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INSURANCE CRIMES

Alfred Manes

(The Professor of Insurance and Economic Research in Indiana University indicates here the enormous volume and range of insurance crimes in our country. To meet the situation criminal law needs the support of good civil laws and of an insurance science that can be understood by the layman. Misuse of insurance can be excluded by legislation covering contracts and supervision, by insurance education, and by more rigid examination of moral hazards.—Editor.)

Insurance is an object of criminal exploitation. From the beginnings of insurance experience we find insurance crimes. These early forms have persisted, and there have been added many new varieties from time to time as the field of insurance has broadened. Hence the field of insurance crime is as broad and complex as that of insurance itself.

The number of insurance crimes attempted and successfully carried out is much higher than the number discovered and punished. Many cases are camouflaged as pure accidents. There is no adequate reporting of insurance crimes or their frequencies.

The chief motive in all insurance crimes is financial profit. In order to receive it, the criminal may intentionally or unintentionally hurt or kill innocent people. The intentional harm to others occurs in life insurance when the insured person is murdered for the purpose of obtaining the amount to be paid at the time of his death. The unintentional harm may happen in property and casualty insurance when in destroying an insured property persons accidentally lose their lives.

Many insurance contracts make it relatively easy to obtain unjust profits. Often it is difficult to avoid over-insurance, that is, insurance on amounts higher than the real value of the property covered. It may even happen that the seller of the policy promotes such practices, especially when his income depends upon the amount insured.

Insurance is complicated, and, to most people, more or less mysterious. To understand it, one must have some knowledge of economics, business, mathematics, statistics, and law. Therefore, it is not surprising that ignorance about insurance prevails not only among average people, but also among lawyers, judges, and legislators as well. So one often finds loopholes for fraud. As soon as one has been eliminated, new tricks are invented to obtain unlawful profits.

When men are reimbursed for the loss of their property, many

will maliciously destroy their own in the absence of strong measures against such behavior. If accidental losses but not planned losses are indemnified, many people will try to make any intended loss appear to result from carelessness. This is the explanation of many frauds connected with liability insurance.

That marine insurance crimes predominated in the past is easy to understand when we consider that marine insurance was the mother not only of many branches of insurance but of insurance law as well.

A few examples will illustrate.

During the third quarter of the nineteenth century, dozens of grain-laden ships went down at the entrance to the harbor of Montreal. Such losses were insured and paid by marine insurance companies. To prevent these losses, the Canadian authorities issued rules for the loading of grain vessels with fines of \$40.00 for each infraction. However, not until 1873, when the fine was increased to \$800.00 did the sinkings diminish. Overloading no longer was profitable to the insured ship owners.

In property insurance most crimes are against fire insurance companies. It is true that an ocean marine insurance policy offers much more opportunity for criminal exploitation because of the far-reaching multilateral coverage guaranteed by the marine insurer in contrast to the very specialized coverage offered by the fire insurer. But it seems to require much less courage and criminal spirit to cause a fire than to cause the sinking of a ship.

A fire is caused by simple friction—to repeat an old story—the simple friction between a \$3,000.00 stock of goods and a \$10,000.00 fire insurance policy. The era of the professional arson-rings and gangs in New York, Chicago, Philadelphia, etc., is ended. They were smashed after the arson laws were passed in the majority of states. The experts in firebug fighting, backed by the efforts of police and fire departments and the organized fire insurance companies, shared responsibility. In spite of all this, the incidence of arson is still considerable. Fire is a ready consumer of unsalable goods. There is about \$125,000,000.00 worth of property damage caused by incendiary fires in the United States each year.

Probably the most striking examples of fire insurance crimes are to be found in Latin America. To correct the situation, a Chilean law provides for the arrest of the proprietor of any house insured against fire as soon as the house burns. He must stay in prison until it has been proved that the fire is not due to arson. In a certain district in Brazil fire insurance was not known until recently. From the moment of its introduction; the number of fires increased enormously.

A typical example of a present-day fire insurance fraud is found in a certain New York store which closed one morning at 1 a.m.

The fire department was called a half hour later. Some damage to stock occurred. The next morning, from some place in the upper part of New York City, stock that had been damaged by a former fire was put in the cellar, and later upon the shelves. While the stock was in the cellar, water was poured on it by the employees. This merchandise was included in the inventory on the loss adjustment, and all the evidence pointed to an incendiary blaze.

