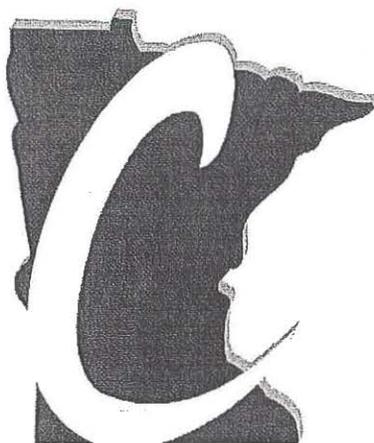


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**DIVISION OF INSURANCE FRAUD PREVENTION
MINNESOTA DEPARTMENT OF COMMERCE**

ANNUAL REPORT 2011



**MINNESOTA
DEPARTMENT OF
COMMERCE**

To detect, reduce and deter insurance fraud crimes by aggressive investigation, identification and prosecution of violators by working cooperatively with the insurance industry, law enforcement and the citizens of the State of Minnesota.

Mission Statement

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Director's Message

To the Chairs of the House Commerce Committee and the Senate Commerce and Consumer Protection Committees.

On behalf of the Division of Insurance Fraud Prevention (IFD) of the Minnesota Department of Commerce, I am pleased to present the annual report of the IFD for calendar year 2011, pursuant to Minnesota Statutes Section 45.0135, subdivision 5.

The IFD is Minnesota's primary law enforcement agency responsible for conducting criminal investigations of insurance fraud. The IFD entered its sixth year in 2011 and continues to make significant progress combating and preventing insurance fraud throughout the state. Since its inception in 2005 through 2010, the IFD has seen an annual increase in the number of referrals of suspected insurance fraud from private citizens, the insurance industry, law enforcement and government agencies with referrals remaining steady in 2011.

The vast majority of the referrals in 2011 were simple, opportunistic fraud crimes, which may be attributable to the economy's impact on the citizens of Minnesota. On the other hand, a number of referrals depict a different trend, detailing organized groups of criminals employing intricate schemes to commit insurance fraud involving healthcare, arson, mortgage and automobile fraud.

Insurance fraud is a serious crime. According to the National Insurance Crime Bureau, it is the most costly white collar crime in the U.S., behind tax evasion. The IFD's anti-fraud efforts produced several noteworthy accomplishments in 2010. These high-profile cases raised the public's awareness of insurance fraud as well as recognition for the IFD and our dedicated staff of detectives and analysts. I am very proud of the hard work and accomplishments by our staff and extremely appreciative of the significant contributions of our many partners in law enforcement as we work together on this difficult crime problem.

In 2011, the IFD had multiple cases which targeted multi-faceted, high-dollar fraud schemes perpetrated by organized groups of criminals (see Appendix). These cases required IFD staff to allocate much of their time to one or two cases throughout the year, as they were resource-intensive investigations. The efforts of the IFD have already proven worthwhile as demonstrated by the number of criminal racketeering charges filed against defendants on insurance fraud cases in the past year.

In 2012, the IFD will continue to focus on complex, high-dollar insurance fraud schemes and target the growing fraud problem in healthcare insurance. We will continue to pursue our goals to aggressively investigate insurance fraud, promote public awareness of insurance fraud, and provide assistance to local and county law enforcement.

BRANDON JOHNSON
Interim Director

I. INTRODUCTION

In 2004, Minnesota became the 41st state to join the fight against insurance fraud by enacting legislation creating the Division of Insurance Fraud Prevention within the Minnesota Department of Commerce. The legislation authorized the Commissioner to appoint peace officers and establish a law enforcement agency to conduct investigations and make arrests. The jurisdiction of the agency is the criminal investigation and assistance with the criminal prosecution of insurance fraud and related offenses in the State of Minnesota.

The Division of Insurance Fraud Prevention, more commonly known as the IFD, is authorized to conduct criminal investigations of insurance fraud by Minnesota Statute § 45.0135, which provided that the IFD shall:

- review referrals of suspected fraudulent insurance fraud submitted by insurers,
- respond to notification or complaints of suspected insurance fraud generated by other law enforcement agencies and consumers,
- initiate inquiries and investigations when the division has reason to believe that insurance fraud has been or is being committed, and
- refer those instances of insurance fraud to the appropriate prosecutorial agency.

