

Challenges in fighting insurance fraud and the value of Special Investigative Unit outsourcing



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Introduction

Insurance fraud has likely existed in the U.S. from the time the first insurance company, the Friendly Society, opened its doors in 1732 in Charles Town (now Charleston), South Carolina. Today, however, the problem has escalated to an alarming magnitude. Insurance fraud is the second largest economic crime in the U.S. after tax evasion, according to the National Insurance Crime Bureau (NICB).¹

While some perceive insurance fraud as a "victimless" crime, its impact on society is far reaching, costing not only insurers but also consumers billions of dollars every year.

According to research firm Conning & Company, insurance fraud cost consumers \$96.2 billion in higher premiums in 1999 and more than \$530 million in higher prices for good and services.² It estimates that all types of insurance fraud cost the average American household nearly \$5,000 a year in the form of higher premiums and higher cost of goods and services.³

Insurance fraud has proliferated in the U.S. because of the myriad challenges insurers face in fighting it. Despite these challenges, however, insurers have become increasingly proactive in implementing anti-fraud programs. Many of these programs involve the establishment of Special Investigative Units (SIUs) to detect and investigate fraudulent claims. How these units are run varies—some insurers keep them in house while others outsource them. This paper explores the benefits of outsourcing SIU functions in terms of both preventing fraud and improving bottom line performance.

Challenges in fighting fraud

Combating fraud is an uphill battle. Stung by staggering fraud-related losses, insurers readily acknowledge the seriousness of fraud and their responsibility to take the offensive in eradicating it. Their anti-fraud efforts, however, are often stymied by enormous challenges on all battlefronts.

Public tolerance.

Research shows that a high percentage of people believe some forms of insurance fraud are acceptable. Surveys, for example, reveal that as many as one in four adults think it is okay to exaggerate a claim. Common justifications include making up for a deductible or making up for paid premiums when no claims were filed. A negative perception of insurance companies is partly to blame for the public's tolerance of fraud. According to the Coalition Against Fraud, two out of five people blame unfair insurers for the fraud crisis and two out of three believe premiums would continue to increase regardless of fraud.⁴

Costs and risks of fighting.

Fighting fraud is a very expensive proposition for insurers. Trained investigators are required to properly identify and investigate suspicious claims, resulting in high costs for salaries, benefits and job-related expenses. Insurers must also invest in fraud investigation tools and technologies, which are rapidly evolving. From a cost-benefit perspective, many insurers, especially small to mid-size companies, take the view that it is cheaper to pay fraudulent claims than to investigate them. Insurers also run the risk of liability for bad-faith lawsuits for failing to pay suspicious claims.

Elusive and sophisticated criminals.

Fraud perpetrators vary widely in age, income, occupation, race, religion and other demographic and psychological attributes, making them difficult to categorize. In addition, their profiles closely mirror those of honest citizens: they hold jobs (many in highly respected professions), are married with children, have higher educations, volunteer in the community, regularly attend church, etc. These criminals are also becoming increasingly sophisticated in their methods, devising more complicated fraud schemes and taking

advantage of technology, such as the Internet. Insurers face an ongoing challenge in keeping up with the latest swindles and guarding against them

Lax legal enforcement.

While most states have insurance fraud laws, there is widespread criticism that existing laws are not tough enough. In addition, insurance fraud is often a low priority for prosecutors because it is difficult to prove and competes for resources with violent and higher profile white-collar crimes. As a result, crooks view the risk of being caught and facing hard jail time for insurance fraud as minimal. In addition, while most states have fraud bureaus that investigate cases, the effectiveness of these bureaus varies widely based on their size, funding, priorities and methods.

SIU trends and types

Insurance fraud took a back seat to other pressing business issues in the insurance industry until the 1980s. Prior to then, insurers were preoccupied with the threat of inflation, the rising cost of personal injury claims and skyrocketing operating expenses due to inefficiencies and productivity lags. Higher premiums and the resulting public backlash coupled with the growth in organized fraud rings, however, moved the problem of insurance fraud up on the list of insurers' priorities.

Insurance companies began to lobby for stronger anti-fraud legislation and tougher law enforcement. They also invested in their own anti-fraud initiatives, including SIUs to investigate and crack down on fraud. Before the 80s, few insurers had SIUs but, by the 90s, a majority of companies had them.

Increasing awareness of the high cost of fraud to the public also motivated state legislators to get involved in the fight against fraud. Today, most states have passed laws that specifically define insurance fraud as a crime and make it a felony as opposed to a misdemeanor. Laws have also been enacted to increase monetary penalties and set prison sentences. In addition, most states have established fraud bureaus and imposed anti-fraud requirements on insurers. In general, these requirements cover fraud plans, mandatory reporting, fraud warnings, auto inspections and SIUs. SIUs are no longer an option for most insurers: they are now a legal mandate in 38 states.

