IAIS

INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

Countering Fraud in Insurance

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1. INTRODUCTION

1. Introduction

Insurance Core Principles 21:

- “The supervisor requires that insurers and intermediaries take effective measures to deter, prevent, detect, report and remedy fraud in insurance.”

1. Introduction

What is fraud?

- “A deceptive act or omission intended to gain advantage for a party committing the fraud (the fraudster) or other parties”

Other important questions

- Who commits it?
- Why is countering fraud important?
- Who is responsible for countering fraud?

1. Introduction

Legal framework

- offences and sanctions for committing fraud
- offences and sanctions for prejudicing an investigation
- ability to obtain documents and information
- ability to restrain assets
- ability to confiscate assets
- could be useful to have civil and criminal immunity for fraud reporting

1. Introduction

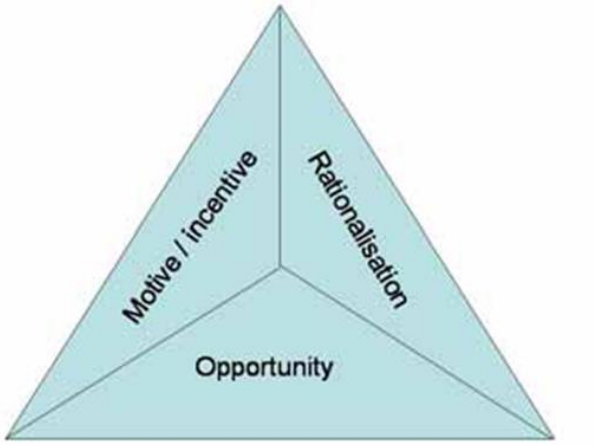
Application paper on countering fraud in insurance:

- Objectives of the paper:
  - provide information on how fraud can occur within the insurance sector (for ease the term insurers includes reinsurers and intermediaries)
  - insurers should assess their vulnerability and implement effective and efficient strategies, policies, procedures and controls
  - provide information for supervisors to assist them on applying anti-fraud measures

2. FRAUD RISK IN INSURANCE

2. Fraud risk in insurance

The Fraud Triangle:



- Motive/Incentive
  - financial problems
  - unrealistic business objectives
- Opportunity
  - more likely to act when risk of being caught is small
- Rationalisation
  - dissatisfied with insurer as an employer
  - compensation against premiums paid
  - everyone does it
  - copying the behaviour of others in the insurer

2. Fraud risk in insurance

Profile of insurance fraudsters:

- The “opportunity” fraudster:
  - law abiding citizen who sees an opportunity for fraud
  - a policyholder could inflate a legitimate claim to compensate for premiums paid
  - employee could falsify expenses or financial accounts for his/her benefit

2. Fraud risk in insurance

Profile of insurance fraudsters:

- The “professional” fraudster:
  - earns or complements income by fraud
  - may continue until detected and target a number of insurers
  - organised crime groups committing complex and extensive frauds
  - funds obtained through fraud could be used to finance other criminal acts

2. Fraud risk in insurance

Fraud risk management by insurers:

- directors should understand and recognise risk of fraud in their business
- policies, procedures and controls based on understanding of risk of fraud
- fraud risk management should be included in all insurers risk management framework

2. Fraud risk in insurance

Fraud risk management by insurers:

- Fraud risk should be:
  - considered when establishing mission, strategy and business objectives
  - analysed and reflected in relevant operational procedures and controls, eg:
    - product development
    - accepting clients
    - hiring and firing staff
    - outsourcing
    - handling claims
    - dealing with intermediaries

2. Fraud risk in insurance

Fraud risk management by insurers:

- Policies, procedures and controls should be based on a risk analysis, taking into account:
  - size of the insurer
  - group, responsibility and organisational structure
  - products and services offered
  - payment methods
  - types of policyholder
  - market conditions
  - distribution methods

2. Fraud risk in insurance

Fraud risk management by insurers:

- a separate fraud management function could be considered
- procedures for responding adequately to suspected cases of fraud (could include fraud investigation) is needed
- fraud investigation may require access to expertise (legal, IT, audit, medical)

3. INTERNAL FRAUD

3. Internal fraud

Risk factors for internal fraud include:

- organisational culture and tone from the top
- complexity of the insurer
- speed of innovation
- remuneration and promotion policies
- weaknesses in internal control
- economic climate and business situation

3. Internal fraud

Internal fraud can include:

- pilfering of cash or resources, eg equipment, stock or information
- falsifying expenses
- bribery – buying influence
- bribery can include kickbacks – receiving funds for awarding a contract to a certain party

3. Internal fraud

Typical warning signs of internal fraud include:

- managers and/or other staff working late
- directors, managers, and/or other staff suddenly resigning
- personality changes
- unexplained wealth and/or lifestyle changes
- key managers and/or other staff having too much control with no or little oversight
- conflicts of interest
- complaints
- missing statements and unrecognised transactions
- unexplained rising costs

3. Internal fraud

Internal fraud prevention policies, procedures and controls include:

