

Institution: University of Southampton		
Unit of Assessment: 18 Law		
Title of case study: 18-01 The Deterrence of Opportunistic Insurance Fraud		
Period when the underpinning research was undertaken: 2011 – 2020		
Details of staff conducting the underpinning research from the submitting unit:		
Name(s): James Davey Johanna Hjalmarsson	Role(s) (e.g. job title): Professor Associate Professor	Period(s) employed by submitting HEI: September 2014 – present September 2004 – present
Period when the claimed impact occurred: September 2014 – July 2020		
Is this case study continued from a case study submitted in 2014? N		
1. Summary of the impact <p>Research undertaken by Southampton Law School (SLS) on the causes of opportunistic fraud in insurance has significantly altered current law, policy and industry practice. This enabled the development of interventions that are more effective and less costly to implement. These advances were achieved by:</p> <ol style="list-style-type: none"> 1. Shaping law and policy relating to the deterrence of opportunistic fraud in arguments before the Supreme Court, which was persuaded to change the limits of the 'forfeiture rule'; 2. Changing insurance industry practice in counter-fraud activities through recommendations accepted by the Ministry of Justice (MoJ) / Association of British Insurers (ABI) <i>Insurance Fraud Taskforce</i> (2016), including specific obligations to adopt insights from law & behavioural science; and 3. Informing and influencing specialist legal practice. 		
2. Underpinning research <u>Background</u> <p>Opportunistic fraud carried out by otherwise honest policyholders has been estimated at £1 billion per year [5.4]. Prior to research by Davey and Hjalmarsson, the common law and the insurance industry shared an assumption that an overriding policy goal of deterrence was required and effective, and that this was best achieved by Draconian sanctions (see <i>AXA General Insurance Ltd v Gottlieb</i> [2005] Lloyd's Rep IR 369 per Lord Mance [31], and <i>Manifest Shipping Co Ltd v Uni-Polaris Insurance Ltd The Star Sea</i> [2003] 1 AC 469 (HL) per Lord Hobhouse [62]). This simplistic belief (that 'Draconian sanctions deter') was the basis for three key (but ultimately flawed) policies: the widespread forfeiture of contractual rights for any deliberately false statement made to the insurer, the use of contempt proceedings, and funding of a specialist counter-fraud police force. Implementation of this model was supported by extensive data sharing between insurers to exclude (potential) fraudsters from the market. These approaches are expensive to implement and risk damaging consumer and commercial relationships, as some insureds will be falsely accused of fraud.</p> <u>Research Findings</u> <p>Research carried out by members of SLS (Davey and Hjalmarsson) successfully challenged this narrative. In 2011-13, Hjalmarsson's research on insurance fraud included a critique of the haphazard development of the law, arguing that the expansion of the scope of the rule on insurance fraud made the Draconian sanction more available to insurers [3.2] (cited by Davey in [3.1]). As a result of an undesirable unpredictability of traditional routes to sanctioning insurance fraud, insurers opted for alternative and more creative routes, including civil contempt of court. Hjalmarsson's analysis of the relevant judgments clearly demonstrated that judicial policy was swayed by insurers' policy arguments [3.3]. Hjalmarsson's work thus clarified the need for analysis of the economic incentives underpinning fraud and commercial practice.</p> <p>Davey's research advances this analysis into new territory. In an article in the <i>Lloyds Maritime and Commercial Law Quarterly</i>, Davey identified inconsistencies in the claimed effects of legal doctrine and their actual and/or likely effects on society [3.1], establishing that 'the forfeiture rule is of</p>		

marginal significance in providing effective deterrence' AND that it 'fails to account for the complex and diverse nature of fraudulent claims'.

Davey's article published in the *Connecticut Insurance Law Journal* [3.6] drew together research conducted for the Insurance Fraud Taskforce (set up under the auspices of the Ministry of Justice to advise Government and industry on insurance fraud) in 2015 [3.4], and work on data science and law presented to the British Insurance Law Association (BILA) in Spring 2019 [3.5]. This research, written for a U.S. audience as part of ongoing dissemination of ideas, demonstrated that 'nudges' towards honest conduct could be more effective than Draconian sanctions. It thus called for industry action to better understand the drivers of opportunistic fraud (including the design of claims forms and other internal processes), rather than continue reliance on the 'punishment / deterrence' message. Furthermore, it analysed data relied upon by insurers in determining how to identify fraudulent insurance claims and where to allocate resources to combat fraud. Davey's research demonstrated the unreliability of these data and the errors in interpreting it, and propounded a more sophisticated approach can inform a more efficient and just allocation of anti-fraud efforts.

