to combat this perceived problem (beyond good claim adjusting and investigation). A Serious Crime Bureau (2004) organized by the UK government and the Association of British Insurers (ABI) Crime and Fraud Prevention Bureau (1995) and their "cheatline," police liaison activity, publicity campaigns about insurance fraud to change public attitudes about the supposed victimless crime, and, most importantly, the establishment of fraud prevention databases described in summary format. Insurer's own initiatives include internal fraud units, claim screening systems, including the Highway Insurance voice stress analysis system. Chapter 8 briefly covers a few recent developments in the claims handling and legal arenas. Call centers, claim cash cards, preferred provider repair facilities with auditing, and the use of the Internet all are discussed in terms of claims handling whereas shortened time frames for claim investigation (Woolf Reforms) and database privacy protections frame the legal changes.

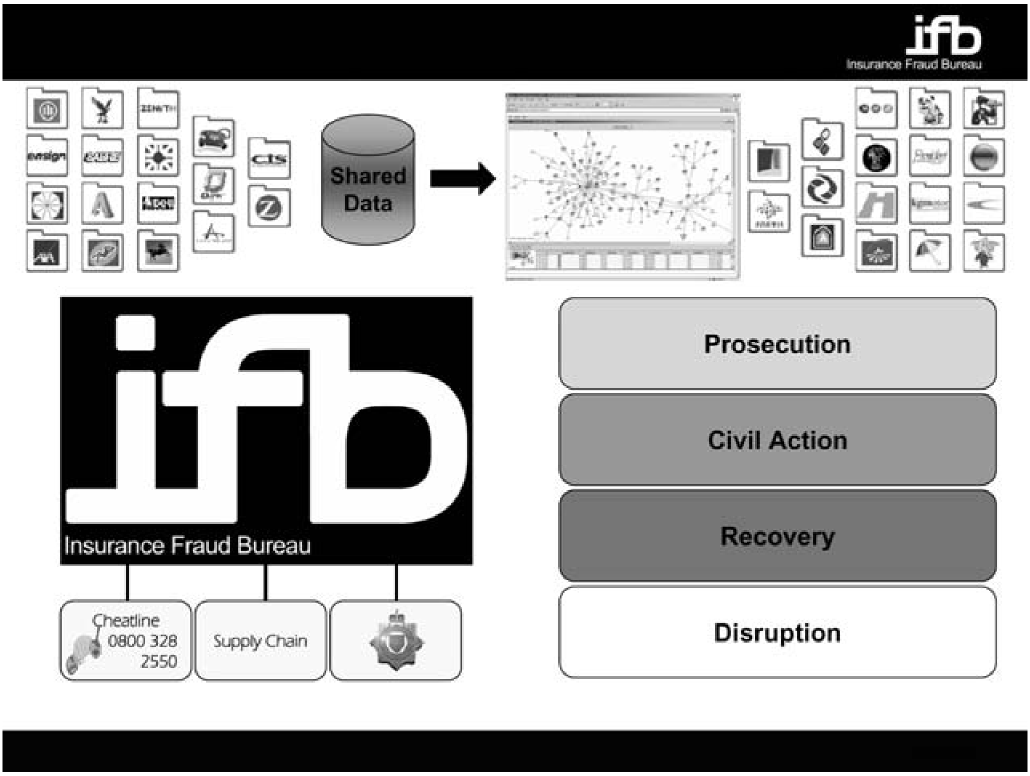
A particularly informative diagram of the current structure of the UK insurers' "new world" is presented by Richard Davies, Fraud Risk Manager for AXA UK and Deputy Chair of Insurance Fraud Bureau, in a September 2006 ABI Conference session on Motor Insurance,[4] *The Fight Against Fraud: Are We on the Way to Victory?* Davies portrays UK motor insurance fraud, the majority of which is opportunistic fraud in line with the U.S. experience, and the central role to be played by shared databases, the cheatline, and

[2] See, for example, Derrig, R. A., Johnston, D. J., and Sprinkel, E., 2006, Auto Insurance Fraud: Measurements and Efforts to Combat It, *Risk Management and Insurance Review*, 9: 109-130.