The IFD collaborates with many partners in local, state and federal law enforcement agencies as well as prosecutorial offices. Additionally, the Division has an excellent working relationship with the insurance industry, special investigation units and claims adjusters.

II. STAFFING

In order to accomplish its mission and responsibilities, the IFD is authorized to employ a Director of Special Investigations/Chief Law Enforcement Officer, Investigations Supervisor, eight detectives, five analysts and a computer forensics specialist. The eight detectives are licensed peace officers and have extensive experience in law enforcement with local, county and state law enforcement agencies. In 2011, the IFD had two retirements, the director and a detective.

III. FUNDING

The IFD is funded by an assessment on each insurer authorized to sell insurance in the state of Minnesota. Specific assessment language can be found in Minnesota Statute § 45.0135, subdivision 7.

To date, the assessment has collected just over \$12.9 million for fiscal years 2004 through 2012. Expenditures total approximately \$9.7 million for the same period. The assessment for fiscal year 2012 was collected during May, 2011 because the statute requires such payment to be received on or before June 1, 2011.

Between 2008 and 2011, however, due to the state's budget shortfall, legislation was enacted that transferred funds from the IFD to the General Fund. In fiscal year 2011, the IFD transferred \$48,000 to the General Fund. In prior years, the IFD transferred \$1.5 million for each fiscal year in 2008 and 2009, and \$64,000 in fiscal year 2010. The transfer of \$3,112,000 to the General Fund over the past four years has had a significant negative impact on the IFD's operational budget and cash flow.

1. Auto Theft Prevention Program

On July 1, 2009, the IFD assumed administrative responsibility for the Auto Theft Prevention Program (ATPP). The ATPP is funded from a surcharge that is collected from automobile insurance carriers that provide comprehensive insurance coverage issued in Minnesota. The amount of the surcharge is \$.50 cents per vehicle for every six months of coverage.

As a result of legislation enacted in 2004, the ATPP transfers roughly half of the dedicated funds raised through the collected surcharge (\$1.3 million) to the General Fund each fiscal year, totaling \$9.1 million over the last seven years. An additional \$2,974,000 has been reallocated to the General Fund by law, including \$1,133,000 for fiscal year 2010 and \$1,111,000 for fiscal year 2011. These transfers and reallocations have significantly reduced the ability to fund efforts to combat auto theft in Minnesota.

IV. REFERRALS

A. PROCEDURE

The IFD is responsible for investigating violations of insurance fraud under Minnesota Statute § 609.611, as well as crimes related to insurance fraud. During calendar year 2011, the Division received 1304 referrals. The referrals came from the general public, the insurance industry, law enforcement or other government agencies.

If it is determined that a referral has sufficient information and is appropriate for criminal investigation, the case will be assigned for investigation. If initially a referral does not include sufficient information to make a determination regarding its appropriateness for criminal investigation, it may be assigned to an analyst for additional research, review and analysis. Thereafter, the referral is either resubmitted for investigation or closed.

B. STATISTICS

Once referrals are reviewed and classified by an analyst, they are entered into the division's confidential case management system database. The IFD maintains the database for the purpose of file management and compiling statistics. The main statistics assembled from our database are related to the type and source of the fraud.

C. ECONOMIC IMPACT

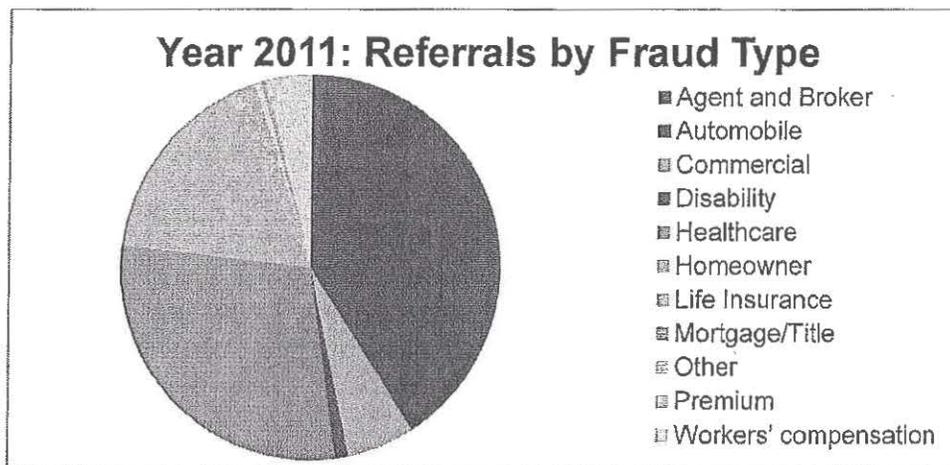
The amount of loss in each case referred for criminal prosecution is recorded to evaluate the financial cost of insurance fraud uncovered from our investigations. However, the IFD does not document losses reported for each and every referral since some losses are unsubstantiated and are a derivative of abuse and error, rather than fraud. In 2011, the total economic impact for the investigations referred by the IFD for criminal prosecution was over \$22 million.

