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The Case for Creating a Michigan Auto Insurance Fraud Prevention Agency

By Eli Lehrer*

Introduction

> Michigan could benefit by following Pennsylvania's lead in forming a public-private partnership to crack down on insurance fraud.

In February 2008, Pennsylvania resident Corey Middleton called the police and his insurance company to report a serious problem. Someone, he said, had stolen his car from a street parking space in Philadelphia. His insurer and the police did cursory initial investigations and, unable to establish the car's location, the insurer cut Middleton a check for more than $15,000.[1]

There was a real crime, but prosecutors say it wasn't a random theft. Government and insurance company officials allege Middleton lied to both police and his insurer—that his claim was fraudulent and, rather than falling victim to a random theft, Middleton had paid someone else to get rid of the car. In late February 2011, almost three years to the day after he allegedly submitted the false claim, Middleton was arrested by agents from the Pennsylvania Attorney General's Office on charges of insurance fraud.

The arrest followed an investigation that, unlike similar ones in Michigan and elsewhere, didn't rely on taxpayer money. The money instead flowed from a special entity, the Pennsylvania Insurance Fraud Prevention Authority, which operates without taking a penny of general revenues and has saved the state's honest consumers more than $113 million since its creation. This *Heartland Policy Brief* describes how Michigan could benefit—in the form of less crime

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[1] Pennsylvania Insurance Fraud Prevention Authority. "Pennsylvania Insurance Fraud Stories: First Quarter 2011," www.helpstopfraud.org.

and lower automobile insurance rates—by following Pennsylvania's lead in forming a public-private partnership to crack down on insurance fraud.

The paper consists of three sections: the first describes Michigan's automobile insurance fraud problem; the second examines the case for an auto insurance prevention authority; and the third makes some Michigan-specific recommendations for designing an insurance fraud authority. A conclusion sums up the case.

The bottom line is simple: Cracking down on automobile insurance fraud by creating a special insurance-industry-funded auto insurance fraud authority would yield enormous dividends to consumers and business in Michigan.

Michigan's Auto Insurance Crisis

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Michigan faces an automobile insurance crisis characterized by high premium rates that result, to a significant extent, from particularly expensive automobile insurance fraud. Michigan residents are given higher auto insurance quotes—above $2,500 per year—than people anywhere else in the nation.[2]

As a result, a high and rising share of Michigan residents—19 percent at last count—go without automobile insurance. Only six states, none of them in the Midwest, have more motorists without insurance.[3] Premium rates in the state's largest city, Detroit, are more than twice those in the state on average: above $5,100 per year, per car, a sum few people in a high-poverty city can easily afford.[4]

Although some insurance industry sources may overestimate the prevalence of fraud (there's little evidence that one in ten claims involve fraud, as some industry sources claim), much evidence exists that the fraud level drives these high premium rates.[5] Three factors are particularly important in this regard.

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[2] Insure.com, "Automobile Insurance Price Comparison," January 14, 2011, http://www.insure.com/car-insurance/car-insurance-comparison.html.

[3] Insurance Research Council, "Recession Marked by Bump in Uninsured Motorists," April 21, 2011, https://mail.google.com/mail/#inbox/1335c7466acbe8f6.

[4] Michelle Burton, "America's Most Expensive Places to Own a Car," June 3, 2009, http://www.autoinsurancetips.com/america%E2%80%99s-most-expensive-places-own-car.

[5] For a review of the academic literature on the prevalence of fraud see, Sharon Tenyson, "Moral, Social, and Economic Dimensions of Insurance Claims Fraud," *Social Research*, 75:4 (2008), pages 1184–1187.

First, the number of claims that investigators believe could involve fraud has skyrocketed in recent years, along with auto insurance premiums. In 2008, Michigan experienced slightly more than 500 questionable medical claims. Just two years later, in 2010, the number nearly hit 1,000, and it will probably go even higher in 2011.[6] Other sorts of dubious claims have risen by similar magnitudes. The overall number of questionable claims rose from 2,690 in 2008 to 5,024 last year, and the number of questionable personal injury protection claims increased from 373 in 2008 to 936 in 2010.[7] Although scholars have identified "substantial consumer discretion in claims filing," there's little evidence of legal changes that would result in this enormous increase in Michigan absent an actual increase in fraud.[8]

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Second, the per-capita level of suspicious claims in Michigan is currently the highest among larger states. Only two states with no-fault automobile insurance systems, Florida and New York, have more potentially fraudulent claims than Michigan.[9] Even if one believes a large share of suspicious claims do not involve fraud, the enormously greater number of potentially fraudulent claims in Michigan almost certainly indicates there is, indeed, more fraud.