Personnel and collaborations

SLS researchers Davey and Hjalmarsson have collaborated with key personnel in the insurance industry and legal practice. For example, discussions between Davey and the Queen's Counsel arguing *Versloot Dredging* [5.2] before the Court of Appeal and Supreme Court took place during 2014-2016. Initial conference calls with Chirag Karia QC prior to the Court of Appeal hearings then continued with Richard Lord QC and Tom Bird (who argued the case before the Supreme Court). These later conversations were specifically prompted by the publication of the Davey & Richards paper in 2015 [3.1] and lasted around 60 minutes each.

Davey also worked with the Association of British Insurers (ABI) and Ministry of Justice (MoJ) Insurance Task Force in 2015-6 in delivering his recommendations [3.4 and 3.6]. Davey's research on data science and law has also been actively disseminated at events attracting multiple senior representatives of the UK's leading law firms, regulators (Financial Conduct Authority), trade bodies (Airmric) and barristers. Summary versions of the research were made accessible via an industry platform [3.5]. SLS Researchers have also provided published research directly to legal practitioners. For example, Hjalmarsson shared her research with senior commercial barrister and Deputy High Court Judge (QBD) Peter MacDonald Eggers QC for him to apply in his legal practice.

3. References to the research

3.1 J. Davey & K. Richards, 'Deterrence, human rights & illegality: the forfeiture rule in insurance contract law' [2015] *Lloyds Maritime and Commercial Law Quarterly* 315-345. <https://www.i-law.com/ilaw/doc/view.htm?id=357020>

3.2 J. Hjalmarsson, 'The law on fraudulent insurance claims' [2013] *Journal of Business Law* 103-117. <https://uk.westlaw.com/Document/I412DD7C03AF811E2B56AA87F780F3A77/View/FullText.html> (Westlaw online version).

3.3 J. Hjalmarsson 'Fraudulent insurance claims as context: moral support for contempt of court decisions' (2020) 39 (2) *Civil Justice Quarterly* 118-143. <https://uk.westlaw.com/Document/ICB354B30747311EA95FEC638142518EE/View/FullText.html> (Westlaw online version).

3.4 J. Davey & K Richards, 'Insurance Fraud and Behavioural Economics'; Research note on role of behavioural economics in deterring insurance fraud, commissioned by Chair of Insurance Fraud Taskforce, (10/05/2015). https://eprints.soton.ac.uk/436176/1/Insurance_Fraud_Behavioural_Economics.pdf

3.5 J. Davey, 'How much fraud in insurance fraud?', CII, Society of Claims Professionals (Winter, 2020, issue 3), version of speech given to British Insurance Law Association (15/03/19), <https://bila.org.uk/event/fraud-lies-damned-lies-and-insurance-claims/>.

3.6 J. Davey, 'A smart(er) approach to insurance fraud' [2020] *Connecticut Insurance Law Journal*, 27, 36-84. <https://cilj.law.uconn.edu/2020/12/#>

4. Details of the impact

Research by Davey and by Hjalmarsson, critiquing the ‘Draconian’ approach and advocating for empirically informed policy, has been used to influence three distinct groups of law- and policy-makers. We describe these three impacts here:

4.1 Shaping law and policy relating to the deterrence of opportunistic fraud

In the case of *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG*, *The DC Merwestone* [2017] AC 1 [5.2], the Supreme Court unexpectedly reversed the long-standing position that any dishonesty meant that the entire claim was forfeit. The law was altered so that the underwriter did not have a defence where the dishonest statement was found not to be relevant to the insurer’s ultimate liability. The Supreme Court decision is ‘*one of the most significant insurance cases to be decided in recent years*’ and it ‘*led to an important change in insurance law*’ [5.3].

As a result of Davey’s conversations with Queen’s Counsel arguing *Versloot Dredging* before the Supreme Court, [3.1] was the primary academic material included in the bundle presented to the court in [5.2] and was referred to by Lord Mance during oral submissions on ‘*multiple occasions, and it was the subject of discussion*’ [5.3]. During detailed argument of the evidence presented in [3.1] in the Supreme Court, Richard Lord QC was asked by Lord Mance for the underlying empirical research cited. These sources were supplied via junior counsel Tom Bird for submission to the court, counsel confirming that:

‘We cited and relied on Professor Davey’s research in our written argument before the Supreme Court.’ [5.3]

This form of direct engagement with active litigation is unusual and reflects the utility of the arguments made to highly contentious litigation. As confirmed by counsel:

‘The article advanced a number of powerful arguments including the fact that one of the main justifications for the rule (that it deterred fraud) took no account of the modern research on deterrence. ... What was particularly original about Professor Davey’s criticism and research was the way it drew upon empirical data (specifically, on deterrence) and used it to test some of the assumptions supporting the existing law. As far as I know, this was the first time that such data had been applied in this context.’ [5.3].

