

House Insurance Committee and
Subcommittee on Crime & Corrections
of the
House Judiciary Committee



Insurance Fraud

Tuesday, August 29, 2006
10:00 a.m.

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Pennsylvania Insurance Department
Commonwealth of Pennsylvania

Good morning. My name is Ron Gallagher and I serve as the Insurance Department's Deputy Insurance Commissioner for Consumer and Producer Services. I have with me here today Mr. Ralph Burnham, our chief investigator for the Department's Special Investigative Unit. Mr. Burnham also heads our Anti-Fraud Compliance Division.

I want to thank the Chairmen of the two committees, Rep. Godshall and other distinguished members of the House Insurance Committee and the House Judiciary Committee, Subcommittee on Crime and Corrections, for giving the Department the opportunity to offer information and to respond to questions that you may have on today's topic.

You could say that the Consumer Services operation with three field offices in the Philadelphia, Harrisburg and Pittsburgh areas serve, in part, as the Insurance Department's "eyes and ears" to the insurance market place - while these operations, by analogy, may play the role of "Miss Marple" in dealing with the world of insurance fraud - as I deal with consumers who are many times our first source of complaint information - Ralph is our Sherlock Holmes. He is always hungry for more information and seeks to uncover things that might give ammunition for enforcement actions, recovery or appropriate referral to the Attorney General for criminal sanctions.

It is my hope that between us - we can give a proper overview of insurance fraud in Pennsylvania and our efforts to combat it, as well as, to answer any specific questions you might have as you consider the proposed legislation.

Before I delve into the specific activities of the Department related to combating insurance fraud, I want to provide some interesting facts about Pennsylvania's Insurance market place. The Insurance Department, with its 370 employees involved in regulating the industry, is singularly focused on consumer protection. This is a daunting task when you consider that Pennsylvania's marketplace for the sale of insurance products tops almost \$71 billion annually among 1700 carriers, over 140,000 producers and an additional 20,000 other individuals involved in the insurance marketplace. This premium value makes Pennsylvania 5th in the nation based on premium dollar but more interestingly 13th internationally. I give you these numbers because they specifically represent the reason why insurance fraud occurs - there is a lot of money involved.

The Insurance Department's work includes licensing new insurance carriers, reviewing and approving certain types of the insurance policies and rates, licensing producers, formerly referred to as agents and brokers, and other individuals involved in the insurance market place, who are the touch points to our citizens, and the important monitoring of market place activities through our complaint and market conduct and enforcement investigations.

Our Office of Insurance Consumer Liaison coupled with the Consumer Services Offices are focused on educating consumers so they can make informed decisions. We

like to say that "education is a consumer's best policy." We have developed information available on the Department's web site - www.ins.state.pa.us - to assist consumers in better understanding insurance. In addition, we have developed a newsletter to assist consumers on a broad range of topics dealing with insurance issues. Though the newsletter is available on the website, I have copies of it available with me today - both in English and in Spanish. Please watch our website for a future edition focused on insurance fraud.

Insurance fraud robs the state's economy of possibly millions of dollars every year. While we cannot immediately quantify the value of insurance fraud in Pennsylvania— we certainly do know that fraud is not a victimless crime – it costs all of us through increased premiums. We applaud your efforts to focus more attention on this important issue.

Insurance fraud occurs when people deceive an insurance company or agent to collect money to which they are not entitled. Insurance fraud can be "hard" or "soft." It can be a deliberate scheme or a little white lie. Regardless, the Department will continue to work with our Fraud Bureau, other state Insurance Departments and our regulated industry to change an attitude that fraud is just a cost of doing business.

Fraud is unacceptable – plain and simple. It is against the law, and if you engage in insurance fraud of any kind, and are caught, there are very serious consequences. We are very serious and we mean business.

Most recently, the Department has been participating in a "Stop, Call, and Confirm" public service announcement (PSA) campaign to combat fake insurance. Insurance Commissioner Koken has distributed a PSA encouraging consumers to contact the Department before signing any insurance documents to make sure consumers are dealing with a legitimate licensed company. I want to take the opportunity now to share with you that PSA. (*Play PSA.*)

These TV PSAs and accompanying radio PSAs were delivered just this week to media outlets across the state.

In addition to the rise of fake insurance – we have also identified fraudulent activities with applicants for insurance, policyholders, as well as third-party claimants and professionals who provide services to claimants.

Nationally, it has been estimated that property/casualty insurance fraud cost insurers about \$30 billion in 2004. Estimates skyrocket to almost \$100 billion annually when life and health insurance fraud are added in.

While fraud, as you know, may be committed at different points in the insurance transaction by different parties, common types of fraud include "padding," or inflating actual claims; misrepresenting facts on an insurance application; submitting claims for injuries or damage that never occurred; and "staging" accidents.

Pennsylvania is one of about 40 states which have set up separate fraud bureaus. Our state Insurance Fraud Prevention Authority and these other state fraud bureaus are reporting a record number of new investigations and significant increases in referrals, tips about suspected fraud and cases brought to prosecution.

In addition, as part of the recent allegations concerning inappropriate insurance broker activity, we assisted the National Association of Insurance Commissioners, better known as the NAIC, in efforts to increase awareness on this issue.

Commissioner Koken was serving as the NAIC president at the time of these allegations. As part of a three-pronged approach to this issue, the NAIC created a special web site that went live in January 2005 for reporting potential fraud and that serves as a national broker fraud clearinghouse with information that could be transmitted to the appropriate state regulator for handling. With this initiative, consumers had the immediate means to report suspected fraud at anytime.

