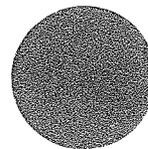


Arizona Department
Of Insurance



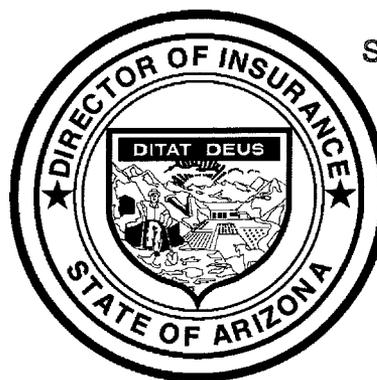
Fraud Unit Annual Report

*For the Fiscal Year
Ending June 30, 2000*

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SPEAKER'S OFFICE



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Charles R. Cohen
Director of Insurance

to

The Honorable Jane Dee Hull
Governor

The Honorable Randall Gnant
Senate President

The Honorable Jim Weiers
Speaker of the House

The Honorable Ted Carpenter
House Financial Institutions and Insurance Committee Chair

The Honorable Edward Cirillo
Senate Banking and Insurance Committee Chair

The Honorable Betsey Bayless
Secretary of State

The Honorable Gladys Ann Wells
Arizona State Library, Archives and Public Records Director

The Honorable Dennis Garrett
Arizona Department of Public Safety Director

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Fraud Unit Annual Report

Greetings

I am pleased to submit to you this annual report on the activities of the Arizona Department of Insurance Fraud Unit for the Fiscal Year ending June 30, 2000, as required by A.R.S. § 20-466.05.

Insurance fraud is a serious social and economic problem in the United States. Insurance fraud perpetrators range from large organized groups to individual opportunists, perhaps even a next-door neighbor. This form of fraud affects every person in Arizona by inflating insurance costs for individual and corporate insurance consumers. The latest estimate for the cost of insurance claims fraud in the United States is \$79 billion.¹ Arizona law designates insurance fraud as a class 6 felony,² punishable by up to 1 year in prison for first-time offenders

Mission Statement
" To deter, investigate and facilitate conviction for insurance fraud "

Established July 1, 1994, The Insurance Department Fraud Unit, is committed to deterring, investigating and facilitating convictions for insurance fraud. The Fraud Unit is purely an investigative unit. Prosecution of criminal cases resulting from Fraud Unit investigations is handled primarily by the Arizona Attorney General and the Maricopa County Attorney. The Fraud Unit has executed intergovernmental service agreements with both agencies to fund prosecutor positions dedicated to prosecuting insurance fraud cases.

Having a Fraud Unit within the Insurance Department is crucial to achieving a properly balanced approach to combating insurance fraud. The Insurance Department is focused on protecting honest insurance consumers. Having an independent Fraud Unit within the Insurance Department, and requiring insurers to refer cases to the Unit when they believe "...a fraudulent claim has been or is being made,"³ reduces the opportunity for insurers to apply overly broad fraud deterrence measures that could adversely affect honest claimants. By accomplishing its mission, the Fraud Unit reduces the inflationary impact of fraud passed onto consumers through higher costs of insurance products and consequent consumer products, and helps assure fair treatment for insurance claimants.

The Fraud Unit's General Fund appropriation is fully reimbursed by assessments on insurers. Thus, the Fraud Unit appropriation has a zero net effect on the General Fund. The Insurance Department is proposing legislation in the 2001 session to increase its allowable assessment so we can continue to fully recoup the Fraud Unit appropriation.

The Department's insurance fraud program aims to accomplish the following strategic goals:

- Efficiently and effectively investigate fraud complaints and referring cases for prosecution
- Provide education and promote awareness within the industry, law enforcement and the community concerning the problems and consequences resulting from insurance fraud.

¹ Coalition Against Insurance Fraud publishes annual estimates for claims fraud in four areas of insurance (auto, homeowners, health and business).