Third, and perhaps most importantly, automobile insurance fraud in Michigan is a much more lucrative business than it is anywhere else in the United States. Unique in the nation, Michigan automobile insurance policies provide uncapped lifetime medical benefits to anybody injured in an accident; no other state typically requires motorists to carry more than $50,000 in coverage. In most other places, health insurance or government programs pay bills above that amount.

Thus, although there's no reason to think Michigan's population is any more or less given to committing fraud than residents of other states (the state's overall crime rates are about average for the country), the potential payoffs from committing fraud in Michigan are much greater.

Setting up an entirely fake "chiropractor's clinic," as investigators allege one Oakland County man did, and bilking insurers and their policyholders out of hundreds of thousands of dollars on individual claims, would be literally impossible in other states because, unlike Michigan, they limit the amount of benefits paid on auto claims. However, it was attractive to do just that in Michigan.[10] The system, in short, makes Michigan more attractive to sophisticated criminals who thrive on fraud.

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[6] National Insurance Crime Bureau, "Michigan: Insurance Fraud Snapshot," May 2011.

[7] Ibid.

[8] Sharon Tenyson, supra note 5, page 1187.

[9] National Insurance Crime Bureau, supra note 6, page 3.

[10] Ibid, page 1.

Fraud is a serious crime problem and ought to be treated as such. A wealth of academic research indicates most people involved in “convictable” automobile insurance fraud cases have prior criminal records for noninsurance offenses; catching people who engage in insurance fraud seems to reduce the level of such fraud.[11]

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Against this background, there’s significant evidence that both the Michigan state government and the private insurance industry currently devote too few resources to fighting insurance fraud. Despite evidence that fraud is on the rise, there is only one full-time auto insurance fraud investigator in the state of Michigan.[12] (Insurance companies all maintain armies of claims adjusters who are on the lookout for fraud as well, but none of them works on fraud alone.)

There’s reason to believe having more people look for fraud will catch more people intent on committing it: It has worked in Michigan and elsewhere. Michigan’s Automobile Theft Prevention Authority successfully has reduced the state’s auto insurance premium rates by $52 per vehicle per year and saved taxpayers an estimated $652.4 million.[13] If Michigan does the right things, it can, should, and will be able to reduce automobile insurance fraud in the state.

An Automobile Insurance Fraud Authority

An automobile insurance fraud authority is not a new idea. Two states—Louisiana and Pennsylvania—have such authorities already in place, and roughly 40 other states have an integrated insurance fraud bureau within the attorney general’s office.[14] Pennsylvania has the oldest such authority in the nation, with a record of success, and the state of Pennsylvania is similar to Michigan in size and character. Thus it appears to be the obvious model for Michigan to follow and do what the state does not do now: Focus significant resources on the problem of automobile insurance fraud. (See sidebar for more on the efficacy of the Pennsylvania Authority.)

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[11] Richard E. Derring and Valerie Zicko, "Prosecuting Insurance Fraud: A Case Study of the Massachusetts Experience in the 1990s," *Risk Management and Insurance Review* 5:2 (2002), pages 77–104.

[12] Arin Greenwood, "Michigan's No Fault Auto Insurance System Might be Rife With Fraud. So Now What?" Out of the Storm News, July 19, 2010, http://outofthestormnews.com/2010/07/19/michigan%E2%80%99s-no-fault-auto-insurance-system-might-be-rife-with-fraud-so-now-what/.

[13] Michigan State Police, "Annual Report of the Michigan Automobile Theft Prevention Authority: 2010," page 1, http://www.michigan.gov/msp/0,4643,7-123-1589_57983---,00.html.

[14] Coalition Against Insurance Fraud. "Go Figure: Fraud Data," n.d., http://www.insurancefraud.org/statefraudbureaus.htm.

An authority modeled on the one in Pennsylvania would have three characteristics: It would be autonomous, funded entirely by the insurance industry, and it would have broad latitude to achieve its specific and limited mandate largely by administering grants.

