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AWASH IN FRAUD

The catastrophes that devastated thousands of Americans last year represent millions of dollars in property loss. Yet the disturbing scenes of fire, flood, windstorm and chemical contamination arouse scant interest when it comes to the costs

By JACK R. TARVIN JR.

of repairing and restoring damaged properties. And while these losses also carry the burden of fraudulent and excessive overcharges, few in the insurance industry have taken the initiative to stem the tide of claims abuse.

In the popular culture of the American insurance executive, initiative is a rare commodity. Rather than investigate the possibility of overpayment by his company, a vice president of claims in Minnesota said he has complete confidence in his claims staff. That way of thinking resulted in a \$50,000 overpayment on a \$180,000 claim. On a flood loss, a property claims manager in Dallas declined to recover more than \$1 million his company was defrauded of by a restoration company. Because his company passed on the loss to a third party through subrogation, the manager was no longer concerned by the claim's fraudulent nature. In yet another situation, the chief financial officer of a Con-

Only by reclaiming their responsibility for managing property loss can insurers stem the tide of inflated and fraudulent claims.

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necticut insurer still has not taken action after learning several months ago that his company needlessly paid a \$2 million claim. The problem continues as the public sits placidly by the fire, paying insurance premiums and marveling at the costs.

Fraud and abuse go hand in hand with large catastrophic property losses. Business interruption, replacement costs, the value of the property, time-

In fairness to the insurance company, it recovered millions of dollars from the restoration and decontamination contractor. The only catch in the recovery was the insurance company's promise not to disclose the culprit to the public and other carriers. So much for moral and ethical responsibility.

The industry has come to rely on these experts because of insurers' efforts to control costs by curbing expenses.

there will not be a need for staff adjusters because he and his cohorts will own the market and dictate the terms of each settlement. Staff and independent adjusters are quick to point out their disgust with public adjusters. However, the resumes of the majority of the public adjustment community reflects a direct link and experience with staff and independent companies. How else would they learn their trade?

If you are an insurance executive sitting in a board room reading this, stop licking your lips: The public adjuster is no scapegoat. No one trusts you either, primarily because you have done so much to help create this monster. Public adjusters would not exist if the mission of the staff adjuster had not been consolidated, streamlined and economized to the point of impotence.

The additional costs incurred by relying on public adjusters, combined with the consolidation of staff and independent claims efforts, have caused this crisis. The solution to the problem, however, lies not in pointing fingers at public adjusters and asking for legislative and regulatory reforms, but in encouraging insurers to reclaim their responsibility for managing property loss. While natural and man-made catastrophes will continue to devastate property, the real tragedy is that restoration costs are inflated as much as 30%. The next time someone offers to reduce the cost of the repair and restoration of a structure destroyed by catastrophe, insurance executives should take the initiative and listen.

GET THERE FIRST

In the meantime, insurance executives should consider the following alternatives. Catastrophic property losses arise from a variety of perils, and unless insurance personnel get to the loss quickly, an insurer's claims staff will be outmaneuvered by the restoration companies and public adjusters. While getting there first may require careful preparation, the best tack is to require the insured to obtain approval from the claims staff before negotiating a settlement. By giving the insured an incentive to inform the carrier first, such as through a toll-free telephone number for reporting claims, an insurer can improve its chances of being first on the scene.

In many cases, however, the psychological impact of loss can be greater than the physical damage to the property. To deal with the emotional effects of loss, the claims staff must be trained to re-

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and-material contracts and a tremendous sense of urgency force the carrier and the insured into open-ended and expensive repair and restoration projects.

While some insurers hire accountants to audit the process, many do so only as an afterthought. Furthermore, the audit procedure is poorly equipped to uncover fraudulent practices. For example, after an insurer paid a large construction claim in Southern California, an accounting firm found \$1 million in inflated and fraudulent overcharges. Not only did the insurer seek help after it was too late, the accounting firm's inexperienced staff erred by \$3 million. The contractor laughed all the way to the next loss.

PRYAMID OF EXPENSE

The boundaries of excess can expand exponentially with hazardous chemical contamination and related losses. An army of specialists descends on the unprepared and unsuspecting: Industrial hygienists, environmental toxicologists, chemists, microbiologists, geotechnical, mechanical, occupational and safety engineers create a pyramid of expense. On a \$9 million PCB loss in San Francisco, an executive for one company commented on the wide array of expertise assembled: "Never have so many done so much with so little opportunity and realized such a phenomenal return on investment."

On yet another PCB loss in Virginia, profits were inflated with pencils, not products, and the fraud was not even perpetrated on the job site.

Efforts to consolidate and streamline company operations have minimized the mission of staff adjusters and increased the role of public adjusters in claims settlement.

But public adjusters seem to add to the confusion and cost of claims settlements. When a public adjuster is involved in a case, the cost of a restoration can increase as much as 20%. This can happen when a public adjuster's contact with a staff adjuster is limited to telephone conversations, an efficiency quota is established for field adjusters or a blanket directive is issued to scrutinize all claims in excess of a certain dollar amount—the possibilities are endless. Management by omission has atrophied the claims handling efficiency of the insurance industry and created the adversarial relationship between insurance adjusters and insureds.

These developments, however, are not what makes the claims process with a public adjuster involved so expensive. Graft, corruption, fraud and kickbacks make public adjusting so distasteful. Some public adjusters act as a broker would by exacting payment from every participant: The insured pays a percentage for representation and everyone from the structural and content restoration contractors to the dry cleaners pay a percentage for the referral. In this way, the cost of a small fire becomes inflated to the point where it achieves the status of a large commercial catastrophe.

By the year 2000, according to a public adjuster in Southern California,

spond compassionately. An empathetic ear will go a long way in fostering trust and understanding.

For many insurers, a three-pronged approach to property-loss management can cut costs significantly. By using a project-management company familiar with catastrophic losses and the ways in which costs can be inflated, insurers can reduce settlement costs. An insurer also should audit the billing, or have a project-management company audit the billing, for all time-and-material and cost-plus contracts. Finally, an outside training company should instruct the claims staff in the finer points of catastrophic restoration projects and

the ways that property repair and replacement costs can be inflated.

Other tactics include requiring the presence of an objective project manager on every major commercial loss. Companies serving as advocates of an insurer can monitor a project from the beginning of the job until the final audit. When an insurance company awards a time-and-material contract for a major loss, it is often a foolish economy to expect the staff adjuster to monitor performance. However, insurers should not assign this task to an accounting firm or other entity that has not been trained in the means and methods of fraudulent pricing and in-

flated overcharging. Accounting, alone, will not solve the problem.

An effective property-loss-management program will include a claims staff that has the knowledge to deal with structural and restoration contractors on an informed and aggressive basis. By dictating the terms of the contract, researching the companies, collecting and comparing contracts and pricing models, and negotiating the terms before the need, insurers can eliminate many fraudulent practices when property damage occurs. But the responsibility rests with the insurer, which must take the initiative to manage the loss. □