² A.R.S. § 20-466.01

³ A.R.S. § 20-466(F)

Fraud Investigations

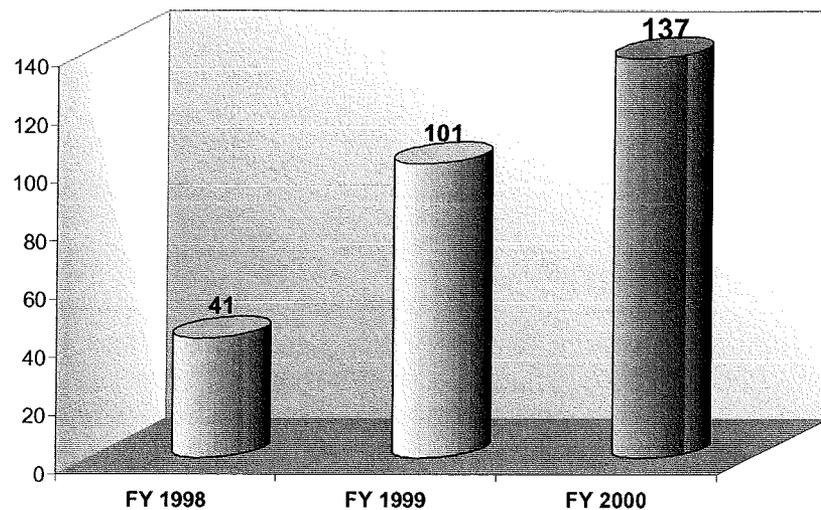
The Fraud Unit's team of 11 investigators is headed by **Terry Cooper**, the **Fraud Unit Chief**, who served 24 years in the Phoenix Police Department before joining the Department of Insurance. The Unit has benefited from recruiting and retaining investigators with extensive prior law enforcement experience. Most Unit investigators are retired police officers, each of whom has more than ten years of experience including criminal investigations involving undercover operations and surveillance.

FRAUD UNIT SUCCESS IN FY 2000

The Unit works in partnership with other law enforcement and prosecuting agencies to bring perpetrators to justice. During FY 2000, the Unit's investigators aided in 137 prosecution cases (**Figure 1**) that resulted in convictions and restitution awards totaling more than \$1.5 million. The following are notable examples of the Unit's success during the year.

- The Unit found evidence that an auto glass repair company had defrauded 328 citizens and 34 insurance companies. Three individuals were arrested and convicted. The business was closed and restitution was paid.
- In the course of a fraud investigation, the Unit discovered Motor Vehicle Division ("MVD") employees were issuing fraudulent driver's licenses and altering prior driving histories. The Unit brought this to the immediate attention of MVD and participated in the resulting investigation and prosecution.

Figure 1: Number of Fraud Convictions



During FY 2000, the Unit's investigators aided in 137 prosecution cases that resulted in convictions and restitution awards totaling over \$1.5 million.

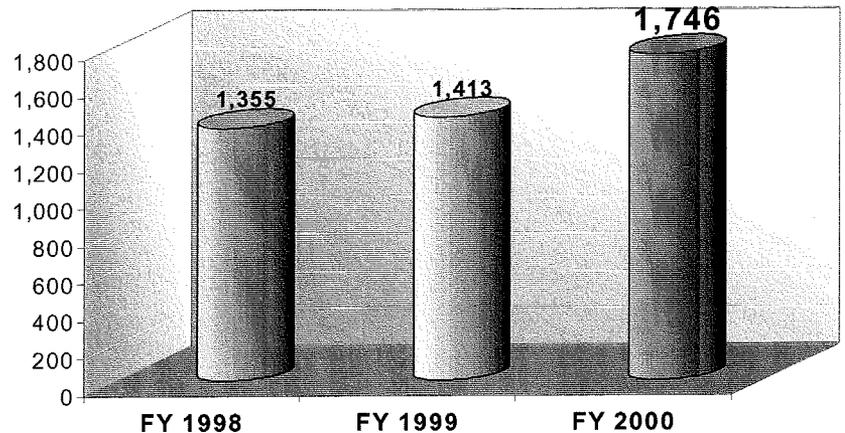
- The National Health Care Antifraud Association (NHCAA) maintains information that is submitted by its member insurers concerning suspected fraud by health care providers. Toward the end of FY 2000, the NHCAA invited the Fraud Unit to subscribe to its database at no cost. The Unit already subscribes to the database maintained by the National Insurance Crime Bureau (NICB), another organization (with a separate membership base) that maintains information concerning suspected insurance fraud. Access to the NHCAA data will provide a significant additional source of fraud case referrals.

INCREASES IN REFERRALS OF CASES

Insurers are required by law to refer suspected insurance fraud to the Fraud Unit. In June, the Unit performed its annual audit of referrals submitted during the fiscal year. The Unit compared each insurer's Arizona market share for various lines of insurance with the share of fraud referrals it submitted to the Unit relative to those lines of insurance.

