Insurance Fraud: What Are the Costs?

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Insurance fraud has been around as long as insurance has existed. From organized fakers that would slip on banana peels conning money from the railroads in the 19th century, to people claiming whiplash in car accidents (Dornstein, 1996, as cited in Derrig, 2002). Insurance fraud has become a significant issue in the insurance world. When people make false claims it costs the insurance company money. The insurers will not absorb this cost instead, they will pass the cost to the policyholders in the form of higher premium rates (Viaene & Dedene, 2004). Fraud makes up ten percent of the losses incurred by the property-casualty insurance industry. Fraud affects everyone from the top insurance company to the smallest policyholder. The question is though, what are the cost of these insurance frauds?

Insurance Fraud

Before talk of the cost can begin, the concept of insurance fraud must first be understood. Insurance fraud is any deliberate deception committed against an insurer or an insurance producer for the purpose of unwarranted financial gain (Popow, 2012). Most authorities agree that fraud occurs when the following conditions are met: presence of material misrepresentation, intent to deceive, and an aim of gaining an unauthorized benefit (Viaene & Dedene, 2004). Fraud can be a staged accident, remitting receipts for treatment not given, faked injury, etc. (Derrig, 2002). Some consumers will even try to get back the money they paid in premiums along with their claim amount (Popow, 2012). This is known as padding.

Most people think that insurance fraud only happens in the claims process. Popow stated, "It can occur during the process of buying, selling, or underwriting insurance, or making a claim" (2012, p. 6.5). If an insured knows of a pre-existing heart condition but withholds that information from the insurer, this would be fraud during underwriting process. The material misrepresentation is the heart condition not disclosed to the insurer. There is obvious intent to deceive because the insured intentionally did not tell the insurer about the pre-existing condition. The insured also aimed for the benefit of an unauthorized lower premium.

Insurance fraud can also be committed by any person that is involved in the insurance transaction or in a claim (Popow, 2012). Insureds, claimants, doctors, lawyers, mechanics, even claim representatives can all commit insurance fraud.

"Some auto repair shops may increase charges to insurers in order to waive the deductible for the insured" (Tennyson, 2008, p. 1184). Some auto repair shops will tell the insurance company that repairs cost more than they really do. The insurance company will pay for the increased bill. The auto repair shops will then keep what it actually cost to repair the car and a little bit more for their trouble. The rest is then passed on to the insured; and they not only get their claim paid, but also any money they lost in paying the deductible.

Insurer Cost

"The insurance industry consists of more than 7,000 companies that collect over $1 trillion in premiums each year" (Federal Bureau of Investigation, n.d.). About 10% of the insurance losses and loss adjustment expenses each year are because of fraud (Coalition Against Insurance Fraud, 2015).

"Fraud steals $80 billion a year across all lines of insurance" (Coalition Against Insurance Fraud, 2015). Non-health insurance fraud is estimated to make up more than $40 billion per year (Federal Bureau of Investigation, n.d.); and according to the Insurance Information Institute (2015), "Property-casualty fraud equals about $32 billion each year" (as cited in Coalition Against Insurance Fraud, 2015). According to the 2016-2018 Executive Budget General Fund Summary, eighty billion dollars would run the Commonwealth of

Kentucky for about eight years (Office of State Budget Director, 2016). The amount that fraud steals from insurance companies could run a whole state for eight years.

Insured Cost

Insurance fraud cost does not stop at the insurer. Insurers pass on their extra cost to insureds in the form of higher premiums. "Insurance fraud costs the average U.S. family between $400 and $700 per year in the form of increased premiums" (Federal Bureau of Investigation, n.d.). Premiums are not the only costs that have increased because of fraud. Out of pocket maximums and deductibles have also increased. According to the Kentucky Employees' Health Plan, a single, non-smoking, Kentucky state employee has a deductible of $500 and a maximum out of pocket expense of $2,500 for $79.98 per month in 2016 (2015). Equivalent coverage in 2013 cost a single employee $30.88 per month (Kentucky Employees' Health Plan, 2012). Some of this increase in price can be attributed to higher cost of medicine, but most of this increase will be because of fraud. Not only are insureds paying more to get and keep insurance in the form of premiums, but they are also paying more once they have the insurance in the form of higher deductibles and higher maximum out-of-pocket expenses.

