

Money Service Business Facilitated Workers' Compensation Premium Fraud

OFR Discussion Item – August 2, 2011

Background:

A new form of workers' compensation fraud has burgeoned within Florida's construction industry. The scheme is fairly sophisticated, with a team of co-conspirators working together to perpetrate this fraud. The typical scenario is as follows:

- The facilitators of this fraud create fake shell companies with generic names that have no real operations, locations, or labor force. Typically, they are incorporated online so as to avoid true review and verification.
- This shell company will turn to an insurance agent to obtain a minimal workers' compensation insurance policy, usually by describing its operations as a two to four person company installing drywall, brick pavers, or performing other low risk activities (to ensure a lower premium).
- The shell company pays the down payment of the insurance policy, usually in cash, and the balance is charged to the shell company's P.O. Box, which will be covered by the facilitator to operate the scheme. Now, the facilitator is able to turn to contractors to "rent" out the certificate of workers' compensation insurance.
- Facilitators will approach uninsured subcontractors who are looking for work but lack the required items (primarily, a valid workers' compensation policy) necessary to obtain contracts from a General Contractor, and make the shell company name and workers' compensation policy available for them to use, for a fee.
- Contractors looking to escape paying for real workers' compensation insurance will pay the shell company, posing as an insured subcontractor, for use of the certificate of insurance, which does not list the amount of coverage. The contractors will then use an uninsured subcontractor to perform their work. After work is completed, they will write the check to the shell company for the work of the mythical insured subcontractor.
- Because traditional banks will typically not cash a check made payable to a business or, third party, as they will insist that it instead be deposited into their account, money service businesses are used to cash these checks.
- Money services businesses, which include check cashers, are regulated by the Office of Financial Regulation under Chapter 560, Florida Statutes. Currently, there are 1,122 check cashers registered with the office.

- The check casher takes out a legally authorized fee between 1.5% and 2.0% for the service of cashing the check. A check casher that is part of the conspiracy takes out an additional fee between 6%-8% for the facilitator as the fee for use of the shell company name and its workers' compensation insurance policy.
- The cash, minus the fees, is either given back to the General Contractor, who will then pay his uninsured subcontractor or employees in cash, or, it goes straight from the Money Service Business or the facilitator to the uninsured subcontractor who performed the work, effectively avoiding the payment of any workers' compensation premiums or applicable payroll taxes on these monies.
- The money paid to the shell company in this manner is not reported to the shell company's insurance carrier, nor are the payments considered payroll exposure because, on paper, this transaction appears to be a legitimate contractor to insured subcontractor payment.
- Aggressive facilitators will duplicate this scheme, often with the same workers' compensation insurance policy, time and time again. When they fear detection, they fold the shell company and form a new one. Because the shell company often contained fictitious information or an owner that either does not exist or is illegally in the country, it is tremendously difficult to track this crime. General contractors who are questioned about their involvement in the scheme show fraud investigators the certificate of insurance given to them, and state that they knew nothing of the scheme, successfully "hiding" behind the rented certificate.
- There are cases in which the shell company is run by the money services business itself, who acts as a full-service operation for contractors looking to take advantage of this scheme. The motivation for contractors is enticing: uninsured subcontractors can save at least 20% by avoiding actual workers' compensation premiums, and therefore are able to pass that cost savings on to general contractors complicit in this fraud.
- Contractors and subcontractors who are in full compliance with the state's workers' compensation insurance laws are placed at a significant competitive disadvantage because they are unable to quote prices anywhere close to those contractors who are knowingly engaging in activities to circumvent the law.
- The effects on the State of Florida's bottom line are considerable. Any time fraud that makes it easier for contractors to pay workers under the table in cash avoids significant tax collections by the state. Additionally, when an uninsured worker is injured, the costs of care for catastrophic injuries are borne by all taxpayers.

Stakeholders:

- Workers' Compensation Insurers (e.g. FCCI)
- NCCI
- Florida Carpenters Regional Council
- Florida Home Builders Association
- Associated Builders & Contractors
- AIF/Chamber
- Florida Roofing & Sheet Metal Assoc.
- FAIA/FAIFA
- FUBA
- Check Cashing Industry



MONEY SERVICE BUSINESS FACILITATED WORKERS' COMPENSATION PREMIUM FRAUD

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Workers' Compensation premium fraud is not a new phenomenon in Florida; however, the chosen and preferred methods to commit it have changed over the last several years. In the past, unscrupulous business owners who decided to avoid the applicable insurance premiums did so mostly by either under-reporting their payroll or misclassifying their employees. Historical examples include businesses keeping two sets of books, one which reflected the true payroll exposure while the other one, designed to be made available to the insurance carrier at audit, reflected only a percentage of the payroll exposure or, classification of employees in lower risk classifications than actually applicable to lower the amount of premium generated. While this type of fraud still occurs on an individual basis, a much larger, more organized scheme has emerged which endangers the entire workers' compensation insurance market and industry.