Each insurer was notified of its referral shares. Where a referral share appeared disproportionately low to market share, the Unit Chief contacted the insurer to determine the cause. We believe these contacts, in conjunction with our broader fraud awareness initiative, described below, are responsible for a significant increase in the number of cases of suspected fraud referred to the Unit, as depicted in **Figure 2**. We anticipate experiencing increases in our caseload from increased public and industry awareness and from new referrals sources such as the NHCAA (described earlier).

Figure 2: Number of Fraud Referrals Received



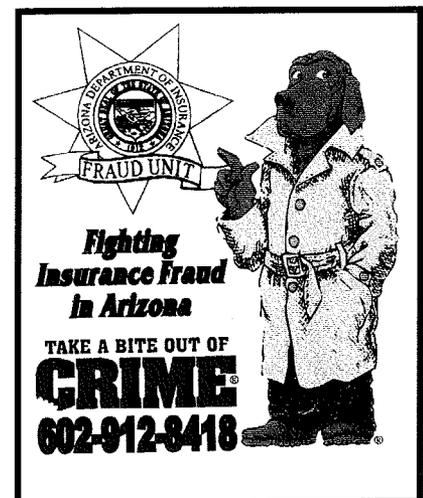
Fraud Awareness

Public awareness and education about the consequences of insurance fraud are an important part of the Department's fraud program. The Department's fraud awareness program focuses on educating the public, law enforcement and the insurance industry that insurance fraud is a crime for which everyone pays a high price. By raising awareness, people learn

- that insurance fraud is not a victimless crime -- insurance consumers ultimately pay more for insurance products and other consumer products when inflated or fraudulent claims are paid by an insurer;
- that insurance fraud is a felony crime, and understand that committing insurance fraud can lead to serious consequences;
- about the role of the Fraud Unit and how to report cases of suspected insurance fraud.

On May 26, 2000, the Unit orchestrated a Fraud Awareness Program event at the Bank One Ballpark. Governor Jane Dee Hull proclaimed "Fraud Awareness Day" in Arizona. McGruff™ the Crime Dog, the symbol of Arizona's fight against insurance fraud, took an honorary "strike against fraud."

The event, held at an Arizona Diamondbacks game, reached thousands of individuals with the message of fraud awareness. Promotional, informational and educational materials, bearing the McGruff™ logo and the fraud referral phone number, were distributed throughout the Ballpark.



Fraud Unit investigators also began offering a training program for law enforcement personnel. More than 15 state and local police departments participated to learn the elements, causes and effects of insurance fraud. This program will continue through next year and beyond.

Fraud Unit Performance

Figure 3 summarizes Fraud Unit performance measures as required by A.R.S. § 20-466.05.

Figure 3: Fraud Unit Performance

Reporting Categories	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000
Total Fraud Referrals ⁴ Received	595	827	1,355	1,413	1,746
a. Referrals for Information Only ⁵	468	468	839	630	763
b. Number of Cases Investigated	127	359	516	783	983
Cases Closed Without Referral for Prosecution	145	247	289	147	751
Cases Referred to Prosecutors	40	69	149	192	149
Indictments	6	48	149	79	149
Prosecutions	4	15	41	101	137
Convictions	4	15	41	101	137
Restitution Resulting from Unit Operations	\$59,465	\$180,206	\$1,044,875	\$388,438	\$1,534,128
Value of Property Recovered	\$0	\$0	\$ 300,662	\$ 99,646	\$ 100,022
Fines Resulting from Unit Operations	\$13,194	\$35,879	\$ 273,192	\$ 38,970	\$ 18,638

Obstacles in Investigating Criminal Fraud

LACK OF PEACE OFFICER STATUS

The most significant obstacle to accomplishment of the Fraud Unit's mission arises out of the lack of peace officer status. Unlike peace officer investigators who work for other regulatory enforcement agencies in Arizona, Fraud Unit investigators are unable to:

- Obtain and serve search warrants or court orders of identification,
- Seize evidence in plain and open view,
- Make arrests, or
- Engage in proactive investigative activity that may be dangerous.

Search and Seizure of Evidence. During the past four years, the Fraud Unit has requested service of 51 search warrants. When non-Unit officers must serve a Fraud Unit search warrant, the officers conducting the search are not familiar with the case or the potential evidence and do not necessarily recognize the items of evidence being sought.

⁴ The Fraud Unit receives referrals from insurers about claims that may be fraudulent and from reports by the public.

⁵ Many referrals are submitted for "information only" for which the insurer is not requesting that the referral be investigated. Data also includes referrals that are reviewed and found not to indicate a violation of Arizona law.