It is not always true that property alone will be destroyed by the burning of an insured house. As mentioned before it may be that, contrary to the intention of the arsonist, innocent persons may be hurt or even killed. In contrast, such loss of human life does not occur in the case of burglary insurance crimes. In this case, not even the property will be destroyed. The insured goods will disappear from their usual place only to appear elsewhere where they will be reclaimed later by the policyholder. It is well known that insurance companies are suspicious of fur shops in certain districts where theft by the shopkeeper himself is a possibility. An incident of this type took place in a small New York City haberdashery shop. The shop was covered by a burglary insurance policy. After a hold-up, while one clerk called the police, the other rang up amounts on the cash register. At first the loss was only \$50. When the insurance adjusters arrived, the book loss had been fraudulently increased to \$350.00, which was paid.

The following is an example of a crime against a plate glass insurer. Some time ago, in the early morning, the police in a small town discovered that the windows of several stores had been broken during the night. The perpetrator of the crime was the agent of a plate glass insurance company whose intention was to show the need for plate glass insurance and its benefits. By breaking windows, the advantages of insurance were advertised effectively and without cost to the agent.

The record of life insurance frauds reads like fiction. It is difficult to say whether the crimes committed in the remote past, with the goal of getting money through the death of persons insured, are more or less dramatic than those committed in our times. As long as insurance legislation was in its primitive stage, what was called insurance was in reality nothing more or less than pure gambling or betting. It was easy to misuse an insurance policy which was a promise by the company to pay an amount in the case of the death of the insured. There were in almost all European states, from the sixteenth until the nineteenth centuries, laws which forbade criminal misuse of life insurance, or more correctly stated, forbade gambling in lives. One may well imagine that insurance did not prolong the life of a king, prince, or other man in power when it was permitted and usual for anyone to make a contract by which a large amount would be paid to the "policyholder" in the

event of the death of the insured person. Undoubtedly, such speculation on the early death of the insured was dangerous to him. And so it came to be forbidden to insure the life of kings and other high ranking people.

It was forbidden, also, to wager high amounts on the date of death of poor fellows who had been brought from the continent to England where they became destitute and welcome objects of shameful speculation by gamblers in lives. It was not until 1774 that the life of every person was protected by the statute of King George III. From that time on "no life insurance contract was valid unless the beneficiary had a bona fide interest in the life of the person insured." However, 100 years later in America not even such a modest preventive measure existed in all our states.

Another type of life insurance crime was associated with issuing policies on the life of little children. What has been disclosed in this connection by parliamentary discussions and the Royal Commissions in England in 1845 and 1870 is almost unbelievable. One of the principal causes for the high infant mortality rate was found to be the insurance against the death of children. In 1884, the Society for the Prevention of Cruelty to Children was founded in London for the purpose of keeping insured children from becoming angels too quickly. The same idea prevails in the American regulations, whereby not more than the burial costs may be covered by insurance of children.

Of more recent date is speculation on one's own life: the insurance of intended suicides. This was promoted greatly by competition among companies which passed reasonable limits in offering highly favorable conditions in policies such as unconditional payment of the whole insured amount in the case of suicide and without any waiting period. It is unnecessary to say that modern legislation has stopped such practice in the companies' own interest. On the other hand, many persons die intentionally, under the camouflage of pure accidents, without being discovered as suicides. The progress of science, first of all, in transportation (automobile, airplane, etc.) has brought much progress in suicide methods.

To obtain statistics on the known false testimonies which have been given by the insured might prove to be enlightening. Among life insurance companies there is a certain organization for the communication of refused risks; all member companies being informed of the persons who were refused life insurance applications by each member company. The members of this organization are thus in a position to control every application entered, whether or not the applicant has mentioned former refusals—about which the application blank contains specific questions. With the object of gathering material, an investigation concerning these concealments

was begun about twenty years ago by a group of European life insurance companies and in this way some statistical material was collected. It was discovered in the investigation that, on the average, out of 100 applicants who approached an agency, seven had already been refused. The investigation further showed that out of these seven, only four admitted the refusal, while the other three attempted to conceal it. Therefore, the rate of intentional concealment is 40%. Consideration of this figure leads to an unfavorable conclusion concerning the honesty of applicants for life insurance policies.

