

HISTORICAL OVERVIEW OF VEHICLE PRE-INSURANCE INSPECTION

How It Started, What It Is, What It Does

The significance of vehicle pre-insurance inspection is best understood through the perspective of history and performance, and an appreciation of the myriad issues related both to the need for vigorous inspection programs, and the benefits provided.

Vehicle inspection, in the most fundamental terms, is a system designed to verify and document the existence of a motor vehicle, as well as its condition and existing options and accessories. The primary goal of the inspection process is to help lower the cost of insurance coverage for physical damage by significantly reducing opportunities for fraudulent claims.

New York State Led The Way

In 1977, as auto insurance rates had risen to unparalleled levels, there was strong sentiment and increasing public protests over the continuing spiral in the cost of insurance, New York State passed the Insurance Reform Act of 1977, also known as “Regulation 79” or the “Photo Inspection Law.” This forward-looking legislation, which has served as the model for other states and has been responsible for saving hundreds of millions of dollars, was designed to help stabilize or reduce auto insurance costs. This has been accomplished to a large degree by preventing non-existing or “phantom” vehicles from being insured, and suppressing both exaggerated damage claims and claims for pre-existing damage from being made by policy owners looking to defraud an insurance carrier.

Regulation 79 required that vehicles with physical damage insurance coverage including fire, theft, collision or comprehensive coverage be inspected by a representative of the insurance carrier prior to issuing a policy, a ground-breaking idea in the ‘70s. The inspection, which involved verification by an inspector that the all-important Vehicle Identification Number, or VIN, matched the vehicle, also established that various options and accessories claimed by the

policy owner were correct. The inspection law required and that pre-existing damage to the vehicle be clearly identified and photographed, along with the Federal Motor Vehicle Safety Certification Standard label, frequently referred to as the EPA label. This type of inspection was arguably the first effective deterrent to vehicle-related insurance fraud.

In late 1977, CARCO Group, Inc., a privately-held corporation, was founded to provide physical damage pre-insurance inspection services to the insurance industry. As a convenience to the motoring public the company established a network of more than 1,000 inspection stations throughout New York, with sites accessible to all residents of the state. An integral part of the inspection service was the leading-edge computer processing and communication capabilities developed by the company, which would ultimately prove to be a powerful investigative and law enforcement tool.

Based on the success of New York's Photo Inspection Law in quickly reducing the number of fraudulent claims, the Commonwealth of Massachusetts and New York's neighboring state, New Jersey, implemented similar programs. As in New York, a comprehensive physical damage inspection site network and vehicle inspection program comparable to New York was established.

Following Massachusetts and New Jersey the next state to introduce an inspection program, although limited in scope, was Florida. Physical inspection services to meet the needs of insurance carriers in Florida, based on the successful programs in New York, Massachusetts and New Jersey, were established by private inspection service contractors. In 1994 the state of Rhode Island also implemented a vehicle pre-insurance inspection program.

Based in large part on the success of pre-insurance inspection programs in the U.S., the Canadian Province of Ontario passed the "Insurance Act", which mandated physical damage inspection of vehicles throughout the Province. Within a few months after passage of the "Act" the site network of nearly 750 inspection facilities in Ontario, was fully operational.

VEHICLE INSURANCE FRAUD IS A NATIONAL PROBLEM

Crime involving motor vehicles is a costly national problem, which unfortunately represents substantial profits. Because of this "profitability" and potential for sizeable fraudulent claims, the insurance industry has come under attack by its critics for not being aggressive in investigating and prosecuting the perpetrators of fraudulent claims. The reasons given have

included the high cost of investigation and litigation, and the consequences of losing cases in court and being sued for non-performance on insurance policies. The safe alternative for the insurance companies has traditionally been to raise rates and pass the cost along to policy holders.

Vehicle crimes and insurance frauds that encompass real theft and legitimate accident damage claims, petty frauds involving inflated claims, and exotic scams executed by skilled individuals and organized crime rings, force honest premium payers to subsidize the enterprises of dishonest citizens and clever criminals. Although vehicle-related crimes represent about a tenth of all reported property crimes, they have accounted for more than half of all property crime losses [in dollars] for a number of years.