Service of Arrest Warrants and Effecting Arrests. The Fraud Unit investigators, who do all the underlying work necessary to investigate the case, must explain the underlying facts to the officers from the arresting agency. Even then, other law enforcement agencies are often reluctant to arrest a suspect when they have not, themselves, completed the underlying work.

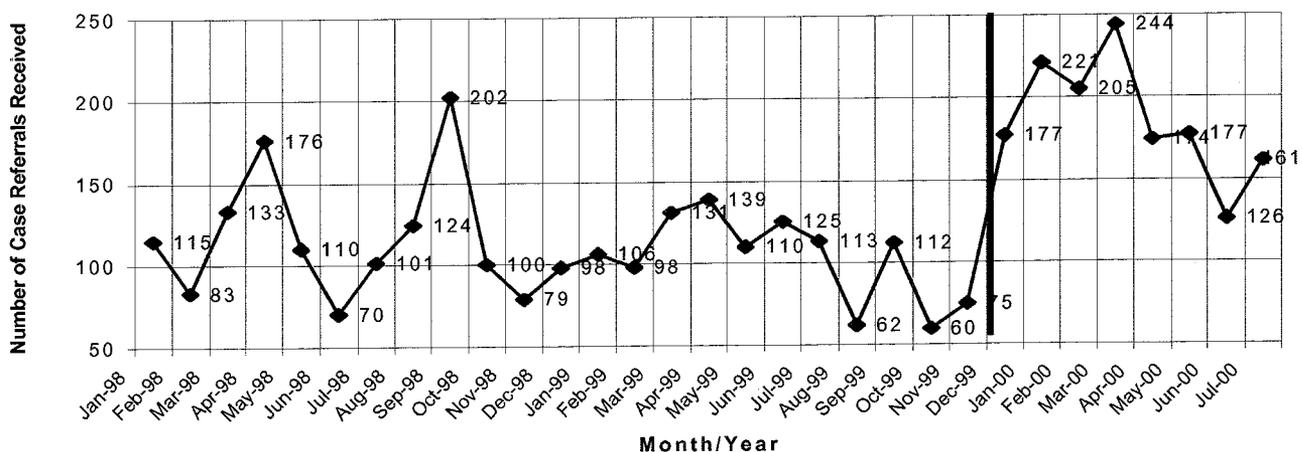
Proactive Investigations. Undercover investigations are one of the most effective means of detecting rings that stage automobile accidents, operate medical mills, or otherwise perpetrate insurance fraud as part of an organized scheme. When an undercover operation is concluded, arrests must be made on the spot to avoid risking harm to the investigators and citizens, and to minimize the opportunity for lost evidence and suspected flight. The Unit's dependence on other agencies to serve warrants, collect evidence and effect arrests often makes conducting undercover investigations impracticable. Moreover, undercover activity is sometimes potentially dangerous. Fraud Unit investigators cannot be permitted to engage in this kind of work without the ability to protect themselves. Consequently, without peace officer status, the Unit must limit the nature and scope of its proactive investigative activity.

In short, Fraud Unit investigators do not possess some of the basic tools needed to fulfill the Department's responsibility to investigate the crime of insurance fraud. The Unit must rely on the Department of Public Safety and other police agencies to perform many of the ordinary, but critical, tasks associated with criminal investigations. Though we greatly appreciate the assistance we have received, it is a considerable logistical problem to rely on other agencies for core services. This reliance drains precious resources from other police agencies, delays the completion of insurance fraud investigations, and limits the potential benefit of the Fraud Unit.

INCREASES IN CASELOAD AND BACKLOG

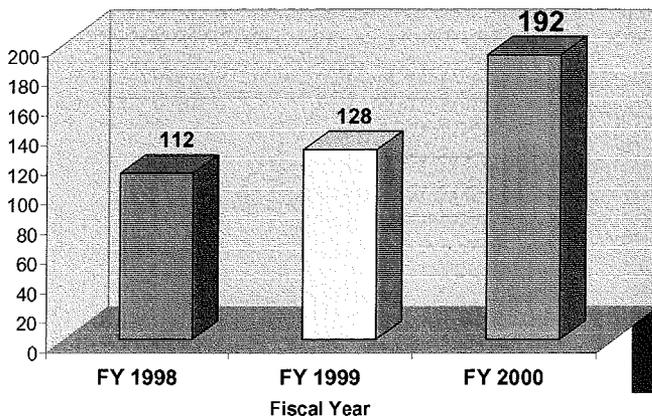
In December 1999, the Fraud Unit implemented a campaign to inform insurers of their responsibilities to refer suspected fraud cases to the Insurance Department. The Unit was also aggressive during Fiscal Year 2000 in its efforts to raise public awareness of insurance fraud and its effects. As illustrated by **Figure 4**, coincidental with its stepped-up fraud awareness activities, the Fraud Unit experienced a substantial increase in the number of cases referred.