Today, insurers cite fraud deterrence as their number one priority and SIUs are the key weapon in their anti-fraud arsenals. Most P&C insurers have an SIU program in place and 40 percent of all insurance companies have increased their SIU spending over the last three years.⁵ Several studies reflect an average return of \$3 for every SIU dollar spent while others indicate a much higher rate of return.

The types of SIU programs vary. Some insurers handle the job in house while others contract with an outside vendor. In-house SIU functions are typically managed in one of three ways: by a small team of SIU advisors that guide claims adjusters on how to detect and investigate fraud (advisory SIUs), by claims adjusters who have received additional fraud investigation training and handle investigations in addition to their adjusting responsibilities (adjusting SIUs), or by a large team of specially trained SIU investigators who concentrate solely on investigating suspicious claims (investigative SIUs).

In recent years, there has been a growing trend toward SIU outsourcing. Since 2002, a number of major insurers have outsourced their SIU activities, including Fireman's Fund Insurance Co. (FFIC) and Clarendon National Insurance Co. In 2003, FFIC turned all of its investigative and management SIU functions over to an outside investigative firm to save costs and focus more on its core mission. Likewise, CGI assumed responsibility for all of Clarendon's SIU functions in 2003.

Benefits of SIU outsourcing

Over the last decade, insurers have increasingly embraced outsourcing as a strategic tool for enhancing their competitiveness. Insurers have been able to achieve a wealth of benefits by placing non-strategic functions in the hands of outside experts and concentrating more on their core business of selling insurance and keeping customers satisfied. Initially, insurers sought outside help in managing their IT functions, but more recently, they have begun to outsource other non-core functions, such as HR, accounting, payroll and SIUs. Some of the competitive advantages that are attracting insurers to SIU outsourcing are described below.

Cost reduction.

The key driver behind SIU outsourcing, like other types of outsourcing, is economics. Managing SIU functions in house requires staffing, training and technology, all of which are very expensive to acquire and maintain. Regardless of which SIU type an insurer implements (advisory, adjusting or investigative), staff must be devoted to fraud detection and investigation, resulting in high costs for salaries, benefits, training and job-related expenses.

In the case of an advisory SIU, an advisory fraud expert or team of experts must be hired and claims adjusters must be trained. Extensive training for claims adjusters is also required with an adjusting SIU. Investigative SIUs often involve the hiring of large teams of experienced field investigators with law enforcement and criminal investigation backgrounds. These investigators command high salaries due to their expertise and incur major expenses while working in the field (e.g., company cars, laptops, office space, travel expenses, etc.).

Training is also a major expenditure for insurers that handle SIUs in house. As with other insurance professionals, continuing education is a mandate for SIU personnel, which requires an investment in continuing education courses and seminars. SIU investigators are also responsible for training other company staff, including claims adjusters, underwriters and, in some cases, agents.

SIU outsourcing not only eliminates the costs associated with creating and running an SIU, but can also limit an insurer's risk for bad-faith lawsuits. If a claims adjuster or in-house investigator steps out of line in investigating a claim, the insurer is liable for the legal consequences. However, if an outsourcing provider does the same, the insurer can point to its contract with the vendor and make the case that the vendor breached its contractual duty, potentially protecting itself from a bad-faith claim.

Greater expertise.

The collective expertise and experience of an outsourcing provider's investigative staff typically far exceeds what an insurer could acquire in house. A good outsourcing provider offers a large staff of experts with significant law enforcement experience involving fraud and criminal investigation, along with extensive insurance fraud investigation experience.

These experts know the insurance industry, know how claims are processed and paid, know the various fraud schemes, and know the processes and technology required to detect, investigate and prevent fraud. In addition, they know the prosecutorial process and what is required for a successful prosecution.

Best practice implementation is a key advantage offered by this level of expertise. Outsourcing experts can recommend and implement processes covering all aspects of fraud investigation—from claim referral to resolution—that lead to more impressive results than with a less experienced in-house SIU. Having worked extensively in law enforcement, they can also more effectively liaison with the National Insurance Crime Bureau, police departments, fraud bureaus and other government agencies.

Cutting-edge technology.

Technology is critical to the effectiveness of an anti-fraud program. In recent years, there has been an explosion in fraud-detecting technology.

Increasingly sophisticated databases and data mining software continue to emerge to assist insurers in identifying fraudulent claims and forwarding them to SIUs. With these technologies, insurers can collect and analyze volumes of claims information to flag suspicious claims based on specific characteristics and detect fraudulent trends.

