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"THE ROLE OF CENTRAL DATABASES TO COUNTER INSURANCE FRAUD"

by Julian Radcliffe

CLAIMS

Traditionally the Insurance Industry has paid little attention to claims. By that I mean that it was not considered as important as marketing, underwriting or investment. There are very few people who have spent an appreciable time in claims who have risen to the top of the industry. Despite the fact that our claims departments have paid out with monotonous regularity, more than we have ever collected in premium, and despite the fact that it is the obvious shop window of our product to our clients, and to the Government, claims departments have been considered a necessary evil at best. Although the technical content of claims work is recognised as being higher than that in underwriting, the insurance industry has often delegated much of the most testing work on claims to loss adjusters and lawyers and has had some difficulty in controlling the latter.

Much of this attitude probably stems from the gilded years when claims were welcomed as a demonstration of the value of the policy and I remember myself in the early 1970's Lloyd's underwriters would often look for the opportunity of paying a claim to clients of long standing from whom they had made significant profits. If the ratio of premiums to claims became unfavourable, then the answer was to increase the premiums and indeed there was a naive view that the higher the premiums and the higher the claims then the greater absolute figure that the profit could be, particularly if this was generated primarily by investment income.

Now we have a time where the client will not pay increases in premium either because he can find another underwriter to give the same cover more cheaply, or because he would prefer to go uninsured, or make alternative arrangements through Risk Management or Captives. There has therefore become a danger that underwriters, having made significant losses in a class of business find that raising premiums without any other measure merely leads to them attracting an adverse selection of clients who are not prepared or able to exercise good risk management and for these perhaps no premium is high enough to produce an underwriting prof-

it. It is therefore obvious, though sadly too late, that our management of claims has been remiss and we have paid a bitter price.

For the lawyers amongst you these may have been golden days but like most golden days they will not last since your paymasters in bankruptcy are not worthy of legal pursuit or defence.

The worst aspects of our claims management has been to settle small claims with little investigation because the cost of that was not economic and to fight all large claims in the hope of finding grounds for denial, exhausting the plaintiff and keeping the money. The insurance industry's public image is geared very largely to the perception of claims settlement. The Government's lack of sympathy in relation to better tax treatment, its reluctance to become involved in giving terrorism cover and many other issues of critical importance to us has probably been coloured by our poor public image in relation to claims.

There is a great deal that can be done, much of it very simple and not that expensive.

The Concept

In the ideal world it should be possible to check every proposal form when it is presented for underwriting against every previous proposal form and claims likewise as part of the history of that assured. Furthermore, subject to the provisions of the Data Protection Act, it would be ideal if the credit history of the assured could be used to improve underwriting decisions. There is no doubt of a strong correlation between those factors which imply a bad credit risk, eg late payment, default and fraud and those that indicate a bad underwriting risk.

Indeed, we need more than this. We need to be able to check that individuals who are claiming for liability claims involving motor underwriters, are not those who have already claimed for the same injury before, such as a bad back from employers liability or personal accident insurers, and that the medical costs which may be part of that claim are also genuine. We know that those who perpetrate frauds against motor underwriters, may be doing the same against household comprehensive, travel insurance, medical insurance, employers liability and so on.

Insurers have used black lists to circulate names of suspected fraudsters but this is inefficient and of doubtful legality since it may deprive innocent individuals of cover or claims and there is no right of appeal.

The answer to all of this is relatively simple. It lies in the use of centralised databases. Before discussing the concept further let us revert to first principles.

Our main aim is to prevent fraud. Subsidiary aims are to improve the industry's underwriting statistics, improve our public image, assist the police and market our product better by providing additional services to the client beyond that of simple financial indemnity. By that we mean that we need to extend the policy to include risk management advantages as well as financial cover.

Very little has been written about fraud in the insurance industry. There is one study which has been undertaken at Birmingham University and the Munich Re has produced one publication examining measures to counter fraud.

How do we define fraud?

Policyholders or third parties obtaining cover, paying lower premiums, or obtaining higher compensation than would otherwise be granted through deceit, omission or multiple insurance, benefiting themselves and forcing higher premiums for the industry.

The methods by which fraud are perpetrated include

- Over insurance
- Multiple insurance
- Suppression of information
- Conversion of uninsured to insured
- Faking of loss
- Deliberate Loss by policyholder or agent
- Loss exaggeration

Historically the insurance industry assumed there was a degree of fraud and merely increased premiums to cover that part of the loss.

As I said in my introduction this led to the disputing of many claims in order to try and prove fraud and this led to a downward spiral with clients inflating claims on the grounds that the insurers would dispute them and a general lack of trust, confidence and an increase in aggravation.

The use of databases is not only to be able to match claims. Uses can include replacement costs, costs of repair of vehicles and as identification systems are

used to tag items, (which are not easily identifiable such as contractors plant and equipment, jet skis etc) we are building up not only negative databases, ie of stolen items, but also of positive databases, ie of ownership. For example virtually all motorcycles are now tagged and the police issued with readers.