Indirect reference to the arguments submitted (including sceptical references to whether courts should consider empirical evidence) was made at paras [10], [98], [108]. These arguments were not present in earlier judicial analysis.

The underlying research is also likely to influence future litigation, as a leading QC noted: *‘Professor Davey’s research is likely to have particular impact in shaping the development of the law by providing insights for solicitors and barristers advising clients and arguing insurance fraud issues in the courts’*. [5.10]

Furthermore, Simon Rainey, a leading practitioner and Deputy High Court judge cited Davey’s research [3.1] as the source for the change in judicial attitudes on the forfeiture rule, and in particular for the new judicial view that “...*whilst deterring fraud is of course a noble policy objective, it must be said that the efficacy of the forfeiture rule in achieving this end is doubtful*” ([5.1], at para 5.41).

4.2 Changing insurance industry practice in counter-fraud activities

Davey’s research was used and his recommendations implemented by the Insurance Fraud Taskforce (the Taskforce), the official Government body responsible set up to ‘*investigate the causes of fraudulent behaviour and recommend solutions to reduce the level of insurance fraud in order to ultimately lower costs and protect the interests of honest consumers*.’ Taskforce membership included the Association of British Insurers (ABI) and other responsible insurance industry bodies, and set down guidance on best practice for the entire British insurance industry.

The impact of Davey’s research through its take-up and implementation by the Taskforce are evidenced by sources [5.4] to [5.9]: a) The statement by the Taskforce chair, David Herzell [5.4], b) the Taskforce recommendations to the ABI and Chartered Institute of Insurers (CII) [5.5], c)

adoption of Davey's recommendations by the ABI [5.6] following independent corroborating industry research (as recommended by Davey) [5.7] and [5.8] as well as take-up within the insurance industry [5.9]. We detail these in turn here.

a) The statement by the Taskforce Chair, David Herzell:

The Task Force Chair's letter [5.4] confirms Davey's pivotal role in shaping its approach:

'The Taskforce ... wished to know why otherwise honest people were prepared to lie when purchasing insurance or making a claim. ... In preparation for the work of the Taskforce members were provided with copies of research published by Professor Davey and Katie Richards and in particular their work on fraud and behavioural economics. Professor Davey ... reviewed the subject of behavioural economics with the group and suggested changes that could be made to improve matters together with the overall customer experience. These suggestions were accepted and implemented by the Taskforce. Customer behaviour is discussed in several places in the final report and in particular at pages 37-41 and 53-54 where the issue of behavioural economics in insurance is reviewed. The contribution made by Professor Davey is acknowledged in Para 3.44 of the report.'

b) The Taskforce recommendations to the ABI and Chartered Institute of Insurers (CII)

Davey's recommendations to the Taskforce during 2015 [3.4] were adopted as the basis for Taskforce recommendations. These recommendations appeared in [5.5] as an action point: *'The ABI and CII should commission research on behavioural economics. The research should be available to all and the ABI should encourage take up of the conclusions through its voluntary best practice guidance'*.

c) Adoption of Davey's recommendations by the ABI following independent corroborating industry research (as recommended by Davey)

As a result of Davey's research-based recommendations being implemented by the Taskforce therefore, independent experimental economics research was commissioned in 2018, to test to effectiveness of 'nudges' as behavioural interventions that Davey recommended. That report [5.7] is recognised as 'ground-breaking' with 'extremely promising' results by a key industry figure, and its results were promoted to the 'insurance CEO community' by the ABI and other trade bodies [5.6]. Crucially, it also independently verifies the analysis offered by Davey in [3.1] both in terms of preventing fraud and also saving on enforcement costs [5.7].

In order to ensure easy adoption of these techniques by insurers, the insurance industry has designed an implementation blueprint. The ABI explained the likely benefits of adopting these techniques in the foreword to the report ([5.7], p. 3).

'... honest customers are rightly fed-up with subsidising fraudsters and expect insurers to take a tough stance on fraud. This is not merely a bald assertion, but rather one that is backed-up results of testing carried out by Decision Technology. This view is also shared by consumer representatives on the Government's Insurance Fraud Taskforce who called upon the industry to develop a public communications strategy.'