Consider a modern example of this type of crime. An officer of a life insurance company was attending a concert presented by the inmates of a tuberculosis sanitarium. The sanitarium encouraged patients to stage amateur theatricals to bolster the morale of the institution. The officer's attention was diverted from the stage to his program. He didn't know what it was, but something about the program fascinated him, so he took it home with him. A few days later he discovered that many of the actors were listed on the rolls of his insurance company, and they were collecting a monthly disability income. The situation was rather unusual. These actors were from all over the United States, but they had all bought insurance from this company, and they were now all at the same institution. They had all passed the company's strict physical examinations and then, in a very short time, all had contracted tuberculosis. After an investigation, one of the patients confessed. The patients spent only enough time—about six months—in the sanitarium to heal the lung lesions. This was also just about as long as their money lasted. When they returned home, they told no one where they had been, and since the usual stethoscopic examination of the chest will not detect an incipient case of tuberculosis nor a healed lesion, they bought life insurance with disability-income riders attached, denying any tubercular history. After waiting for the contestable period—usually a year—to expire, they claimed disability and returned to the sanitarium with a comfortable life income. This was one of the largest life insurance frauds ever carried on. There were about 160 cases in this one institution. It is a type of life insurance fraud that does not depend on real or faked death for its success.

In a small western town a business man had a friend who was an undertaker in a neighboring city. The undertaker had as one of his duties the disposal of the pauper dead. The business man "died" one night as his friend was driving him home. The undertaker stated that his friend had got out of the car to crank it, and when the undertaker looked for him, he was dead. The undertaker then put the body back into his car and took it to his undertaking parlor. The body was cremated after the usual death notices were

published. After this was done, the "widow" claimed payment of a life insurance policy for \$25,000. The man who had burned the body was interviewed, and from his description there were marked differences between the weight and height of the man he had cremated and those of the supposedly dead business man. Finally, by watching the "widow's" mail, the "dead" husband was located alive in Nebraska. Both he and the undertaker were sent to prison. The body was discovered to be that of a pauper which was supposed to have been sent to a dental school for dissection.

The case of Mr. Tetzner, an Austrian, which occurred in Vienna about 15 years ago, proves the importance of the services of special detectives to insurance companies. Mr. Tetzner had a large life and accident insurance policy, which covered automobile accidents. One day, Tetzner's automobile was found burned after an explosion, and inside the car was found the dead body of the driver. It seemed without doubt that this was Tetzner's body, and he was buried. However, the appraiser of the company became suspicious and ordered the body to be exhumed and autopsy performed. It was discovered that Tetzner was still alive. He had killed a traveling workman, burned his body, and caused the explosion. The dead artisan was at the driver's seat. This incident shows also the importance of the policy condition which states that the insurance company must be notified of each accident immediately after it has happened. It is interesting for another reason: similar frauds were tried, probably successfully, in various other countries shortly after the case of Tetzner became known.

A modern specialty of insurance crimes occurs in automobile liability insurance. It is the fake accident claimant. For about thirteen years there flourished in Missouri a gigantic faked accident ring which was able to collect \$100,000.00 in insurance claims. The leader of the ring was the former operator of benefit assessment insurance concerns and was general agent for several companies in Missouri. He was sentenced to five years in a Federal prison for having used the mails to defraud. The various members of the ring were sentenced to prison for shorter terms. They faked accidents by self-mutilation and by automobile crashes. Several of the people had limbs amputated. An osteopath was fined \$500.00 for manipulating a smashed limb of a member so as to necessitate amputation. Even a sheriff was sentenced to the custody of the United States marshal. Some of the defendants against whom charges were dismissed died within a year of their indictment.

An example of fraudulent claims against insurance companies for automobile collision insurance was supplied by a supposedly reputable business firm in New York City. An adjuster was sent to a garage to estimate the damage done to a car of a

holder of collision insurance. He found the damage considerable and recommended a sizeable amount in settlement. Later, while talking to another adjuster in his company who had handled this car in a former accident, he was asked if he noticed a scratch on the left door that had not been fixed after the first accident. He had not, and after talking the situation over, they examined the car. The result was that they discovered the company had three cars with identical identification numbers on the chassis and motor and that they switched the license plates when an accident occurred.

Adjusters are sometimes in collusion with claimants. An adjuster representing the company which insured the second car of a collision came to see the owner of the first car. He found him putting some second-hand and damaged mudguards on his old car. He suggested that he claim \$350.00 and give him, the adjuster, \$50.00. The real damage was approximately \$25 and the public would have been paying the extra \$300.00.