The scheme, found mostly in the construction industry and, more specifically, among the first-tier construction subcontractors who supply mostly, if not solely, labor for various construction trades. This new scheme is highly organized, set up and run by individuals familiar with the construction industry, as well as the nuances of workers' compensation insurance coverage and the proof of such required to obtain contracts for work. What these individuals, commonly referred to as "facilitators," do is create fake or "shell" companies, with no real business operations, labor force, or physical location, other than a post office box. The name these companies using very vague or generic names such as "XYZ General Services, Inc.," vs. "XYZ Roofing, Inc.," as to not reveal the type of construction work allegedly being conducted. This is an important aspect of the start of the scheme which will become evident later in this paper. The facilitators will incorporate the company usually using the online incorporation process offered by the

Florida Department of State, Division of Corporations. This allows them to name the company, as well as the company owner and registered agent, anything they like without any review or verification process. The facilitator's name will rarely, if ever, be associated with the company, but rather a "nominee" owner or, in many cases, a completely fictitious owner, will be named as the company's sole officer and registered agent. In either case, this person will never be able to be located once the scheme is in place, allowing the facilitators to use the company for illegal purposes, but never be revealed as the actual owner, controller, and operator of the company.

Once the facilitator has an active corporation, he or she will then turn to an insurance agent in an effort to obtain a minimal workers' compensation insurance policy. Sometimes the insurance agent is directly involved and aware of the purpose for setting up the company and obtaining an insurance policy, and other times is duped by the facilitator. The facilitator will usually accompany the nominee owner (usually a person who has entered the United States illegally and who may be using an fictitious name / identity) to the insurance agency and explain to the insurance agent that the he or she is helping the owner start a company, and further, that the owner speaks little or no English, and that they (the facilitator) will handle much of the paperwork and any required servicing of the policy. The "looseness" of the insurance policy application process plays right into the facilitators hands at this point, with reports on occasion of facilitators actually taking the blank insurance policy application with them from the insurance agency only to return with it completed, signed, and notarized, reflecting the nominee owner as the applicant, a person who the insurance agent may never even see. The application will usually describe the business operation as a small, two to four person

company conducting work in one of the construction trades such as drywall installation, brick paver installation, or carpentry work.

The insurance agent, knowing which insurance carriers are likely to insure a company of the likes described on the application, obtain a workers' compensation insurance policy for the "shell" company. An estimated premium is generated, the down payment of which is paid at the time of the application, usually in cash, and the balance is paid in installments billed to the "shell" company address, again usually a post office box. The payment of these premiums is an investment covered by the facilitator to operate the scheme, and investment which will return ten-fold as the scheme takes off. The facilitator now has an active, insured corporation at his or her disposal, and now they are ready to get out into the construction industry and make some money. What the facilitator does is make the newly formed company available to anyone who wishes to use it, of course, for a fee. What happens is an uninsured subcontractor who is either unwilling or simply unable to obtain a workers' compensation insurance policy of their own will start working under the shell company name. That is, they will go to general contractors looking for work, and when they are asked for the name of their company and for proof of the required workers' compensation insurance, they will contact the facilitator who will have a certificate of insurance issued to the general contract listing the shell as the insured entity. It is important to note that currently, there is no requirement to list the number of employees or the scope of operation on the certificates of insurance nor is this information currently available on the Florida Department of Financial Services, Division of Workers' Compensation online compliance database. There are currently efforts underway to add this information to both, however, without a

mandated requirement that the general contractors verify not only a valid policy, but also check to see that the number of employees and scope of insured operation are consistent with the volume and scope of work being performed, along with punishments for failing to do so, this change will not have much effect. Once the work is performed by the uninsured subcontract, payment will be made to him from the general contractor via company check made payable to the shell company. This is where the Money Service Businesses, or check cashing stores, enter the scheme. Normally, a traditionally financial institution such as an established bank will not cash a check made payable to a business or, third party, but rather require that the check be deposited into the payee's account. Some Money Service Businesses, however, allow the cashing of the third party, business to business checks, by certain "authorized" person's allegedly related to the payee. These "authorized" persons are usually the facilitator, and others designated by the facilitator, introduced to and known by the owner / operators of the selected Money Service Business. Many times, limited powers of attorney listing these "authorized" persons are found in the Know You Customer files of the shell companies required to be kept in the Money Service Businesses check cashing records.

When checks made payable to the "shell" company are negotiated at the check cashing store, two fees are taken out. One, usually between 1.5% and 2.0%, is taken out for the Money Service Business owner as the fee for cashing the check. The second, usually between 6% and 8%, is taken out for the facilitator as the fee for the use of the shell company name and, more important, the workers' compensation insurance policy. None of the monies paid in this fashion are reported to the shell company insurance carrier, nor are any of the payments considered payroll exposure by the general

contractor's insurance carrier, because, on paper, this appears to be a legitimate, contractor to insured subcontractor payment. The result, no workers' compensation insurance premiums are assessed to what is actually a labor expense, effectively avoiding any applicable premiums. Considering that a modest construction industry class code rate is around 20%, and that State and Federal payroll taxes add close to another 10%, the total payment of 8%-10% to use the shell company name and insurance and to negotiate the check at a Money Service Business results in an immediate 20% savings to the uninsured subcontractor. If the uninsured subcontractor is working in a higher risk, thus a higher class code rate trade, the savings are even greater. This immediately puts legitimate subcontractors, paying their required workers' compensation insurance premiums and payroll taxes at a distinct disadvantage when it comes to bidding for jobs. There is no longer a "level playing field" on which honest subcontractors can compete.