Auto Insurance

"Automobile claim fraud and buildup added $5.6 billion-$7.7 billion in excess payments to auto-injury claims paid in the U.S. in 2012" (Coalition Against Insurance Fraud, 2015). Excess payments represent 13-17 percent of total payments under private-passenger auto injury insurance (Coalition Against Insurance Fraud, 2015). Padded claims account for 15 percent of dollars paid for BI and PIP claims in 2012 (Coalition Against Insurance Fraud, 2015).

"The adjuster typically believes that few people cut false claims from whole cloth, but that nearly everyone exaggerates his loss" (Derrig, 2002, p.272). In the case of auto insurance most people really do have some form of legitimate claim. It is just the amount of claim that comes into question. "The average two-car family in Florida pays nearly $100 more in auto premiums thanks to no-fault scams" (Coalition Against Insurance Fraud, 2015). People will try to get damage paid for that was always there, or claim to have injuries that do not happen. Soft tissue damages are hard to substantiate and can be an easy way for people to receive more money on their claims.

Arson

According to WKYT, a married couple from Lexington, Kentucky, was arrested for purposely setting a home on fire last May. The home was built by Habitat for Humanity and evidence collected indicated that the couple wanted to burn the home down to collect the insurance money (2016)

"Insurance fraud was suspected in 8 percent of intentional fires" (Coalition Against Insurance Fraud, 2015). 9,100 intentional fires were set in 2014 and caused $190.3 million in losses (Coalition Against Insurance Fraud, 2015).

Fraud like this costs many people money and time. In 2014, the Louisville Metro Arson Squad was called out on 620 runs. The 10 person squad solves around 35% of the arsons they investigate which is well above the national average for similar cities of 17% (WDRB, 2015). This arson squad, and many like it, spend their days fighting arson on the tax payers' dime. Now not only is money being stolen in the form of higher insurance costs, but also in the form of higher taxes.

Fighting Fraud

One cost that is not usually taken into account with respect to fraud is the cost of fighting fraud. Groups such as the National Health Care Anti-Fraud Association, Coalition against

Insurance Fraud, National Insurance Crime Bureau, etc. were all formed to fight fraud. "41 states and the District of Columbia have a fraud bureau" (Coalition Against Insurance Fraud, 2015). With the cost of fraud being enough to run a state for eight years, it is no wonder so many bureaus and associations striving to bring the cost down.

"In some cases claims investigation is not a solution because its cost is prohibitive" (Tennyson, 2008, p.1189). "Transaction costs of policing fraud are also high, taking into account both the resource expenditures of insurance companies and the costs of legal enforcement" (Tennyson, 2008). It costs money to hire experts, send out claims adjusters, and prosecute each and every fraudulent claim. It can sometimes cost the insurance companies less money to just settle a claim than it would to fight it. Insurance companies resist settling questionable claims though because settling would only increase the incentive for fraud.

Fraud bureaus step in to help investigate and prosecute the fraudulent claims that the insurance company may not have the time or the resources to do themselves. "32 states have enacted laws that classify insurance fraud as a felony, according to the Insurance Information Institute" (as cited in Blakely, 1998). Sixteen states do not define fraud as a crime, and some states have statutes that are so vague that they are not very effective, according to the Insurance Information Institute (as cited in Blakely, 1998). As more bureaus are added to help fight fraud, more government employees will be hired to run the bureaus. Government employees are paid for by taxpayers; therefore, the more insurance fraud there is to fight, the more everyone is losing.

Fraud breaks down trust between the insurer and the insured. "Attempts to prevent fraud create contractual restrictions for all consumers that lead to less protection from risks than would occur in a market without fraud" (Tennyson, 2008, p. 1182). The more fraudulent claims a company pays, the stricter they become with who they insure. They will be less willing to take on risky insureds and will charge insureds higher premiums to not only cover their current losses but also to cover their potential fraud losses. Their contracts will also be much more defined. As people attempt to cheat them out of money they will start to spell out coverages very specifically to reduce fraud.

Conclusion

Insurance fraud can not be ignored. Most people think that insurance fraud is not big deal and it is not hurting anyone, except maybe the insurance companies. Insurance fraud hurts everyone. Fraud hurts the insurers who have to pay for fraudulent claims. It hurts the insureds who will have to pay higher insurance costs. It hurts the taxpayers because insurance fraud also increases taxes. According to the Coalition Against Insurance Fraud, each household in America pays an additional $1,000 in higher insurance premiums and taxes every year because of fraud (as cited in Popow, 2012). Insurance fraud has become a huge issue that is costing people more than higher insurance prices.

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