Analysis of the preceding examples is concerned with crimes committed against insurance companies. These are the most frequent ones. But it is difficult to say whether the crimes committed by insurance companies against the people generally, although smaller in number and less frequent in our time, are not more pernicious. Such insurance crimes are typical white-collar crimes with all their far-reaching disturbances. One such crime may ruin the confidence of large parts of a nation, even of the world, in insurance. It is for just that reason that in most countries during the past decades, the legislators have been busy fighting against many methods of white-collar crimes, and with some success. The United States was a pioneer in insurance supervision laws, beginning as early as 1840 in Massachusetts. However, if the country had not had much experience with insurance company crimes, it would not have been the first to eliminate free insurance enterprises. Not only has the confidence in insurance companies been re-established, but insurance supervisory legislation also has developed morale and trust among the people.

The criminal behavior of insurance companies consists in violation of trust by making misrepresentations. They published false financial statements, erroneous statistics, incorrect advertisements; there was embezzlement and misapplication of funds, and bribery of public officials, and all these violations were at the expense of the policy-holders—the insurance consumers. By enforcing certain controls in accounting and calculations, regular audits by public accountants, and other measures to be found in the supervisory laws of most countries, many opportunities for fraud have been eliminated.

Insurance companies' assets should be considered inviolable and

in need of the strongest protection. If there were no preventive devices the nature of insurance business would offer special possibilities and enticements for fraud. Stock companies, however, have not defrauded the public more than the so-called brotherhoods, lodges, friendly societies, etc.

England, in the 30's and 40's of the 19th century, was afflicted by insurance crimes by bogus companies. Parliament lacked the power to fight against them. Not until 1862 was the principle of limited liability recognized so that it was possible to invest property in an insurance company without risking all of it.

Several novels have popularized insurance crimes. Dickens' *Martin Chuzzlewit*, published in 1842, contains information about the bogus "Anglo-Bengales Disinterested Loan and Life Association Company." Thackeray's *The Great Hoggarty Diamond*, 1839, about the "West Diddlesex Fire & Life Insurance Company", contains many details of fraudulent insurance.

What happened even half a century later in the United States is reported by the Insurance Commissioner of Massachusetts. In his Annual Report in 1890 he said: "It is doubtful if, since the famous South Sea Bubble at the end of the eighteenth century, such a gambling mania has seized an intelligent people as that which developed in the spread of the assessment endowment and its natural and legitimate offspring, the bond investment insanity."

These associations were built up on mysteries. Their chief officers were called "Supremes," etc. They were experts in making people believe that they could make profits out of nothing. They hoped that many lapses would occur so that payments could be distributed among the others. About one million people paid in approximately 40 million dollars in a four year period to these associations and about 75% of it was wasted. It is unbelievable that many thousands of people would join these unsound companies, that they did so is shown in the *Cyclopedia of Insurance in the United States* and in State Reports, especially those prior to 1906. One astounding example of an epidemic in swindling is "Graveyards," 1879-1882. "The secretary individually took all money paid to the Association and divided the admission premiums among his fellow officers, paid the expense of carrying on the business, collected all assessments for deaths, and paid such claims as were paid, without keeping any account."

The fake life insurance company is chiefly a fly-by-night organization with its office in somebody's brief-case. It operates mainly by mail and though it has headquarters in one state, it operates in another. Therefore the Federal Government alone can punish their fraudulent activities, but even so they often escape through the many loopholes in the Federal statutes. In addition to using the mail, they have advertisements and radio broadcasts, and their

contracts usually contain a clause that permits them to escape without paying when the beneficiary comes to collect. It has been estimated that \$50,000,000 is collected annually by these companies.

Insurance undoubtedly has brought many large and small crimes in its wake, but just as one would not condemn religion because it has caused terrible wars, so the shadows which stand opposite the bright side of insurance should not condemn the entire insurance system. There is no radical method of eliminating bad results. Criminal law alone can accomplish little. It must be supported by a good civil law, but above all by an insurance science which can be understood by all classes of people. Our duty is to exclude as much as possible all misuse of insurance. That can be achieved by:

1. Better insurance legislation; covering insurance contracts and supervision.
2. Better insurance education: the public should be instructed in the elements of insurance in schools and colleges.
3. Better preventive service by insurance companies in many countries: examination of the moral hazard of applicants.

It is by no means exceptional to find low opinions about the behavior of insurers due to which, at least in times past, insurance crimes were made easy. It is recently that insurance companies have discovered what a large stake in crime prevention they have, and that, in the long run, their former attitude toward criminal behavior of the insured was rather costly to the company itself.

The man in the street needs much more knowledge of the value of insurance to the community. Especially in a democracy everyone must have such knowledge. The common men make the laws.