1. Referrals by Type of Fraud

The IFD assigns a case code to every referred case received. The classification system enables the division to determine the most prevalent type of insurance fraud in Minnesota. The categories for each type of fraud and the number of referrals in 2010 and 2011 are as follows:

<u>Case Code</u>	<u>2010</u>	<u>2011</u>
Agent and Broker	28	14
Automobile	451	519
Commercial	106	75
Disability	22	15
Healthcare	309	379
Homeowner	241	208
Life Insurance	29	21
Mortgage/Title	35	9
Other	4	7
Premium	11	6
Workers' compensation	88	51

The number of total referrals slightly decreased in calendar year 2011 to 1304 from 1324 in calendar year 2010.



2. *Referrals by Source*

The IFD receives case referrals from four main sources: the general public, insurance companies, law enforcement agencies and government agencies. The subject of the referrals varies from individuals to businesses suspected of committing insurance fraud. The majority of these referrals are received from the insurance companies through the National Association of Insurance Commissioners. The general public can contact the IFD through its toll-free hotline (1-888-FRAUDMN), the US mail and the department website, www.insurance.mn.gov. The division has an inter-agency agreement with the Minnesota Department of Labor and Industry (DOLI) to conduct investigations on workers' compensation insurance fraud.

V. PREVENTION

A. *EDUCATIONAL PRESENTATIONS*

One of the primary goals of the IFD is to educate the public, the insurance industry, law enforcement, government agencies and prosecutors that insurance fraud is a crime that has a negative impact on insurance rates in Minnesota. The National Insurance Crime Bureau (NICB) estimated that fraud accounts for between 10 and 30 percent of all property and casualty insurance claims. The Coalition Against Insurance Fraud estimated that insurance fraud costs consumers \$80 billion a year in damages, leaving the average American family paying a minimum of \$950 a year in higher insurance premiums and increased costs of goods and medical services.

In 2011, the IFD made several presentations to the general public, the insurance industry, law enforcement and government agencies. Our audience members included the Minnesota Professional Insurance Agents, Minnesota Management Risk Employees, Minnesota Chapter of the International Association of Special Insurance Units and the Reinsurance Association of Minnesota Mutual Insurance Companies. A common goal of our presentations was to provide a brief background on the IFD and its role and responsibilities with specialized areas of interest, such as workers' compensation fraud and staged automobile accidents. Additionally, the division offered POST (Peace Officers and Standards Training) sponsored training for law enforcement on insurance fraud.

In 2011 the division leased exhibit booths at the annual conferences for the Minnesota Chiefs of Police Association, the Minnesota Crime Victims Association, the Minnesota Crime Prevention Association and the Minnesota State Fair to provide awareness about insurance fraud and reporting of insurance fraud.

The second Minnesota Insurance Fraud Awareness Week was announced on February 14, 2011. The program was a coordinated effort by the Insurance Fraud Awareness Steering Committee, which included representatives from the Insurance Federation of Minnesota (IFM), NICB, the Minnesota Chapter of the International Association of Special Investigation Units (MNIASIU) and the IFD.

B. EDUCATIONAL MATERIALS

As part of its public awareness program, the IFD developed an informational pamphlet on insurance fraud to distribute to the general public and businesses. The pamphlet provides information about why people commit insurance fraud, the types of insurance fraud, the elements of insurance fraud and how to contact the IFD. The division also distributes pamphlets designed by the Coalition against Insurance Fraud, "Insurance Fraud, the Crime You Pay For," which has information on the types of fraud, the costs of fraud and how to prevent becoming a victim of insurance fraud.

