REGIONAL WORKSHOP FOR ASIAN INSURANCE SUPERVISORS (CRISIS MANAGEMENT, COUNTERING FRAUD AND ANTI MONEY LAUNDERING)

MONETARY AUTHORITY OF SINGAPORE

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COUNTERING FRAUD IN INSURANCE

- **Countering fraud is a must**
- **Supervisors role in countering insurance fraud, ICP 21**
- **Working together to combat fraud**
- **Challenges for the supervision according to ICP 21**
- **Understanding fraud risk**

COUNTERING FRAUD IN INSURANCE

- Fraud arises in a spectacular number of ways, with potential misfeasors ranging from policyholders, claimants all the way to investigation companies and loss adjustors (salvage firms).

For instance in motor insurance:

- Fraud types range from fake vehicles, fake policies, fake accidents, fake driving licences, exaggerated invoices, all the way to fake claims for exaggerated disability, medical expense fraud and so on.
- In the UK, it is estimated that £2 billion a year of the £15 billion motor insurance sector ends up as fraudulent payments.
- In Jordan, where individual motor cars have been known to have as many as 83 "accidents" in a single year.

SUPERVISORS INVOLVEMENT IS NECESSARY, BUT CHALLENGING

- How insurers and intermediaries deal with fraud is critical.
- Privacy law vs fraud combat
- Internationally information sharing is critical.
- The complexity of reinsurance treaties and placements should be fully understood

SUPERVISORS INVOLVEMENT IS NECESSARY, BUT CHALLENGING

- The supervisor should consider contributing to or promoting anti- fraud initiatives such as:
  - working with relevant industry and trade associations
  - the establishment of anti-fraud committees consisting of industry or trade organizations, law enforcement agencies, other supervisors, other authorities and possibly consumer organizations as a platform to address fraud in insurance – for example, by discussing trends, risks, policy issues, profiles and modus operandi
  - the establishment of **a fraud database** on suspected and/or confirmed fraud attempts;

SUPERVISORS INVOLVEMENT IS NECESSARY, BUT CHALLENGING

- Require insurers to submit information and statistics with respect to fraud attempts
- the enhancement of consumer/policyholder awareness on insurance fraud and its effects through effective education and media campaigns
- Whenever a supervisor is informed of substantiated suspicious fraudulent activities which might affect insurers, intermediaries or the insurance industry as a whole, it should consider whether to convey warning information to insurers and intermediaries to the extent permitted by local legislation.

COUNTERING FRAUD IN INSURANCE-ICP 21

- **The supervisor requires that insurers and intermediaries take effective measures to deter, prevent, detect, report and remedy fraud in insurance.**
- Is fraud a criminal act?
- Fraud is costly and reduces consumer and shareholder confidence.
- Countering fraud is in principle the concern of the individual insurers and intermediaries.
- But, the supervisor is one of the competent authorities that has an important role to play in countering fraud in insurance.

COUNTERING FRAUD IN INSURANCE-ICP 21

- **Fraud in insurance is addressed by legislation which prescribes adequate sanctions for committing such fraud and for prejudicing an investigation into fraud.**
- Enforcement? Public notice?
- Legislation should contain offences and sanctions for committing fraud and for prejudicing an investigation into fraud. It should also provide the ability:
  - to obtain documents and information, for intelligence and investigation purposes;
  - to restrain assets which represent, or are believed to represent, the proceeds of fraud; and
  - to confiscate assets which are, or are believed to be, the proceeds of fraud.
- It may be helpful for anti-fraud legislation to provide appropriate civil and criminal immunity for fraud reporting in good faith, including where no fraud was subsequently found to have occurred.

INSURANCE FRAUD: 13 PEOPLE IN PRISON

COUNTERING FRAUD IN INSURANCE-ICP 21

- The supervisor has a thorough and comprehensive understanding of the types of fraud risk to which insurers and intermediaries are exposed.
- The supervisor regularly assesses the potential fraud risks to the insurance sector and requires insurers and intermediaries to take effective measures to address those risks.