[3] Fraud indicators and other variables are the inputs to recent attempts at predictive modeling for identifying fraudulent claims. See, for example, Viaene, S., Derrig, R. A., and Dedene, G., 2004, Cost-Sensitive Learning and Decision Making for Massachusetts PIP Claim Fraud Data, *International Journal of Intelligence Systems*, 19: 1197-1215.

[4] The full PowerPoint show can be found at www.abi.org.uk/Display/File/Child/646/Richard_Davies.pdf.

an Insurance Fraud Bureau, all working toward prosecution, civil action, recovery (of stolen funds), and disruption (of the fraudsters).



Short summaries of insurance fraud fighting in other countries fill Chapter 9. The U.S. experience dominates the discussion because, as the authors observe, "The US identified the problem of insurance fraud at a relatively early stage and was quick to act," beginning with the establishment of the Florida Division of Insurance Fraud within the Insurance Department in 1976. Several U.S. state fraud bureau histories are covered with the first being the Massachusetts Fraud Bureau because "in view of the fact that Massachusetts is such a success story in this field, it is worth examining this State Fraud Insurance Bureau first to see why this might be the case." This reviewer, with an obvious conflict of interest, agrees. Beginning from the authors' legalistic perspective, the Massachusetts record of 42 percent of insurance fraud convictions receiving jail time[5] appears to define their view of success, although they cite the use of an extensive database on auto injury claims (DCD) and access to prosecutors as two of the keys to that success. Other databases, notably those of the Insurance Services Offices (ISO), and their use by Allstate and others to pursue civil suits for both hard and soft fraud, as well as forming the inputs to

[5] Derrig, R. A., and Zicko, V., 2002, Prosecuting Insurance Fraud—A Case Study of Massachusetts in the 1990s, *Risk Management and Insurance Review*, 5: 77-104.

predictive modeling or scoring systems are covered. Canadian efforts are surveyed citing the Canadian Coalition Against Insurance Fraud and the Manitoba Public Insurance among others. Of the remaining country efforts, New Zealand is complimented for its National Claims Database (ICR) whereas the EU initiatives of Comite Europeen des Assurances (CEA) for 25 countries has problems coping with many different types of fraud data from its members. The lesson from this quick trip around the insurance world is that fraud is perceived as a large financial enterprise and that motor insurance may be the single most affected line.

Accepting that insurance fraud is a "quiet catastrophe," the authors take the position in the introduction that companies do not devote resources commensurate with the problem as they grow larger through mergers: "establishing fraud handling units, but these are often underfunded and understaffed." The conclusions section offers a well worn laundry list of desirable changes for British (or any) insurers: establish an antifraud bureau, perhaps facilitated by the ABI, to coordinate across insurers; publicize insurance fraud as a crime, prosecutions by insurers with tougher penalties; initiate closer work with police and brokers; establish in house fraud units or special investigative units (SIUs) as they are known elsewhere; and provide anti fraud warnings on claim forms. The authors report that insurers are of the universal opinion that fraud can only be handled on an industry basis with a full industry wide database as called for at an industry conference in 2000. The summary of the current UK fraud situation by Richard Davies cited above appears to say that insurers are well on their way to knowing what to do with the means established to accomplish the prosecution objectives of this book. One wonders what the progression toward these changes has been in the EU generally, given that the unregulated market economics, prevalent in the UK and elsewhere, may not support such efforts without many free riders.

Source materials are documented in four separate sections, two on legal cases and legislation (with page references) and two in a bibliography of books, mostly legal, and articles from newspapers, magazines, and Websites (without page references). Citations to the developing academic insurance fraud literature in the *Journal of Risk and Insurance*, *Risk Management and Insurance Review* and elsewhere are not included. The 12 page index is quite helpful.