C. OTHER ACTIVITIES

As part of its mission to reduce and deter insurance fraud, the IFD works cooperatively with the general public, the insurance industry and law enforcement. The division staff has joined, or is associated with, various professional groups, both from the insurance industry and the law enforcement community. These groups include but are not limited to the IFM, NICB, National Association of Insurance Commissioners, Coalition Against Insurance Fraud, Mid-States Organized Crime Information Center, FBI Mortgage Fraud Task Force, Minnesota Health Care Fraud Task Force, National Health Care Anti-Fraud Association, Twin Cities Securities Partnership, Association of Certified Fraud Examiners, Minnesota Chiefs of Police Association, High Technology Crime Investigation Association and the Minnesota Cyber Crimes Task Force. Our association and participation with these groups provide valuable assistance, resources and information to us in our efforts to combat insurance fraud in Minnesota.

VI. INVESTIGATIONS

A. OVERVIEW

The IFD conducts criminal investigations on insurance fraud and offenses related to insurance fraud, including healthcare fraud, mortgage fraud, securities fraud, arson-related insurance fraud and other state and federal criminal violations.

The investigation process includes activities such as:

- interviewing witnesses,
- conducting background checks on suspects,
- interviewing victims,
- witnesses and suspects,
- executing search warrants,
- serving subpoenas,
- conducting surveillance,
- reviewing/analyzing documents and evidence,
- conducting computer forensic examinations, and
- making arrests.

By statute, the jurisdiction of the IFD is limited to offenses related to insurance fraud; however, given IFD detectives are fully sworn peace officers of the State of Minnesota, detectives have full powers of arrest – anywhere in the state. Accordingly, Minn. Stat. § 45.0135, Subd. 2b(4) provides that the IFD *shall otherwise assist any law enforcement authority having jurisdiction*. In essence, IFD detectives conduct criminal investigations with a nexus to insurance fraud; however, detectives do not stop their investigations when additional crimes are uncovered or are believed to have occurred. When these offenses are identified, detectives partner and collaborate with local, state or federal law enforcement, which includes the prosecuting authority having jurisdiction. These investigations often involve all facets of state and federal criminal code.

B. INTELLIGENCE AND OTHER ACTIVITIES

Information is a key element in solving crimes. Insurance fraud is a white collar crime, which crosses jurisdictional boundaries of city, county and state lines. The IFD shares information and intelligence with other law enforcement agencies and government agencies throughout the state to accomplish its mission. Many of the Division's investigations have developed into coordinated efforts by multiple law enforcement agencies to bring forth successful prosecutions.

Some of the agencies that the Division's detectives have either provided assistance to or worked with on joint investigations include Minnesota Sheriffs' Offices, Minnesota Police Departments, Minnesota County Attorneys, Federal Bureau of Investigation, Internal Revenue Service, Bureau of Alcohol, Tobacco and Firearms, U.S. Postal Inspection Service, U.S. Department of Health and Human Services, Social Security Administration, U.S. Attorney's Office, Minnesota Department of Labor and Industry, Minnesota Department of Employment and Economic Development, Minnesota Department of Human Services, and the Insurance Market Conduct and Real Estate/Securities Divisions in our department, the Minnesota Department of Commerce. This cooperation has helped solve many criminal cases, establish and build valuable relationships, and consolidate resources in the fight against insurance fraud.

VII. PROSECUTION

A. OVERVIEW

The IFD is authorized to refer investigations on insurance fraud and offenses related to insurance fraud for criminal prosecution. The investigations are either referred to the Minnesota County Attorneys or the U.S. Attorney's Office, depending on the jurisdiction and criminal violations applicable to the investigation. Under state law, the division enforces violations of:

- Minnesota Statutes § 609.611 (Insurance Fraud),
- Minnesota Statutes § 609.612 (Employment of Runners),
- Minnesota Statutes § 609.45 (Perjury), 609.52 (Theft),
- Minnesota Statutes § 609.63 (Forgery) and
- Minnesota Statutes § 609.903 (Racketeering).

Under federal law, the Division enforces violations of:

- US Code, Title 18 for Section 1341 (Mail Fraud),
- US Code, Title 18 for Section 1343 (Fraud by Wire),
- US Code, Title 18 for Section 1347 (Health Care Fraud) and
- US Code, Title 18 for Section 1956 and 1957 (Money Laundering).