This, as [5.4] confirms, is a reference to Professor Davey's role on the Taskforce. An account of the process and findings is written up for an academic audience. [5.8]

Evidence of the impact of Davey's recommendations on practice within the insurance industry is provided by a fraud expert practitioner and member of the Insurance Fraud Taskforce who confirms: *'as a result of Professor Davey's research, and in particular its presentation to key industry representatives at the Taskforce in 2015, it has become standard practice in the insurance industry to take into account the insights of behavioural science in developing approaches to reducing levels of fraud. This specifically includes the effective measurement of process changes, strategies to encourage non-fraud behaviours and highlight the risk of perpetuating fraud.'* [5.9]

4.3 Informing and influencing specialist legal practice

Senior and experienced legal practitioners and other-counter fraud specialists have described (in [5.9] – [5.13]) how they have benefitted from and have been informed by the research. Referring to both [3.4] and [3.5], one expert practitioner writes: *'Professor Davey's research has crucially*

informed the legal services that I provide to insurers, and has enabled me better to support insurers in implementing the changes to their own counter fraud measures, particularly in first party insurance claims.' [5.9]. Referring more specifically to [3.5], a QC testifies that the research *'enriches the evidence which is taken into account [in assessing the prevalence of opportunistic insurance fraud], and in doing so, challenges assumptions about the level or prevalence of insurance fraud.'* [5.10] According to the same source, the value of Davey's research for the insurance industry is that it *'encourages a more efficient allocation of resources by insurers and those acting for them in attempts to combat insurance fraud. This increases the prospect of fraud being challenged appropriately, and reduces the likelihood of genuine claims being considered to be fraudulent - with payment either denied, or delayed, leading to increased costs and potentially to serious injustice in individual cases.'* [5.10]

[3.1] has informed senior and experienced legal practitioners: one confirms that the research has been *'invaluable'* to her, and that it is *'provided clarity on a number of issues'*, citing as *'particularly valuable'* for developing and informing her own legal practice Davey's findings on the limited role of judges in deterring fraud, the benefits of the insights of behavioural science for clients and on the use of fraud clauses in contracts [5.11]. Another notes: *'Davey's research demonstrates that far more can and should be done at every stage of the insurance process to influence seemingly honest policyholders to make better decisions through the use of modern forms of technology and communication'* and that it *'has potential to further, change market practice for the better.'* [5.12].

On Hjalmarsson's research, senior commercial barrister and Deputy High Court Judge (QBD) Peter MacDonald Eggers QC confirms that he has found [3.3] (article on legal judgments on insurers' use of contempt of court as a means of combatting fraudulent insurance claims) *'informative and illuminating in its incisive analysis'*, as *'especially astute'* and that it has *'enriched my own knowledge and understanding'* of the relevant developments [5.13].

5. Sources to corroborate the impact

5.1 Simon Rainey QC in M Clarke and B Soyer (eds) *Insurance Act 2015: A new regime for commercial and marine insurance law* (Informa, 2016).

5.2 *Versloot Dredging BV v HDI Gerling Industrie Versicherung AG, The DC Merwestone* [2017] AC 1.

5.3 Letter from Tom Bird, Quadrant Chambers: junior counsel on the *Versloot Dredging* appeal.

5.4 Letter from Chair of Insurance Fraud Taskforce David Hertzell (former Law Commissioner)

5.5 *Insurance Fraud Taskforce: Final Report* (2016) [3.44] – [3.49]; Recommendation 2 (p. 77).

5.6 Insurance Fraud Taskforce, *Insurance Fraud Taskforce: report 2017*, (2018)

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/764561/Insurance_Fraud_Taskforce_2017_Report.pdf

5.7 Decision Technology Ltd, *Reducing Opportunistic Insurance Fraud with the Use of Behavioural Interventions: Insights Report*, (2018).

5.8 Mitchell, T. and Cheung, B. (2020) 'Using behavioural science to reduce opportunistic insurance fraud', (2020) *Applied Marketing Analytics*, Vol. 5(4) 294–303.

5.9 Letter of Support from [text removed for publication], partner, Kennedys LLP

5.10 Letter of Support from [text removed for publication] QC, 4 New Square

5.11 Letter of Support from [text removed for publication], partner, Sullivan & Worcester LLP

5.12. Letter of Support from [text removed for publication], partner, Wynterhill LLP

5.13 Letter of Support from Peter MacDonald Eggers QC, 7 King's Bench Walk.