Billions lost each year

In 1987 annual losses for property crimes involving vehicles were in excess of six billion dollars, compared to the combined losses attributed to all other major categories of property crime, which totaled \$6.4 billion. In 1990, vehicle crime losses totaled more than \$8 billion out of the total property crime losses of \$15 billion. In statistics published in the 1992 FBI Crime Reports, the figures were virtually unchanged, even though the percentage of year-to-year increase in auto crime decreased: over \$7.6 billion for motor vehicle crimes out of the total of \$15 billion. The conclusion is that vehicle crime, including the sizeable fraud component, continues to be big business. As you can see by the figures shown for two reporting years, albeit a decade apart, the financial significance of vehicle-related crime remains relatively unchanged.

Major Property Crime Losses			
<u>1992</u>		<u>2000</u>	
Larceny-Theft & Burglary	\$7.6 Billion	Larceny-Theft & Burglary	\$8.1 Billion
Vehicle Theft	\$7.6 Billion	Vehicle Theft	\$7.8 Billion
\$15.2 Billion		\$15.9 Billion	

Although the estimated percentage of fraudulent claims varies from year-to-year depending on the source, it is substantial. Figures from the insurance industry, however, tend to disguise the problem. The industry's estimates have generally been within the 10–15 percent range of claims submitted. By contrast, law enforcement, fraud bureaus and insurance claims investigators feel

that fraudulent claims represent far higher percentages, generally between 20 to 30 percent of all claims submitted. In some states, even more.

Whichever range is correct, or perhaps somewhere in between, the results are measured in billions of dollars. Each year, huge profits are made by criminals who successfully commit insurance frauds on a regular basis and by policy owners attempting to recover part of their premiums from the insurance company. These losses place a significant financial burden on honest consumers who ultimately pay the bill in the form of higher insurance premium rates. A resource problem is also created for law enforcement agencies who are required to investigate fraudulent claims. In the case of theft fraud, for example, law enforcement agencies spend valuable time investigating accidents that never took place, and searching for “phantom” vehicles that do not exist.

In 1987, according to the FBI Crime Reports, a motor vehicle was reported stolen every 24 seconds. The FBI's 1993 statistics showed that vehicles were reported stolen on an average of every 20 seconds, while in 2000, the frequency was reduced to every 35 seconds – only a slight improvement over a 13 year period. If you factor in the fraudulent theft reports for phantom vehicles that would have been filed if pre-insurance inspection programs didn't exist in a number of states, the total number of offenses would have been significantly higher. And while many of the vehicles included in these statistics were in fact stolen, a large percentage, however, were phantom vehicles.

THE PHYSICAL INSPECTION SOLUTION

It is unlikely that there will ever be a satisfactory solution to all vehicle property crimes, or absolute deterrents to real theft, vandalism and other criminal activities. In the case of insurance fraud, however, mandatory inspection programs have proven their worth in deterring a spectrum of schemes in every state with a strong pre-insurance inspection law and active anti-fraud programs. As a requisite for obtaining an insurance policy, inspection can produce dramatic results. It makes the insured prove that a vehicle actually exists, thereby preventing a host of otherwise easy to execute schemes.

Vehicle insurance fraud, like other insurance crimes, is often referred to as a hidden or invisible crime. Regrettably, it is also widely perceived as acceptable because “everyone does it.” Because of the very nature of fraud and the intent of the perpetrator to deceive, the evidence of

the crime isn't usually visible and is therefore difficult to detect.

John Reiersen, formerly Chief Examiner in the New York Insurance Department's Property and Casualty Bureau and an important force in making New York's mandatory inspection law a reality, agrees with the prevailing perception that insurance fraud isn't considered a crime by those who reap the benefits. According to Reiersen, "Many policy owners feel that filing an inflated or fraudulent claim isn't a crime. It's simply getting back at the company that's been ripping you off." In Reiersen's opinion, a significant percentage of all vehicles reported stolen in states with serious crime problems, are attempts to defraud insurance companies.

In reality, insurance fraud is a crime of major economic significance. In the long term its consequences do not affect insurance carriers, but the public who will ultimately pay billions of dollars each year in increased premiums and law enforcement costs. Policy owners pay the price for fraud, whether it's day-to-day abuses such as inflated damage claims or sophisticated schemes engineered by organized crime rings. Although a large portion of vehicle-related insurance fraud is the result of organized crime such as high volume chop shops, a substantial portion is also attributable to fraudulent claims made by "average" citizens. Many routine theft claims, for example, include accessories or personal items that didn't exist such as an expensive CD player, car phone or expensive radio. Claimants regularly inflate the value of lost or damaged property, attempt to collect for damage that existed when the vehicle was purchased, or try to obtain inflated estimates for damage repair.

