

US Experience on Combating Insurance Fraud

Ekrem Sarper

Acting Chair, Implementation Committee, IAIS

Chief Bilateral Relations Liaison and Senior International Relations
Policy Advisor, NAIC

U.S. Perspective

- What is Insurance fraud?
- Insurance fraud costs the American economy 80 to 230 billion dollars each year.
- Why is insurance fraud committed?
- Insurance fraud causes injury and humiliation.
- Studies have shown one in four people feel insurance fraud is okay.

State Insurance Departments

- All states have insurance departments, but not all insurance departments have an Insurance Fraud Bureau
- Fraud Bureaus investigate and fight insurance fraud
- 44 States have dedicated Fraud Units, either within the Departments of Insurance (34) or other Agencies (10)

Regulatory Controls

- Company licensing process
- Form A database
- Investment custodian requirements
- Holding company requirements
- Reinsurance regulation

Regulatory Controls

- Financial Condition Examiners Handbook Exhibit G – Consideration of Fraud
 - Requires consideration of fraud during each full scope exam
 - Planning, Testing and Reporting Procedures
 - List of fraud risk factors to be considered
 - Requires review of AML compliance at Life Insurers
 - Encourages use of existing CPA work

Information Sharing & Systems

Systems

- IFB Fraud Alerts System
- NHCAA PERC System
- NICB's FOREWARN System
- NAIC Life Insurance Alert System
- National Equipment Registry
- Cargo Theft Alerts
- Law Enforcement Online

Administrative, Civil or Criminal Actions

State agencies may take a variety of actions when “bad behavior” is found:

- Administrative: internal agency, commissioner has authority, hearing officers assigned
- Civil: court system, commissioner files a case against entity is state court
- Criminal: commissioner asks prosecutor to take criminal action against individual or entity

Enforcement on Fraud

- State and Federal working together
- Conduct administrative investigations
- Action is typically pursued against the individual/ entity involved
- Fraud Units typically conduct criminal investigations

Enforcement on Fraud

- The investigations usually focus on insurance agents, consumers, third parties, and healthcare providers who are committing insurance fraud
- Fraud investigators frequently work with local, state and federal law enforcement agencies
- Depending on state laws, criminal cases may be referred to local, state and federal prosecutors

NAIC Antifraud Task Force Members

- The investigations usually focus on insurance agents, consumers, third parties, and healthcare providers who are committing insurance fraud
- Fraud investigators frequently work with local, state and federal law enforcement agencies
- Depending on state laws, criminal cases may be referred to local, state and federal prosecutors

NAIC Model Act

- The investigations usually focus on insurance agents, consumers, third parties, and healthcare providers who are committing insurance fraud
- Fraud investigators frequently work with local, state and federal law enforcement agencies
- Depending on state laws, criminal cases may be referred to local, state and federal prosecutors

Anti-Money Laundering

The United States Federal Government has ultimate authority over AML and CFT activities:

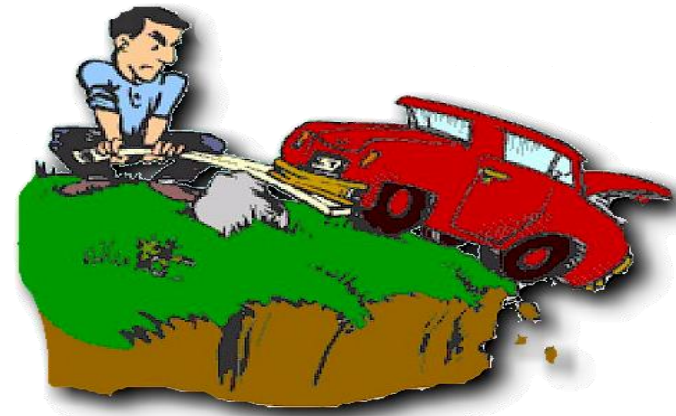
Agency: Financial Crimes Enforcement Network (FinCEN) of the US Department of Treasury

Laws:

- The Bank Secrecy Act (BSA) of 1970
- The Money Laundering Control Act of 1986
- The Suspicious Activity Report Act of 1996
- The USA PATRIOT Act of 2001

Insurance Fraud Schemes

- Financial Statement Fraud
- Claimant Fraud
- Healthcare Fraud
- Organized Fraud Groups
- Insurance Agent Fraud



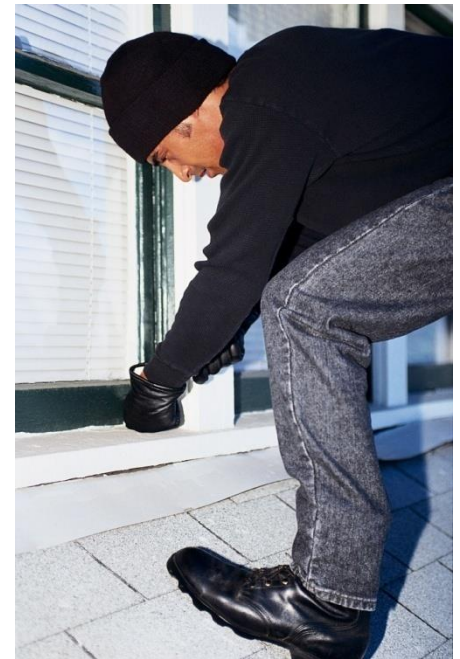
Likely Candidates for Financial Statement Fraud