COUNTERING FRAUD IN INSURANCE-ICP 21

The supervisor should identify the main vulnerabilities in its jurisdiction, taking into account independent risk assessments where relevant, and address them accordingly.

- Crossborder activity
- Unlicensed insurance operations
- Complex products
- Fake reinsurance
- Commission structure

FRAUD THROUGH CYBER RISK

- Cyber risk refers to the unauthorised loss, destruction, or disclosure of confidential information.
- To gain knowledge and expertise, a 'Technology and Cyber Risk Strategy Group' should be established, in which the insurance supervisor is an active participant.
  - Consideration of Cyber risks during on-site work.
  - Update the 'Supervisory Review Process' guidance materials, to include, cyber/IT risk.
  - Increased utilisation of 'skilled person reviews' in order to examine in detail any issues arising from the activities elucidated from cyber risk.

COUNTERING FRAUD IN REINSURANCE

- In the center of a reinsurance transaction that allows for a reduction in statutory reserves or required solvency capital is the risk transfer element. A typical risk transfer requirement could look like:
- Contracts that do not result in the *reasonable possibility* that the reinsurer may realize a *significant loss* from the *insurance risk* assumed generally do not meet the conditions for reinsurance accounting and are to be accounted for as deposits.
- A risk transfer test should be part of regulation that include a threshold level for measures like TVAR or VAR of the NPV of all cash flows.

COUNTERING FRAUD IN REINSURANCE

- The following steps can be used to determine the supervisory steps towards monitoring the risk transfer requirement of a reinsurance treaty:
- Determine if contract transfers "substantially all the risk" – if so, stop.
  - Assumed downside essentially same as cedant's original
- Determine if Reinsurance contract would qualify as insurance – if so, stop.
- Determine whether or not risk transfer is "reasonably self-evident" – if so, stop.
  - For example cat x/s, x/s with no claims experience sensitive features like sliding scale reinsurance premium.
- Require the calculation of recommended risk metrics and compare values to critical threshold values.

CERTAIN KEY REINSURANCE PROVISIONS RELATE TO POSSIBLE RISK TRANSFER LIMITATIONS

Aggregated limit (per event)

- Common in non proportional reinsurance.
- Depending on the market it may also apply to proportional reinsurance

Important features:

- Limits the partnership spirit in a proportional treaty
- Limits risk transfer
- Is it sufficient?
- Is the reinsurance program considering the limitation of the coverage

CERTAIN KEY REINSURANCE PROVISIONS RELATE TO POSSIBLE RISK TRANSFER LIMITATIONS

Reinstatement clause for catastrophic protection

- This clause allow the reinsured to have access to protection in case of multiple events that affect its portfolio during the duration of the contract.
- It is usually used for catastrophic protection.

Important features:

- A reinstatement premium that is close to the reinstated capacity limits severely the risk transfer component.
- Is the use of the full capacity allowed before the reinstatement capacity is required?

CERTAIN KEY REINSURANCE PROVISIONS RELATE TO POSSIBLE RISK TRANSFER LIMITATIONS

Reinsurance exclusions

- The reinsurer excludes risks from the reinsurance treaty using explicit exclusions or referring to standard exclusion clauses of a particular market (Lloyds market exclusions number xxx)

Important features:

- Is there full understanding of the referred exclusions?
- Are they the same as those from the original policy?
- Which risks are not transferred?
- Can the insurer administer the exclusions?

CERTAIN KEY REINSURANCE PROVISIONS RELATE TO POSSIBLE RISK TRANSFER LIMITATIONS

Experience Refund

- A method of sharing the profitability of the reinsured business between the ceding company and the reinsurer.
- In exchange for sharing profits, the reinsurer normally insists that losses be carried forward

Important features

- Right motivation?
- Makes financial sense?
- Experience refunds are usually not viable for small blocks of business subject to significant fluctuations in the experience