Insurance frauds can be implemented in many ways and classified under a number of categories. The intent, however, is generally the same – to make a profit through deception. A definition given by the Coalition Against Insurance Fraud accurately describes the nature of insurance fraud: "Any deliberate deception perpetrated against or by an insurance company or agent for the purpose of unwarranted financial gain. It occurs during the process of buying, using, selling and underwriting insurance."

Experienced insurance claims specialists in the property and casualty industry generally agree that fraud accounts for a significant percentage of all claims, perhaps ten to fifteen percent of all claims, or more. The major problems occur with vehicle casualty and property losses associated with theft and arson where, according to the National Insurance Crime Bureau [NICB], between ten to 30 percent of all property/casualty insurance claims are fraudulent.

The key to fighting fraud in general and vehicle insurance fraud in particular is to understand its nature, scope, mechanics and economic implications. Only then will the solutions be clear. In states with strong legal deterrents such as mandatory inspection programs, insurance fraud bureaus, and the commitment and resources to vigorously pursue offenders, progress is being made. A result of this progress can be seen in the various states that now have fraud bureaus within state insurance departments that cooperate with law enforcement agencies and the insurance industry.

While completely eliminating vehicle insurance fraud may not be a realizable goal, making it more difficult for individuals or organized crime rings to profit is. Through effective anti-fraud laws and regulations the situation will change. Laws that make it difficult for dishonest people to dupe insurance companies, that encourage investigation of suspicious claims, that require physical inspection before an insurance policy is written, and enforce laws that punish people who commit fraud, will make the difference.

MANDATORY INSPECTION IS WORKING IN NUMBER OF STATES

Mandatory vehicle inspection, with visual documentation [photographs or digital images], as a requisite for obtaining an insurance policy is the only proven deterrent to vehicle insurance crime. Inspection laws now in effect in various states require a new policy applicant or policy holder adding a newly acquired used vehicle to have it inspected and photographed at one of the many designated inspection sites located within the respective states. Inspection programs prevent a variety of costly insurance frauds from being successful and often save countless hours of police work to investigate fraudulent claims.

New York's pioneering legislation, which is still the model used as a baseline by other states considering comparable programs, established rigid standards for physical inspection and photo documentation of newly acquired used vehicles including autos, trucks, vans, and motorcycles. Since the insurance carrier is given the option to inspect any vehicle, in many cases even high-priced new vehicles are candidates for inspection.

The inspection process virtually eliminates future claims for the theft or repair of phantom cars, or the repair of damage that existed before the vehicle was insured. It requires that inspectors see the vehicle and acknowledge in writing that they performed the inspection. The resulting paper trail linking the inspector to the vehicle is also an effective deterrent to collusion between inspectors and dishonest policy holders.

The success story about the war on fraud began to unfold with New York's Photo Inspection Program in the late 1970's. In 1979, for example, about ten percent of all reported vehicle thefts in the U.S. occurred in New York City. In fact, New York led the country in the number of vehicles reported stolen with a 14.8 percent increase over 1975. It also had the smallest percentage of recovered vehicles, only 38 percent. As evidence of the law's dynamics, there were more than 7000 fewer reported vehicle thefts in New York in 1987 than 1977, ten years after pre-insurance inspection went into effect. During this period the problem of vehicle crime was mushrooming in different parts of the country.

The success of New York's legislation had an almost immediate effect on surrounding states. While reported vehicle thefts declined by about seven percent in New York in the two years following its enactment, neighboring states such as Pennsylvania, Connecticut and New Jersey experienced sharp increases: 16 percent, 19 percent and 36 percent, respectively. The New York law was amended and strengthened in 1988. Since its enactment the consensus is that New York's inspection law has accounted for more than \$100 million in loss payout savings annually, which is translated into a stabilization of insurance rates. Paradoxically, despite New York's success, it took more than ten years for any state to follow its lead in enacting a comparable mandatory vehicle inspection law.