In all prosecutions, the Division seeks the forfeiture of assets from defendants and restitution for the victims.

B. STATISTICS

In 2011, the IFD filed 35 criminal complaints in either federal or district court, including seven defendants charged with racketeering. The total economic impact for cases charged by the IFD in 2011 was in excess of \$22 million, with untold sums related to mortgage fraud still unrealized.

VIII. ADMINISTRATIVE ACTIVITIES

In the summer of 2011, the state government shutdown had a great effect on many agencies, Commerce included. As a result of the shutdown, the IFD furloughed six of its eight detectives, 1 supervisor, and all of its analysts. Like other state agencies and divisions within the Department, this had great effect on its ability to serve the public.

2011 saw two retirements from the IFD – one detective and the director. The director had been with the IFD since 2007. A detective was named interim to handle administrative duties while the commissioner's office began its search for a replacement.

XI. CONCLUSION

The IFD has worked with the general public and our partners in law enforcement, the insurance industry and government agencies during 2011 in our efforts to combat insurance fraud. The IFD will continue to aggressively investigate and seek prosecution of fraudulent insurance fraud acts and increase public awareness of insurance fraud across the State of Minnesota. We proudly serve and protect the citizens of Minnesota in our pursuit of justice against those who commit insurance fraud.

APPENDIX

2011 Highlighted Cases

The Beat Down Posse

Economic Impact: \$278,000

Case Type: Mortgage/Title Insurance Fraud, Homeowners Insurance Fraud

A joint investigation between the IFD, Minneapolis Police Department, FBI, and Internal Revenue Service – Criminal Investigation Division uncovered a prolific and violent organized crime syndicate based out of North Minneapolis. The BDP, as they were known, was accused of committing mortgage fraud, arson (to collect insurance payouts), aggravated assault, terroristic threats, kidnapping, and drugs and weapons offenses, with many of their alleged crimes committed under the guise of bondsman for Gustafson Bail Bonds, Inc.

The case originally came to the IFD as a series of arsons in which co-conspirators related to BDP fraudulently collected insurance proceeds from properties that were purchased with straw buyers and later intentionally set on fire.

Further investigation into the case uncovered a criminal organization that was robbing and terrorizing residents of North Minneapolis, as well as selling illegal drugs and weapons, and using multiple schemes to swindle numerous people or companies out of their money.

The complaint alleged the father and son team of “Big Joe” Gustafson and “Little Joe” Gustafson were the de facto leaders of the BDP. The Gustafsons, along with other members of the BDP, would lead “missions” in which they would break into the residences of drug dealers while posing as bond agents in order to rob them of their drugs and money.

The BDP also utilized friends and associates to perpetrate mortgage fraud involving at least seven homes in and around the North Minneapolis area. Straw buyers would make cash down payments using funds provided by the Gustafsons and provide phony employment and income information to the lender, for the purpose of purchasing a property the Gustafsons were selling.

Similar “sales” occurred in which the Gustafsons were not actually the owner, but provided phony contract for deed documents so they could receive payoffs for properties where they did not have a recorded interest.

In all instances, down payment funds were provided to the straw buyers by the Gustafsons to make purchases of properties already owned by the Gustafsons, creating more than \$287,000 in fraud proceeds. The majority of those properties went into foreclosure.

Both Big Joe and Little Joe Gustafson were charged with racketeering, and seven other co-conspirators were charged with various crimes related to BPD activities.

Travis Magdalena Scott

Economic Impact: \$11.4 million

Case Type: Commercial Insurance Fraud

In June 2007, Scott purchased an insurance policy for Security Management Technologies (SMT), a business owned and operated solely by the defendant. The original policy covered SMT's property, specifically supercomputers, for \$7.5 million. In approximately December 2007, the policy was increased to \$9.5 million because the defendant allegedly claimed that he purchased new computer equipment for SMT.

On June 1, 2008, approximately one year after purchasing the SMT policy, the defendant reported to his insurer, Zurich that SMT had been struck by lightning, sustaining damage to its computer equipment. Scott contacted Silicon Graphics, Inc. (SGI) in Eagan, Minnesota, purportedly to order replacements for the damaged supercomputers. Scott began ordering a supercomputer system for approximately \$11.5 million, but did not complete the order, or pay for the computer system. Scott represented to Zurich, however, that the new system had been delivered, and, in reliance on the defendant's misrepresentations, Zurich delivered three checks to Scott in payment of the property insurance claim, for a total of approximately \$9.5 million. Scott did not use this money to purchase replacements for the "damaged" property, and instead kept it or used it for personal gain.