Autonomous

The Michigan Auto Insurance Fraud Prevention Authority, like a toll road authority or port authority, would be an autonomous entity independent within the government, overseen by a board consisting of members appointed by industry, elected officials (or their designates), and appointed officials (or their designates). This is the way the Pennsylvania authority has worked to date.

The authority wouldn't be part of any existing department, and it would not have a sizeable staff (or, quite possibly, any staff) of its own. The authority would not have any regulatory powers, law enforcement authority, or powers to impose broad-based taxes.

Self-Funding

Instead of imposing broad-based new taxes or using general revenue, the authority would fund itself entirely through a special assessment paid for by auto insurers. This could be structured to be passed along to consumers in the form of surcharges on automobile insurance policies. The special assessment would be based entirely on an auto insurer's market share. An insurer that collected 10 percent of the auto premiums in the state, for example, would pay 10 percent of the authority's yearly costs.

Success in Pennsylvania

Since it began operations in 1996, Pennsylvania's Insurance Fraud Authority, funded by market-share-based assessments on the state's insurers, can point to a record of success.

Since its creation, the authority has spent less than $40 million and achieved savings of about $113 million in fraud prevented – a nearly three-to-one ratio. In the cases of the most serious crimes it deals with – arsons and gangs that stage auto accidents – the improvements in public safety are even greater.

Because it's largely independent of the rest of the government, the authority also has had a good deal of flexibility in deciding what to do. In its early years, a large portion of its budget went to efforts intended to convince state residents that insurance fraud was a problem. More recently, much of its work has funded special units aimed at insurance fraud both at the state level and with some of the state's larger police agencies.

To date, the authority has not micromanaged the agencies to which it gives grants. So long as they make progress against insurance fraud, the authority rarely has told them how to go about their business.

Pennsylvania's insurance fraud authority has experienced bumps in the road. Since it works based on grant applications (and often, only larger law enforcement agencies have the resources to write these), the authority mostly has benefited larger cities. And some of the crimes investigated by the authority – such as falsifying insurance cards – are probably best handled with civil fines rather than the criminal charges Pennsylvania authorities sometimes bring.

Nonetheless, the Pennsylvania Insurance Fraud Authority, as a whole, must be considered a significant success.

Limited, Specific Mandate

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Finally, the authority would have a very limited and specific mandate to reduce automobile insurance fraud, but broad latitude in achieving that goal.

Although it would have no law enforcement powers, the authority could devote resources to public education campaigns about the costs of auto insurance fraud (something the Pennsylvania authority does), hire investigators of its own (who would not have law enforcement powers but could make referrals to law enforcers), or provide support grants to any entity in the state. It would not step outside of its narrow mandate and devote resources to investigating frauds in areas other than automobile insurance. Instead, it would focus tightly and intently on Michigan's automobile insurance fraud problem.

Specific Recommendations

In creating an Automobile Insurance Fraud Prevention Authority, the legislature should look to both Pennsylvania's model and Michigan's existing Automobile Theft Prevention Authority. It should not slavishly follow the legislation that created either one, but instead draw on good ideas from these two authorities and elsewhere to create an entity well-suited to Michigan's needs.

If it wants the proposed authority to work in the most effective and efficient manner possible, the legislature should consider following some of the best practices carried out by other states and write them into any legislation authorizing the statute.

Require the Authority to Report on Consumer Savings Each Year

The authority should be required to show, in annual reports, how it is benefiting consumers, and those reports should be released publicly. If the authority is successful in reducing auto insurance fraud, then the reports will help consumers and insurance companies share the benefits. If it does not produce savings for consumers, the authority should not exist.

Creating an authority, of course, should not be taken as a guarantee that auto insurance rates will go down – the level of fraud is only one factor that helps determine rates – but the authority should make enough recoveries and reduce overall fraud enough that the "fraud load" in rate filings should decline over time, just as occurred with the state's auto theft load.

Sunset the Authority After Five Years

There's no guarantee that an insurance fraud prevention authority will work as well in Michigan as it has in Pennsylvania. The quality of the authority's management, the enthusiasm of law enforcement for devoting more resources to fighting fraud, and its success in achieving its goals should all be reviewed after five years.

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If upon review lawmakers determine the authority is not working, they should not reauthorize it, and the authority would automatically expire. If the authority proves a success, Michigan may wish to consider expanding its mandate to include other lines of insurance beyond automobile insurance, as Pennsylvania has done. In any case, the authority should be considered a test run, not a permanent part of government.