Only with these are we likely to be successful in the efficient prosecution of fraud which must be better than disputing claims where we strongly suspect fraud but are wary of alleging it because of the higher burden of proof required in criminal as compared to civil cases.

The industry can argue against all of these measures on grounds of costs and that in some cases there is a feeling that the industry is becoming the "big brother", snooping on all aspects of our clients. Some will argue that checking all these items is too expensive and that it means that every policyholder is being treated as a potential criminal. I profoundly disagree and believe that this is no different to what has been done, for example, by the second hand car trade where every vehicle is checked to ensure that (a) it has not been stolen and (b) that it does not have an outstanding hire purchase commitment, through a database.

I won't say much about the way in which Fraud Is An Almost Acceptable Crime or that Prevention is Better Than Cure. In due course we would expect that all proposal forms and all claims forms will have on them a warning, as required by the Data Protection Act, (but also a useful deterrent) that all the information contained on them may be searched electronically to discover discrepancies.

When the Motor Insurance Anti Theft and Fraud Register was formed, there was a long debate as to whether the existence of the register should be kept secret for some time in order that a number of criminals could be successfully prosecuted. This was done but after about a year it was agreed that the maximum publicity should be given (a) to those prosecutions and (b) to the existence of the register in order to act as a deterrent for the future.

For the matching of previous proposals forms, with new proposals forms, there are some interesting legal problems under various data protection acts in different countries but essentially we hope that provided we make it clear that this process is going on and that the individual has the right to verify the information and appeal, then there is no major barrier to our doing so.

The principles of the Data Protection Act are worth enumerating.

Data shall be:

- Obtained and processed fairly and lawfully
- Used only for the purposes declared in the register entry
- Adequate, relevant, up to date and not excessive in relation to their purpose
- Held no longer than necessary for registered purpose
- Surrounded by proper security
- Open for inspection and correction by individual concerned

Indeed the database could often help an innocent policyholder greatly who may have omitted something from a proposal form by accident which could be picked up through the use of the central database. The systems required for this intelligent underwriting, ie taking scoring factors based on the credit history of the individual or the underwriting/claims history, are extremely sophisticated and have their dangers for insurance companies that use them too blindly but on the whole should improve our underwriting profits significantly.

The key to underwriting profitability whether it be private or commercial is often the moral standard of the client. Only this provides loyalty at renewal, the implementation of the best loss prevention measures, prompt premium payment and easy claims handling. To select the good client requires the database.

In the UK we only have two databases operating; The Motor Insurance Anti Theft and Fraud Register run by the ABI with the support of Lloyd's, and The Art Loss Register of which I am Chairman. The latter is an initiative of the insurance industry and the fine art trade working in close collaboration with the police on an international basis.

In this we are leading the world but in America they are miles ahead of us in central databases for the insurance industry.

They have run central databases initially on card index files for up to 50 years. The index system in New York has 40 million claims with 12 million updates per year, 900 insurers subscribing and covers all bodily injuries from automobile, general liability, personal injury and workers comp claims. This enables them to reject a significant percentage of claims purely on the basis of information held in the database.

The National Insurance Crime Bureau in Chicago runs an equivalent of our Motor Insurance Anti Theft and Fraud Register but it is far more developed covering not

only thefts but also all vehicles salvaged, and those sold overseas. It includes a very sophisticated system on spare part numbers to cover shipping and assembly. Evidence from this database helped with the World Trade Centre bomb arrest.

There is also a database for all life and health proposal forms, but interestingly enough not on claims. In the USA any database on underwriting information has to be kept strictly separate from any database on claims. Hence the Property Insurance Loss Register which registers (see view foil) all property claims, whether for fire, theft flood etc, cannot use this information for underwriting by integrating the two databases of claims and proposal forms. I don't believe that we will have the same problem in this country but discussions with the data protection authorities continue.

There is discussion on whether these databases should be set up as mutual associations or whether they should be profit making concerns.

I am a strong believer in trying to obtain the best of both worlds.

The problem with any association scheme, such as those run in the USA by the insurance company associations is that they try to keep their costs to a minimum for their members and do not therefore reinvest in technology or develop the potential of their business as they might. This is not to say that they have not been successful, they have, but they could probably have been more successful if there had been more commercial discipline applied to them. The result of this has been that many private companies such as Equifax have come in to fill obvious vacuums round these operations and the first area they tackled was to provide an intelligent underwriting system for automobile insurance, which should of course have been developed by the association which was running the claims database. Under their common loss underwriting exchange, they provide a pool of information for insurance companies and have begun to compete very effectively with the association schemes.

Now competition is healthy in itself but it can lead to a fragmentation of the databases which is certainly not helpful in the early years.

The first equipment in the early years is to get one database which is recognised and used by everybody since only then can it be efficient. Thereafter competition may be desirable although these operations are probably natural monopolies. This means that they must be handled responsibly. Not only are there monopoly impli-