Web-based fraud detection technologies are also becoming more important in the battle against fraud. Online policy applications, claims filing and underwriting have created new insurance processes and workflows and have also opened the door to new fraud schemes. The e-commerce world has made traditional fraud detection techniques obsolete, forcing insurers to develop new solutions to combat online fraud.

The proliferation of technology in insurance fraud investigation has imposed on insurance companies the enormous burden of keeping up with the latest technologies and choosing, implementing and maintaining the right technology solutions for their organizations. Outsourcing can relieve this burden by placing an insurer's technology requirements in the hands of technology experts who can lead the insurer down the right technology path and ensure it benefits from the best possible solutions.

Choosing the right vendor

The majority of SIU vendors are small with only one or two investigators on staff. These vendors are usually confined to a city or small geographical territory and handle fraud investigations on a limited assignment basis. While there are some larger regional companies, there are few national vendors. For mid- to large-size insurance firms, a nationwide network of experienced investigators is preferable to ensure comprehensive support. Other key capabilities insurers' should look for in a vendor include:

- In-depth knowledge of the insurance industry
- Insurance fraud investigation experience
- Law enforcement experience, particularly in fraud and criminal investigation
- Advanced technologies, including comprehensive SIU databases and data mining/risk assessment software
- State-of-the-art equipment (e.g., video surveillance, high-resolution cameras)
- Ability to conduct full fraud investigations using field-tested systematic methods
- Proven record of generating significant cost savings
- Ability to measure, track and report ongoing cost savings
- Strong client references
- Results-driven interaction with federal, state and local law enforcement, the NICB, state insurance departments and state fraud bureaus
- Processes to enhance the flow of information and communication between claims departments and SIU investigators
- Full compliance with state statutory requirements for SIU contract service providers
- Full state-mandated reporting capabilities
- Ability to seamlessly manage third-party vendor relationships

As with any outsourcing relationship, a strategic partnership approach yields the greatest rewards. The ideal SIU vendor should be responsive to the unique needs of the client and flexible in adapting to its changing SIU requirements. It should also share in the risks of the partnership by offering clearly defined service level agreements with performance metrics and stipulated penalties for non-performance. In addition, it should have a strong commitment to delivering the highest quality of service possible.

Conclusion

Insurance fraud has reached epidemic proportions in the U.S. and shows no signs of abating. Although fighting fraud poses numerous challenges, insurance companies can no longer afford to remain complacent. The high cost of fraud has forced them to take the offense and invest in securing the expertise, skills, processes and technologies required to effectively detect and prevent fraud. Special investigative units have emerged as the dominant tool for addressing fraud and, while there are many options for setting up an SIU, insurers are increasingly choosing outsourcing as the preferred approach because of the many competitive advantages it offers. SIU outsourcing delivers impressive results when it comes to tackling fraud along with considerable cost savings and other bottom line benefits. Its importance will continue to increase as insurers look for more effective ways to win the battle against fraud.

CGI offers comprehensive SIU services for all lines of insurance. Our services include internal investigations, pre-employment background checks, claims assistance, statutory compliance, reporting and fraud awareness training. For more information on our SIU capabilities, visit our Web site at www.cgi.com.

About CGI

Founded 1976, CGI has worked with clients in a wide range of industries to help them leverage the strengths of information technology (IT) to optimize their business performance and produce value-driven results. We also offer a comprehensive array of business process outsourcing (BPO) services, enabling us to help manage and improve our clients' day-to-day business processes while freeing them up to focus more on strategic decision making. Our consulting, systems integration and outsourcing services provide a total solution package designed to meet our clients' complete business and technology needs. We approach every engagement with one objective in mind—to help our client win and grow. CGI provides services to clients worldwide from offices in Canada, the United States, Europe, as well as centers of excellence in India and Canada.

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Footnotes:

- ¹ National Insurance Crime Bureau, Insurance Fraud Brochure, World Wide Web: <http://www.nicb.com/public/publications/NICBInsuranceeng.pdf>, 2004.
- ² Conning & Company, "Insurance Fraud: Renewing the Crusade," 2000.
- ³ Conning & Company, "Insurance Fraud: Renewing the Crusade," 2000.
- ⁴ Coalition Against Insurance Fraud, "Insurance Fraud: The Crime You Pay For," World Wide Web: http://www.insurancefraud.org/fraud_backgrounder_set.html, 2004.
- ⁵ Insurance Research Council and Insurance Services Office, "Fighting Insurance Fraud – A Survey of Insurer Anti-Fraud Efforts," 2001.