Require the Authority to Follow Open Meetings and Open Records Laws

One existing insurance industry-run entity in the state – the Michigan Catastrophic Claims Association – is not subject to the state's open meetings and open records laws. It conducts meetings in public but doesn't respond to open records requests. An Automobile Insurance Fraud Prevention Authority, although similarly funded by the industry, should not operate in secret. It should conduct all business meetings in public, open all records to the public, and post information about all grants on its Web site.

Strictly Limit the Authority's Administrative Costs

Almost all the money collected from the authority should go directly to its programs. To make sure the tax supporting it gets used wisely, any statute establishing the authority should limit its administrative overhead to no more than 5 percent of the funds taken in.

Keep the Automobile Insurance Fraud Authority Separate from the Existing Automobile Theft Prevention Authority

Since 1992, Michigan has maintained an Automobile Theft Prevention Authority under the Michigan State Police. That authority serves a valid and valuable function and has presided over a decline of more than half in the state's auto theft rate. (Auto theft fell at the same rate nationally, but almost all significantly populated states created similar capacities.)
Some legislators have proposed adding insurance capacities to the theft authority. This is a problematic idea for at least three reasons.

First, although both involve automobiles and the insurance industry, the crimes of auto theft and automobile insurance fraud do not have much in common. Insurance fraud is a crime of deception, whereas car theft is a crime of violence. Nobody but a hardened criminal steals cars (doing so requires both a degree of skill and a total disregard for the needs of others), whereas people who are otherwise law-abiding are known to engage in insurance fraud. It's almost certainly ineffective, for example, to run ads discouraging people from stealing cars (everyone knows it's wrong), but ads that drive home the costs of insurance fraud may remind otherwise law-abiding people they shouldn't engage in it.

> Creating an automobile insurance fraud prevention authority carries few real risks and could bring significant benefits.

Second, insurers do not have a major role in investigating or tracking people who steal cars, but they do have a large role in investigating acts of financial fraud committed against them. Except in the lowest-crime areas, police cannot and should not devote significant resources to investigating a claim an insurance company investigator believes is false. Instead, it's incumbent upon insurers to investigate claims and turn over to police those they feel contain truly criminal acts of fraud. Whereas dealing with car theft is essentially a government responsibility, insurers have a responsibility for protecting themselves from fraud. This indicates a need for a different approach.

Finally, given the auto theft prevention authority's success to date, it's foolish to mess with success by expanding its mandate to include a large new class of offenses that have little to do with auto theft. Doing so could distract it from its vital mission in fighting auto theft and, simultaneously, give short shrift to the auto insurance fraud prevention authority.

Conclusion

Michigan has a significant automobile insurance fraud problem characterized by high and growing levels of suspicious claims. This contributes to the state's highest-in-the-nation automobile insurance premiums. Creating an automobile insurance fraud prevention authority could focus more resources on the problem, fight fraud, and potentially reduce automobile insurance premiums.

An automobile insurance fraud prevention authority is not a cure-all. It will not reduce auto insurance premiums by itself. But creating one carries few real risks for the state and could bring significant benefits to Michigan's automobile insurance consumers.

About the Author

Eli Lehrer is vice president of Washington, DC operations for The Heartland Institute and national director of its Center on Finance, Insurance, and Real Estate (CFIRE). Lehrer played a major role in founding the smartersafer.org coalition, a coalition of taxpayer, environmental, insurance, and free-market groups dedicated to risk-based insurance rates, mitigation, and environmental protection.

Prior to joining Heartland, Lehrer worked as speechwriter for U.S. Senate Majority Leader Bill Frist (R-TN). He previously worked as a manager in the Unisys Corporation's Homeland Security Practice, senior editor of *The American Enterprise* magazine, and a fellow for The Heritage Foundation. He has lectured at Yale and George Washington Universities.

Lehrer holds a B.A. (cum laude) from Cornell University and an M.A. (with honors) from The Johns Hopkins University, where his Master's thesis focused on the Federal Emergency Management Agency and flood insurance. His work has appeared in *The New York Times*, *Washington Post*, *USA Today*, *Washington Times*, *Weekly Standard*, *National Review*, *The Public Interest*, Salon.com, and dozens of other publications.

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