JEWELRY INSURANCE ISSUES
REPRINT

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Bogus Appraisals & Fraud

Do valued contracts on jewelry constitute a moral hazard?

Last fall Wal-Mart announced it would begin selling high-end jewelry. Wal-Mart is already the largest jewelry retailer in the country. Other "big-box" retailers such as Costco are also big jewelry sellers. Jewelry, even expensive jewelry, is now mass-marketed.

Increasingly, such sales are accompanied by bogus appraisals; that is, appraisals of questionable value, often from a source of questionable reputation, and containing information of questionable accuracy, completeness, or verification.

A few months ago Wal-Mart's Price Club Web site advertised several expensive pieces of jewelry, accompanied by appraisals valuing them at far above purchase price. If the gems' qualities were as stated in the appraisals (and surely the qualities were not deflated), the appraised values were almost double the jewelry's worth. For example, one particular necklace selling for $300,000 came with an appraisal valuing it at $575,950.

Costco's Web site and its in-store jewelry cases showed pieces of jewelry accompanied by a GIA certificate and an appraisal valuing the jewelry at well over twice its selling price. GIA (Gemological Institute of America) is a world-respected grading lab which describes/grades gems but does not assign value. Coupling an inflated appraisal with a GIA report lends an air of authority and authenticity to the appraisal that is wholly unmerited.

Costco and Wal-Mart's Web sites illustrate the widespread use of the inflated appraisal as a sales gimmick. One New York City lab alone provides an estimated 200,000-300,000 bogus appraisals yearly!

Settling claims based on these inflated appraisals means the insurance industry pays and pays — either with lost customer good will when the adjuster offers a reduced settlement or with an overpaid lucrative cash settlement mandated by "valued loss settlements."

Potential for Fraud

You can be sure that customers are not oblivious to the potential value of an inflated appraisal. Indeed, that's one of its draws. Not only is the buyer getting a "great bargain," but regardless of what happens, he "can't lose." One insurance specialist called that $300,000 Wal-Mart necklace with the $575,000 appraisal, "a claim in the making."

JCRS studies of insurers' claims consistently show a spike in jewelry claims activity at tax time. There's no explanation for increased jewelry loss at this time of year except that money is needed. It's also been repeatedly shown that when one makes a bad investment, the easiest way to recoup the loss is through a convenient claim filed against an insurance company.

An Accenture study found that 25% of U.S. adults have no qualms with inflating insurance claims, and that one in ten approve of submitting claims for items that were not lost or damaged at all. Furthermore, half of the respondents in the Accenture survey said that people commit insurance fraud because they can get away with it.

The Problem with Valued Contracts

A number of insurance companies are writing valued contracts on jewelry with a broad-form pair-set clause, agreeing to pay scheduled values for the vast majority of total losses (estimated at over 90% of all jewelry claims).

As more and more jewelry sellers — especially the national and regional chains, big-box, and Web-based retailers — offer grossly inflated appraisals, insurers will increasingly be writing policies based on valuations far in excess of the purchase price. A valued contract on such jewelry means the insured could receive a benefit up to TWICE the actual loss sustained.

Under such circumstances, the temptation for policyholder fraud is great. As the court noted in ruling on Ryan vs. Royal Insurance Co. of America in 1990, "to the extent that reimbursement might exceed the value of the loss, policy holders will have the incentive to rid themselves of the insured property."

It may be time for insurers to consider doing away with valued contracts on jewelry!

Instead of paying the appraised amount on a valued contract, the policy should state that the insurer will repair or replace with like kind and quality, or will pay in money the lesser of 1) actual cash value (ACV), 2) cash equivalent of the company's cost to repair or replace, or 3) an amount equal to the insured's interest.

Under a valued contract, the insurer is bound by inflated valuations. Also, policyholders are tempted to profit from false claims. Under an ACV (or replacement cost) contract, however, there is less temptation for fraud and the carrier does what insurance was intended to do: make the insured whole.

The industry may not go broke by over paying inflated jewelry appraisals, but if policyholders see how easy fraud is, they may be tempted to file other bogus claims. The insurance industry needs to actively use insurance industry appraisal standards and sponsor training programs to educate agents, underwriters, and adjusters in spotting clues that suggest inflated valuations and false claims. The best solution is prevention.

FOR UNDERWRITING

Because jewelry appraisals tend to go unchecked by insurers, bogus appraisals and inflated valuations are likely going undetected as well. Insurers should seriously consider writing ACV policies for jewelry, rather than valued contracts, as the best safeguard against overpayment and fraud.

For all quality jewelry, require an appraisal that precisely details the qualities of the piece, such as the ACORD 78/79 Jewelry Appraisal or ACORD 805 Jewelry Sales Receipt. If a claim is made, a jeweler can replace the piece based on the description, rather than just supply something that matches the (possibly inflated) valuation.

FOR CLAIMS

Carefully check and compare all documents on file. A simple tool for this purpose is the ACORD 18 Jewelry Evaluation Form. Keep in mind that appraisals supplied by the seller are sales tools that are meant to impress the buyer with appraised valuations that may have no real-world basis. If the appraisal shows a valuation considerably higher than the sales receipt, suspect an inflated valuation. ■

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