CERTAIN KEY REINSURANCE PROVISIONS RELATE TO POSSIBLE RISK TRANSFER LIMITATIONS

Termination Provisions

- Termination provisions affect the cession of new business under an arrangement

Important features

- Are the provisions reasonable
- Are they equal for both parties
- Do not create systemic risk
- Allow for sufficient time to adjust
- Does not leave the insurer exposed to risk without coverage

CERTAIN KEY REINSURANCE PROVISIONS RELATE TO POSSIBLE RISK TRANSFER LIMITATIONS

Recapture Provisions

- Recapture provisions affect all business ceded under the agreement
- Recapture is a useful tool for the ceding company to maintain flexibility in reinsurance arrangements
- Recapture is sometimes prohibited if the reinsurance account has a negative experience to prevent anti-selection by ceding company

Important features

- Is this limiting risk transfer?
- Will the insurer be without coverage when most needed?
- Are the recapture payments reasonable?

COUNTERING FRAUD IN MOTOR INSURANCE

- The Fraud Database is a useful component in the success of the struggle with the fraud, both organized and opportunistic.
- The database is used in conjunction with a set of early warning indicators for possible fraud:
  - Claims occurring very close to commencement date of the policy where the policy is not a renewal
  - Claims occurring after midnight with no witness
  - Large value "hit and run" losses
  - Policies with a frequent number of claims reported in a certain period

COUNTERING FRAUD IN INSURANCE-ICP 21

- **The supervisor has an effective supervisory framework to monitor and enforce compliance by insurers and intermediaries with the requirements to counter fraud in insurance.**
- The supervisor should issue anti-fraud requirements by way of regulations, instructions or other documents or mechanisms that set out enforceable requirements with sanctions for non-compliance with the requirements.
- The supervisor should issue guidance to insurers and intermediaries that will assist them to counter fraud effectively and to meet the requirements set by the supervisor.
- The supervisory and insurance staff engaging in anti-fraud activity should be appropriately skilled and provided with adequate and relevant training on countering fraud.

TOOLS TO COUNTERING FRAUD

Crucial tools in managing fraud include

- Central co-ordination
- High levels of co-operation between insurers
- Heavy use of IT capabilities to identify common claimants and common claim patterns.

COUNTERING FRAUD IN INSURANCE ICP 21

- Insurers and intermediaries should be able to demonstrate to the supervisor that they have effective management of their fraud risk.
- The supervisor should use both off-site monitoring and on-site inspections to:
  - evaluate the effectiveness of the internal control system of insurers and intermediaries to manage fraud risks; and
  - recommend or require appropriate remedial action where the internal control system is weak and monitor the implementation of such remedial actions.
- Where a supervisor identifies suspected criminal activities in an insurer or intermediary it should ensure that relevant information is provided to the financial intelligence unit (FIU) and appropriate law enforcement agency and any other relevant supervisors.

COUNTERING FRAUD IN INSURANCE-ICP 21

- **The supervisor regularly reviews the effectiveness of the measures insurers and intermediaries and the supervisor itself are taking to deter, prevent, detect, report and remedy fraud. The supervisor takes any necessary action to improve effectiveness.**
- This review could cover aspects such as:
  - the risks of fraud in the insurance sector and whether these are adequately addressed by the risk-based approach of the supervisor
  - whether the number and content of on-site inspections relating to anti-fraud measures are adequate and whether off-site supervision of anti-fraud measures is adequate
  - Sufficiency of the actions taken by the supervisor against insurers and intermediaries

COUNTERING FRAUD IN INSURANCE-ICP 21

- **The supervisor has effective mechanisms in place, which enable it to cooperate, coordinate and exchange information with other competent authorities, such as law enforcement authorities, as well as other supervisors concerning the development and implementation of policies and activities to deter, prevent, detect, report and remedy fraud in insurance.**
- Mechanisms of cooperation and coordination should normally address:
  - operational cooperation and, where appropriate, coordination between supervisors and other anti-fraud competent authorities; and
  - policy cooperation and, where appropriate, coordination across all relevant anti-fraud competent authorities.

COMBATING INSURANCE FRAUD: NOT ONLY A PRIVATE SECTOR RESPONSIBILITY

MANY THANKS

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