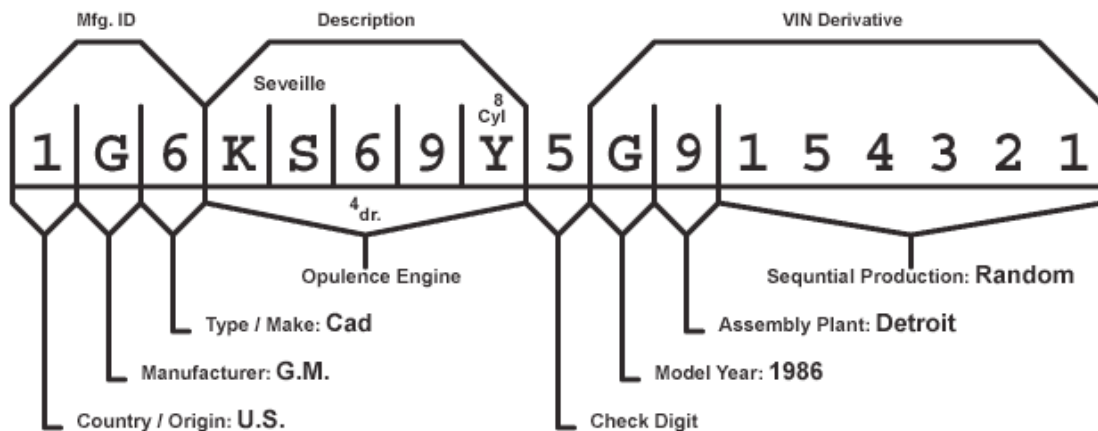
THE PHYSICAL INSPECTION SOLUTION

Mandatory inspection programs provide the opportunity for an authorized inspector to carefully examine the vehicle's documentation and identification numbers, its condition and optional equipment, and record the findings on an inspection report form. The addition of color photographic or digital images provides a permanent record of what actually exists, not necessarily what the policy owner claims.

The inspection process, as now performed in states with inspection laws, involves a thorough inspection of the vehicle and, in states with photographic requirements, pictures of the vehicles. This includes newly purchased used vehicles and if required by the insurance company, high value new vehicles. The general consensus within the claims investigation community is that physical inspection and photographic documentation is arguably the only successful deterrent to vehicle-related insurance fraud.

The Inspection Process

Vehicle inspection generally starts with the inspector copying the Vehicle Identification Numbers [VIN] from the VIN plate seen through the windshield. The uniqueness of the VIN is its specially encoded 17-digit alphanumeric sequence that identifies the vehicle and establishes its origin. It is the equivalent of the vehicle's birth certificate. The make, model, year and odometer reading are also recorded on the inspection report, along with a description of any expensive accessories found in the vehicle, optional equipment and comments about the vehicle's physical condition.



In states where digital or photographic images are required, at least three color images are produced: two oblique views which show the rear and passenger side and front and driver's side of the vehicle. The third photo, a vital component in the inspection report, shows the Federal Motor Vehicle Safety Certification Standard Label, including the VIN. The self-adhesive sticker, often referred to as the EPA label, is located on the driver's side door post or door jamb. Additional photos are taken of physical damage or special features that the inspector deems to be important.

The completed report and photos are promptly sent to a central data processing facility such as the CARCO computer center located in New York [CARCO is one of the major vehicle inspection services in the country, with operations in all states with inspection programs]. Here, the inspection information is entered into a powerful computer database that automatically checks the authenticity of the VIN to ensure that the vehicle and VIN match. Irregularities can

be detected in seconds. If there is any disparity the insurance company is alerted that further investigation may be needed.

The photo inspection process results in permanent, tamper-proof, high quality images that are attached to the inspection report and kept on file by the inspection service or the insurance carrier. When the insurance company or law enforcement agency needs inspection information, a copy of the report can be quickly provided, electronically.

Inspection requirements are essentially the same in all states with mandatory programs regarding the number of photos and the contents of each image. Some aspects, however, differ from state-to-state such as: the documentation format and information required, the need for photos, grace period after notification, exemptions and waivers [in years], renewals, age of vehicles to be inspected, and new/used car inspection guidelines. When an insurance company receives a request for coverage involving a newly acquired used vehicle, or a change in carriers, the insured is notified in writing that the vehicle must be inspected within a specified period of time and provided with a list of convenient authorized inspection facilities.