The accounting firm of Matson, Driscoll & Damico, LLP was brought in by Zurich to establish the business interruption portion of Scott's claim. Working from information provided by Scott, which included a 2007 U.S. Corporation Income Tax Return (Form 1120) for SMT, as well as SMT Income Statements provided by Scott, the accounting firm determined that SMT's average monthly revenues between June 2007 and May 2008 were \$671,736.00. Based on the accounting firm's analysis, on December 11, 2008, Zurich issued a business interruption check to Scott for just over \$1.9 million. The information provided by Scott, including the 2007 Tax Return and the Income Statements, was false.

For his fraud, Scott agreed to plea to information in Federal Court on charges of wire fraud and money laundering. However, prior to his sentencing, Scott staged his own death on Lake Mille Lacs, and fled to Winnipeg, Manitoba in a small airplane. He resided there under an assumed name until he was arrested passing forged prescriptions and found to be in possession of a loaded handgun. He was arrested and convicted of his crimes in Canada, and upon release will be returned to the United States where he will face sentencing for his guilty plea, as well as possible additional charges related to his absconding.

As part of his original plea agreement, Scott agreed not to fight for more than \$7 million dollars in assets seized by the IFD and IRS-CID. Scott was also fined more than \$250,000.

Mortgage Planners

Economic Impact: \$10 million

Case Type: Mortgage/Title Fraud, Homeowners Insurance Fraud

This investigation began when a Minnesota title company, SNS Title, reported unusual and possibly fraudulent activity associated with two files that were sent to them by MPI for closing. After receiving this information, the Minnesota Department of Commerce investigators contacted Franklin American Mortgage Company (FAMC), the lender for the two suspect loans, and notified FAMC of the possible fraud.

The IFD then conducted a detailed investigation of eight of the 62 transactions. The investigation demonstrated that MPI, through its individual mortgage brokers and related business entities, committed a pattern of loan origination fraud to acquire loan proceeds used to purchase of foreclosed properties. Specifically, MPI processed loan applications in which the borrower's employment, education, and assets were fraudulently misrepresented. These fraudulent misrepresentations were bolstered by accompanying fraudulent supporting documents, including forged college transcripts, verifications of employment from fictitious employers, forged bank statements, phony gift letters, stolen identities, and even false court records with a forged signature of a Minnesota state court judge. In all cases, after the loans were approved and funded, MPI, through its related entities, including Eagle River and OFC, would receive at closing substantial sums of loan proceeds by way of a junior mortgage that was recorded after the subject property was sold at a Sheriff's Sale. Many of these properties became rental properties owned and managed, either in part or in whole by the Obers, companies operated by the Obers, or people associated with the Obers or co-conspirators.

In all, there were 62 cases where fraud was present, where similar misrepresentations to occupancy of the homes were made to the homeowners' insurance companies.

Four co-conspirators, James and Wendy Ober, Raul Pliego, and Alex Sanchez, were charged with aiding and abetting racketeering.

Melissa Sue Mickelson

Economic Impact: \$9,119.37

Case Type: Automobile Insurance Fraud

On the morning of August 10, 2011, a high speed police pursuit involving the vehicle of Mickelson ended with the vehicle crashing. The suspect, Mickelson's boyfriend, was apprehended near the scene.

Later that afternoon, Mickelson contacted her insurance agent to report her vehicle stolen and made a claim for the damage. Mickelson refused to be interviewed by police, but did make several statements to the insurance investigator, including the fact that she did not know the driver of the vehicle.

The investigation later showed Mickelson's vehicle had her keys in the ignition; Mickelson was in a serious and on-going relationship with the driver; the driver had been in possession or had used the vehicle for several months prior to the alleged theft; and the driver admitted he had received authorization from Mickelson to use the vehicle, and if Mickelson were to state otherwise, it was to get the damage covered by the insurance company.

This case was worked jointly between the IFD and the Park Rapids Police Department, and resulted with Mickelson being charged by the Hubbard County Attorney with one count of Insurance Fraud