**Figure 4: Cases Received by Fraud Unit
 1/1998 to 7/2000**



The increase in caseload has led to a rise in the amount of time needed to close a case, increasing from an average of 128 calendar days in Fiscal Year 1999 to 192 calendar days in FY 2000 (**Figure 5**)⁶. Similar to many other types of criminal investigations, as time elapses after the commission of a crime involving insurance fraud, investigation activities become more difficult. Evidence, witnesses and involved parties become progressively more difficult to secure. Thus, the delays caused by caseload increases are compounded as cases age. The Department has included in its FY 2002/FY 2003 biennial budget request and has identified as a critical issue the need for additional Fraud Unit investigators so the Unit can keep up with the increasing number of referrals.

Figure 5. Average Calendar Days to Close a Case from Date Referral Received



The Department has included in its FY 2002/FY 2003 biennial budget request and has identified as a critical issue the need for additional Fraud Unit investigators so the Unit can keep up with the increasing number of referrals.

Special Thanks

Our Fraud Unit cannot be successful without the efforts of our partners in crime prevention.

- The Department of Public Safety's Vehicle Theft Task Force and the Arizona Automobile Theft Authority coordinate investigations with the Fraud Unit.
- The National Insurance Crime Bureau provides the Fraud Unit with referrals that are submitted by its member insurance companies.
- Municipal police departments, the Department of Public Safety, and the Office of the Attorney General assist with serving warrants, conducting searches and seizures, obtaining criminal justice information from other law enforcement agencies, executing arrests, and other proactive investigative work.
- The Arizona Attorney General's Office and the Maricopa County Attorney's Office vigorously prosecute insurance fraud cases.
- Insurers support the efforts of the Fraud Unit by referring cases and related evidence of suspected insurance fraud, and by paying assessments that reimburse the General Fund for the costs of operating the Unit.
- Governor Hull and the Legislature provide support and resources that enable us to continue work to deter and investigate insurance fraud.

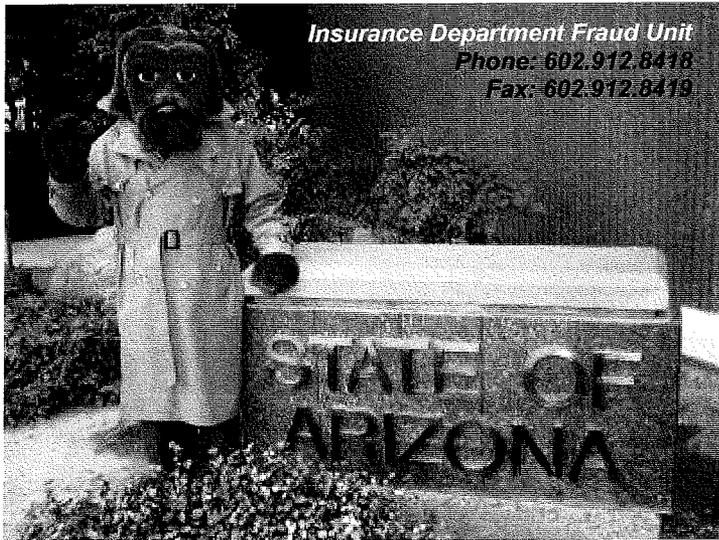
⁶ The method used to calculate the fraud investigation cycle time recently changed. In the Department's agency budget request and strategic plan, data was calculated based on all referrals received, regardless of whether the referral led to an investigation. The method applied in Figure 5 excludes "information only" referrals thereby only including in the results referrals for which investigations were launched. Both methods show an increase in fraud investigation cycle time and illustrate the need for additional investigators.

To all our partners, thank you and we look forward to a new year of working together to fight insurance fraud.

Sincerely,



Charles R. Cohen
Director of Insurance



The Fraud Unit is saying "goodbye" to its offices at 2910 North 44th Street, and "hello" to new offices at the Centre Pointe Complex.

Starting January 16, 2001, the new address of the Fraud Unit will be:

***Insurance Fraud Unit
1651 East Morten Avenue, Suite 150
Phoenix, Arizona 85020***

Phone and fax numbers will remain the same.