This process is then duplicated, with the facilitator "renting" the use of the name and workers' compensation insurance policy of the shell company to as many uninsured subcontractors as possible, taking a fee for each, and dramatically increasing his or her profit at the expense of the workers' compensation insurance market in Florida. This is where the generic or vague company names helps out, as uninsured subcontractors working in any trade can utilize the services of the shell company without any flags coming up as they might if the name were to identify a specific trade and the work was being performed in another. There have been instances identified that during any given week, dozens, if not hundreds, of uninsured subcontractors in all different trades were being paid for services under a rented shell company name. One shell company alone accounted for 27 million dollars worth of checks in excess of \$10,000 over a four year

period. None of these monies, most if not all of which went toward labor expense, was ever assessed any applicable workers' compensation insurance premiums.

Also at the transaction stage, the Money Service Business may choose to become complicit in the scheme by falsifying required documents regarding the true identity of those persons authorized to conduct the transactions. That is, while they may have the authorized persons identification along with the aforementioned limited power of attorney, they will almost always choose, at the direction of the facilitator, to complete the required IRS Currency Transaction Report for transactions in excess of \$10,000 in the name of the nominee owner of the company to avoid identifying the facilitators or any of his or her co-conspirators on any documentation. Falsifying Currency Transaction Reports is both a Federal and State crime, and once it is determined that the Money Service Business has decided to join the criminal enterprise by doing this, because an additional target of law enforcement during investigations into this type of scheme.

If and when an employee of the uninsured subcontractor suffers an injury, several things could happen. The facilitator instructs those "renting" his or her certificate of insurance that minor injuries are to be paid for by the renter as reporting them to the shell company insurance carrier would reveal that there are other, unreported employees working under the shell company name. Catastrophic injuries of course cannot be covered by the renter, and when, tragically, this type of thing happens, the general contractor holds up the certificate of insurance in the name of the shell and states that the injured worker is an employee of a sub (shell). The shell company insurance carrier, while they may try to defend the claim, will ultimately start processing the claim, as per Florida State Statute, even unreported employees are covered under a company's

insurance policy. After further investigation, the claim may be subrogated between the insurance carrier of the shell and the insurance carrier of the general contractor, depending on where the more clearly defined employer / employee relationship existed, however none the less, one carrier of the other will pay for the claim for an employee who's payroll was never assessed any workers' compensation insurance premiums.

Sometimes, the facilitators "burn" the shell companies each year, starting a new one, and leaving the insurance carrier, and anyone else for that matter including law enforcement, looking for the nominee owner to attempt an audit, or get other information about the company and its activities. In this case, the facilitator simply walks away. In other instances, such as the one noted above, the facilitator will actually agree to an audit each year by the shell company's insurance carrier, however will create a separate set of books which reflects the same, small, two to four person company which was described on the application, which will generate a small premium which will continue to be the facilitators "investment" in the company to use in the scheme. The large business to business checks to cover millions of dollars of labor expense will never be seen by the insurance carrier, as they are cashed at the Money Service Business, cleared through the Money Service Business bank account, and returned to the general contractor.

The scheme as described, and detailed in the attached schematic, looks very good "on paper," as payments appear to be being made from one legitimate entity to a second, fully insured entity. Investigations have revealed the prevalence of the use of this scheme by contractors and subcontractors as a way to avoid paying applicable premiums on payroll exposure and Money Service Business owners and operations as a way to generate addition income. For example, recently it was discovered that Currency

Transaction Reports listing ten (10) specific individuals as conducting check cashing transactions totaling nearly one billion dollars were filed with the Internal Revenue Service by Money Service Businesses in South Florida. These transactions were consistent with the use of the described scheme which leads us to believe that many, if not all of those transactions were conducted for the purpose of avoiding the payment of workers' compensation premiums on those monies, resulting in the loss of hundreds of millions of dollars to the workers' compensation market in Florida. One individual interviewed during an investigation stated that he believed that 75% to 80% of all subcontractors he knew in various trades in the construction industry were using this method of "renting" insurance for the purpose of fraudulently showing compliance with the workers' compensation insurance coverage requirements in Florida and avoiding the payment of workers' compensation insurance premiums.

While law enforcement in general, and particularly the Florida Department of Financial Services, Division of Insurance Fraud, has made significant headway in indentifying and investigating the various individuals operating these criminal enterprises, and has completed several successful criminal investigations of the facilitators and money service business owners, the scope and magnitude of what has been referred to as the "largest organized financial crime in the State of Florida," and been dubbed, "Florida's Financial Hurricane," continues to make this a real threat to the workers' compensation market in Florida.