The Pennsylvania Insurance Department has received numerous grants from the Insurance Fraud Prevention Authority (IFPA). These grants have enabled the Department's Anti-Fraud Compliance Division to enhance its fraud-fighting efforts. These efforts have had an undeniable impact on reducing insurance fraud in the Commonwealth of Pennsylvania. We are committed to continuing these efforts and are grateful to the IFPA for these grants. These grants funded the Department's Anti-fraud Compliance Division and enable us to continue to work with every facet of the insurance business in our state, including consumers, insurance companies, insurance producers, professional insurance groups, and all law enforcement agencies to assure that everyone understands insurance fraud is a crime.

The Department's Anti-Fraud Compliance Division has worked closely with Pennsylvania's motor vehicle and workers' compensation insurers to produce a best practices report on Pennsylvania's anti-fraud effort. This report is available to consumers, to law enforcement agencies and to you on the Department's web site. The Department's Anti-Fraud Compliance Division was instrumental in bringing about the department's joining with the IFPA for production of a first-ever, all lines summit meeting on the subject of insurance fraud. The division has also worked extensively with our more than 1,700 licensed insurers to obtain up-to-date information on benchmarking and reporting insurance fraud.

Insurers, too, can be in denial about how fraud impacts their bottom line. It is our job also to educate them about the value of fraud plans and how they can be effective. We emphasize training and the sharing of information in our ongoing efforts to combat.

In response, a growing number of insurers have begun to implement sophisticated fraud detection tools to support manual methods. Fraud management technology that uses predictive modeling to identify suspicious claims can accurately cull out high-risk claims and identify them earlier. It not only makes it practical for insurers as they process and

close claims faster, it also focuses the adjuster's review on claims that require the most attention. Importantly, it provides higher quality referrals to investigative units.

And that is very critical – the quality of the information gathered. Even Sherlock Holmes cannot make a case unless the fact-finding is complete and the case is tightly pulled together. I am sure any criminal agency which might address you will say it does not take fraud cases with a lot of missing details. It is just too costly and time consuming to pursue. So our job, and that of the industry, is to tee up fraud cases as best we can – that takes time, tools and talent. But we are seeing the value in focusing those resources on fraud.

Motor vehicle and workers' compensation insurers annually provide the Department of Insurance a statistical reporting of antifraud activity for the prior year (75 Pa. C.S. §1814 and 77 P.S. §1040.4).

A summary of the past four years of reporting shows an increased reporting of suspected insurance fraud to criminal law enforcement authorities, increasing investment in antifraud programs and a decrease in identified fraud. Reports and antifraud plans of individual insurers are filed with the department.

The most current data reported by the industry to the Department demonstrates an increase in the number of reports of suspected fraud to law enforcement authorities and, at the same time, a decline in amount of fraud identified. As you can see from the chart in this testimony, the number of reports of suspected fraud has increased from 954 in 2002 to 1,619 in 2005, a 70% increase, while at the same time the amount of fraud identified as declined from \$68,552,441 in 2002 to \$64,716,267 in 2005. You can also see that over this same time period, the industry reports an increase in resources used to combat fraud starting with \$21,949,798 in 2002 to \$36,621,874 in 2005, a 67% increase in expenditures directed at fighting fraud.

Calendar Year	Reports of Suspected Fraud to Law Enforcement Authorities	Program Cost	Fraud Identified
2005	1,619	\$ 36,621,874	\$ 64,716,267
2004	1,556	\$ 30,372,933	\$ 71,108,541
2003	1,478	\$ 28,605,457	\$ 74,883,954
2002	954	\$ 21,949,798	\$ 68,552,441
Average	1,402	\$29,387,516	\$69,815,301

In addition to detecting fraud, we want to assist the IFPA in changing attitudes so that people know insurance fraud is against the law and has serious consequences. Changing someone's mind - how they think - is hard enough - but changing attitudes - how someone really feels - now that can be really tough. Attitudinal changes take time and require a very deliberate approach. You have to get to the very core of someone's values or belief systems. The IFPA's communication campaign shows that fraud is not a mischievous act - it is criminal - pure and simple. You may be familiar with this campaign which uses television commercial and roadside bill boards to convey the message.

According to independent research conducted by the IFPA, Pennsylvanians' attitudes about fraudulent activity in several types of insurance are changing - in large measure due to the communications strategies put in place by the Insurance Fraud Prevention Authority.

- Workers' compensation: In 1997, 25.3 percent of Pennsylvanians said they would be willing to receive bogus workers' compensation payments. By 1999, that number had dropped to 15.9 percent.
- Auto insurance: The number of Pennsylvanians willing to inflate an auto accident claim fell dramatically, from 12.5 percent in 1997 to just 5.5 percent 1999.
- Medical insurance: In 1999, nearly 80 percent of Pennsylvanians said they review their medical bills for accuracy. In 1997, that number was just 70.5 percent.

The Insurance Department's newly created Office of Consumer Liaison includes information about insurance fraud at its outreach activities. In addition, the on-line newsletter encourages consumers to check their medical bills. The Office has held events in conjunction with other agencies, Chambers of Commerce, advocacy groups and legislators, in addition to hosting educational sessions on Medicare Part D and Fraud Prevention.

Detection and Prevention - not only is relevant for dealing illnesses, such as with cancer, but it also is applicable to fraud. We will continue our work to educate consumers, encourage the industry to develop robust fraud plans and work with law enforcement agencies to prosecute cases of fraud, with the overarching goal of detection and prevention.

I would be happy to entertain any questions you may have.