INSPECTION DETERS VARIETY OF FRAUDULENT SCHEMES

Inspection programs are now playing an active role in a number of states in preventing certain types of insurance fraud. An intriguing variety of fraudulent schemes can be discouraged or detected by physical inspection. These include claims for non-existent phantom vehicles abandoned by their owners and reported stolen, claims for pre-existing damage, dumping vehicles into a body of water such as a lake, river or canal, and later claiming it stolen. Inspection programs provide strong deterrents to a spectrum of costly schemes including:

Typical Schemes:

- Non-existent or phantom vehicles using phoney VINs.
- Claims for damage that existed when vehicle was purchased.
- "Paper Car" and counterfeit title frauds using falsified documents.
- Salvage schemes involving titles and VIN plates from salvaged vehicles.
- Duplicate car frauds using same VIN plate and documentation.
- Duplicate title frauds: to collect claims from sale of vehicle, and theft claims.
- Increasing claim value by adding equipment and accessories not in vehicle.
- Import/Export frauds using authentic documentation for vehicles residing in another

country.

- Staging accidents or claiming accidents that never occurred.
- Multiple policy frauds to collect on multiple claims.

Supported By Law Enforcement

Law enforcement officials favor mandatory vehicle inspection as a strong deterrent to crime and as a tool for obtaining convictions in insurance fraud court cases. This opinion is prevalent throughout law enforcement communities in states with inspection laws, and in states with high vehicle crime problems that are considering similar legislation. The speed and versatility of the inspection process provides insurance company Special Investigation Units [SIUs], law enforcement agencies and insurance fraud bureaus with effective tools.

Although insurance rates have historically moved upward because of increased vehicle crimes such as theft, vandalism and property damage resulting from accidents, the percentage of overall rate increases related to insurance fraud is lower in states with inspection programs. Even in states with vehicle inspection regulations, however, rates may continue to stay high, or even increase, because of the surge in legitimate personal injury claims as well as fraudulent personal injury claims. Despite the increase in personal injury claims, the net result of inspection programs and other anti-fraud activities is a containment of costs by insurance carriers, stabilization of rates for the consumer and improved productivity for law enforcement agencies.

THE NATIONAL AGENDA

Although the increased problems in property crimes have grown to nationwide proportions in a number of areas, representing more than 15 billion dollars each year, vehicle-related property crimes seem to be the fastest growing, and without strong measures to counter the escalation in insurance fraud, it is likely to continue. The results are higher premiums, which tend to heighten fraudulent activities in a never-ending spiral. Organized crime rings that specialize in insurance fraud, whether it be health care or vehicle-related, flourish in states lacking effective deterrents.

Unfortunately, no strong federal standards exist other than the Standardized Requirements Regulations For Vehicle Identification Numbers [VIN], which went into effect in 1981 and the Federal Motor Vehicle Theft Law Enforcement Act of 1984, which commenced with the 1987 model year. The lack of nationwide reporting, a unified national database and uniform laws

makes it difficult or impossible to track fraudulent activities on a national basis.

The 1984 Act requires standardized marking of the VIN on targeted new vehicles and replacement parts. The Motor Vehicle Theft Law Enforcement Act, which requires that standardized National Highway Traffic Safety Administration [NHTSA] identification labels be used on specified new vehicles and replacement parts, is divided into three sections:

Section One

Covers manufacturer's requirements for permanent ID numbers to be placed on up to 14 major parts of certain vehicle models.

Section Two

Makes it a felony to alter or remove ID numbers from a vehicle.

Section Three

Makes it illegal to import or export stolen vehicles.

IN SUMMARY

Mandatory inspection as a requisite for obtaining vehicle insurance is the only proven deterrent to vehicle insurance fraud. To date, it is the only strategy that has proven successful in significantly reducing fraudulent claims and stabilizing insurance rates. Since 1977, when the first inspection law was passed In New York, billions of dollars have been saved through this unique anti-fraud measure.

The benefits of the photo inspection process extend far beyond the inspection report itself. Because the policy-holder must prove the existence and condition of a vehicle, the possibility of future claims for the theft of non-existent vehicles or the repair of vehicles with prior damage is greatly reduced. In addition to its deterrent value, photographic evidence also provides an excellent investigative tool.

The major benefit of pre-insurance vehicle inspection lies in its pro-active rather than reactive attributes. It allows the insurance carrier to take action to prevent an insurance fraud from occurring, rather than passively allowing criminals and dishonest citizens to create economic havoc for the motoring public.