1. Fast-growth companies whose growth is slowing
2. Troubled companies trying to survive
3. Public companies fighting to meet expectations
4. Private companies with weak controls



Claimant Fraud

- Staged burglaries and thefts
- Arson for profit
- Murder for profit
- Application fraud
- Workers compensation fraud

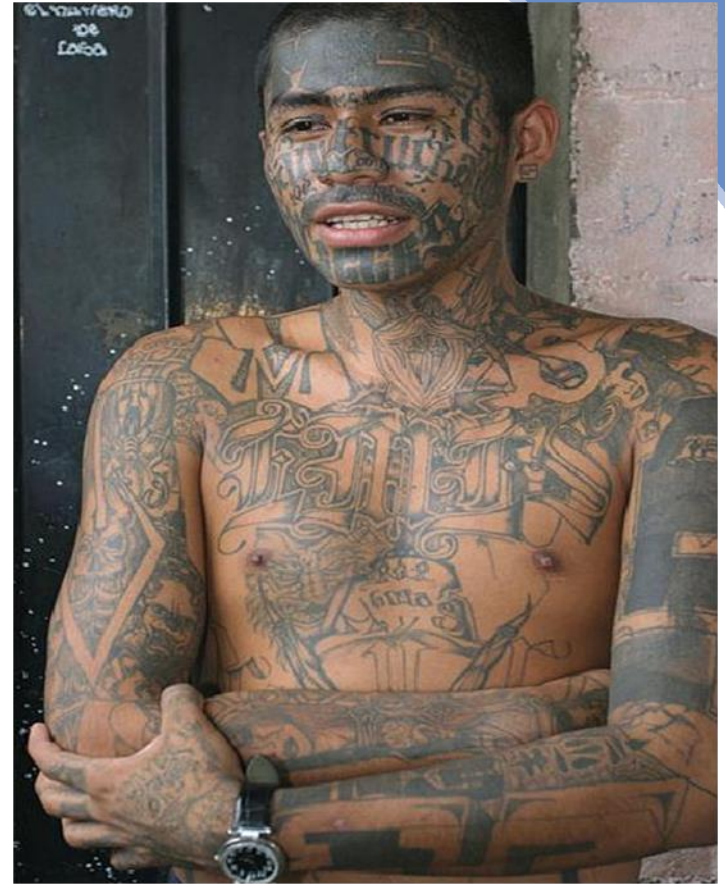


Health Care Fraud

- Billing for treatment as payable when it is not payable
- Charges inconsistent with services provided
- Unlicensed personnel performing services
- Illegally obtaining prescription drugs



Organized Fraud Groups



Insurance Agent Fraud

- Filing false claims with insurers
- Clean sheeting
- Backdating
- Kickbacks



Fraud Cases

Company A

- Very simple, straightforward fraud by President of Company

Company B

- Increasing complaints
- Affiliate transactions
- Pledged securities

Claimant Fraud

Company C

- Very complex reinsurance assumed and ceded transactions
- Publicly traded
- Intimidating President

Company D

- Entering into unfamiliar line of business
- New business partner didn't remit premiums or report all policies in force

Prominent Financial Statement Fraud Cases

- Equitable Life Insurance (UK)
 - The company used money from guaranteed annuity rate policyholders to subsidize variable annuity rate policyholders
 - No executives/directors were convicted
- HIH Insurance (AZ)
 - The company understated reserves, overstated goodwill, reinsurance recoveries and DTAs
 - Executives/directors were convicted of stock market manipulation, disseminating false information, etc.

Fraud Cases

Information sharing between insurance companies and government

- Stop ongoing frauds
- Discourage future frauds

Prevention programs for government and insurance companies

Insurance fraud awareness for the public

- More pro-active project

ABC Case Study

- Unusual item noted on AS
 - “Premiums due from reinsurer” appeared as a write-in for \$10 million
 - Analyst asked company to explain line item
 - Company response:
 - Balance related to reinsurance premiums due early in the first quarter of 20XX. Since ABC had a favorable cash position at year end, it was a business decision to make the payment early.

ABC Case Study

- What was discovered later:
 - ABC had an offshore affiliate reinsurer for which it was taking \$68 million in credits
 - Collateral was underfunded by \$10 million.
 - ABC transferred \$10 million to its offshore affiliate days before year end to fund the trust account
 - The \$10 million was counted as prepaid reinsurance and as reinsurance collateral
 - This double counting of \$10 million and other problems caused company to fail

Key Takeaways

1. Insurance Particularly Susceptible to Fraud
2. High Pressure Situations = High Fraud Risks
3. Regulators must be vigilant and maintain professional skepticism

Don't be afraid to ask questions when something appears unusual!

Contact information

Ekrem M. Sarper
Chief Bilateral Relations Liaison
and Senior International Relations Policy Advisor

National Association of Insurance Commissioners
444 N. Capitol Street, NW
Suite 700
Washington, DC 20001

Tel: 202 471 3976
Fax: 816 460 7824
esarper@naic.org