- culture of ethical behaviour
- adequate supervision of management and staff
- screening of management and staff
- establishing clear responsibilities
- eliminating conflicts of interest
- observing the four eyes principle
- safeguards over use of assets
- internal complaints procedures
- transparent and consistent anti-fraud policy
- clear dismissal policy

3. Internal fraud

Internal fraud detection:

- internal audit is most successful
- internal audit should be:
  - risk based
  - independent, either internal or external
  - accountable to the board
  - include all business lines and processes

3. Internal fraud

Internal fraud detection:

- other possible detection methods include:
  - encouraging staff to report irregularities
  - establishing a policy on disclosure of information on potential fraud, eg whistle-blowing
  - exit interviews

4. POLICYHOLDER AND CLAIMS FRAUD

4. Policyholder and claims fraud

Policyholder fraud and claims fraud can be committed by policyholders:

- at inception of the insurance contract
- during the insurance contract
- when claiming payment or compensation

Claims fraud can also be committed by third parties, eg medical services, engineers

4. Policyholder and claims fraud

Policyholder fraud at inception:

- deliberately withholding, or providing, incorrect background and other information, for example, the refusal of coverage by other insurers or claims background
- may affect decision of insurer to offer cover and at what premium

4. Policyholder and claims fraud

Typical features of claims fraud that could occur during the insurance contract include:

- reporting and claiming of fictitious damage or loss
- exaggerating damage or loss
- misrepresenting a fact to create appearance of an incident covered under a policy
- misrepresentation of the damaged party by an imposter
- staging of incidents covered under a policy

4. Policyholder and claims fraud

When establishing policies, procedures, and controls, insurers need to:

- understand that quick claims settlements increase risk of fraud
- consider moral and ethical responsibility to prevent fraud
- recognise that fraud affects reputation
- identify and prevent fraud that could threaten policyholders or other third parties

4. Policyholder and claims fraud

Policyholder and claims fraud prevention

- consider risk enhancing factors for new products
- “product proofing”
- assess fraud risk of existing products
- adequate client acceptance policy
- ensure risks posed by intermediaries are managed - the insurer remains responsible for delegated actions
- make policyholders and beneficiaries aware of their duties

4. Policyholder and claims fraud

Policyholder and claims fraud detection

- advise potential policyholders of consequences of false or incomplete statements
- consider quality and reputation of third parties
- client could provide incorrect or incomplete information – mitigate with fraud profile of product-client combination
- fraud risk assessment of claims
- clear criteria for claims assessor
- automated checking against red flag lists
- operational targets should be combined with fraud detection targets
- ascertain competence of claims adjusters
- maintain incident database

5. INTERMEDIARY FRAUD

5. Intermediary fraud

Intermediary Fraud Risk

- intermediaries involved in some of the most important processes
- danger of trust being abused, for example:
  - withholding of premiums
  - insuring non-existing policyholders, paying a first premium, collecting commission, annulling the policy by non-payment of premiums
  - colluding with policyholders

5. Intermediary fraud

Typical warning signs of intermediary fraud include:

- request for commission immediately or in advance
- policyholder lives outside intermediary's normal region of operation
- small portfolio but high insured amounts
- premiums received and commission paid above or below industry norms
- policyholder asked to make payments via intermediary
- insured and intermediary represented by the same person
- personal relationship between client and intermediary

5. Intermediary fraud

Typical warning signs of intermediary fraud (cont):

- unexpected developments or results
- intermediary often changes address and/or name
- frequent changes in control or ownership of intermediary
- frequent changes in control or ownership
- a number of complaints or regulatory inquiries
- intermediary is in financial distress
- churning
- intermediary insists on certain loss adjusters or claims contractors

5. Intermediary fraud

A warning sign can also exist where the portfolio of an intermediary includes a significant number of policies:

- where the commission is higher than first premium
- with arrears on premium payments
- with a payment shortly after inception
- with a high amount of claims fraud
- with a disproportionate amount of high risk insureds, for example elderly people

5. Intermediary fraud

Intermediary fraud prevention and detection

- fit and proper standards for intermediaries
- policy for appointment of intermediaries
- signed application forms and TOBAs
- require disclosure of relevant facts
- check financial soundness of intermediary
- effective sanctions policy in case of non-compliance by intermediary

5. Intermediary fraud

Terms of Business Agreements (TOBAs) could require the intermediary to confirm:

- agreement does not breach any legal obligation or rules of a competent authority
- intermediary will maintain relevant licences, authorisations etc
- compliance with insurer's anti-fraud policies, procedures and controls

5. Intermediary fraud

To reduce potential for fraud, insurers should consider:

- not paying commission until first premium paid
- not paying more commission than a certain percentage of premiums paid
- keep unearned commission in a temporary deposit
- make a clear distinction between funding of intermediaries and paying of commission

5. Intermediary fraud

The insurer should monitor the performance and business of the intermediary, and consider:

- quality of business, including business conduct, integrity of directors, management, staff
- anticipated and actual levels and patterns of business
- warning signs

5. Intermediary fraud

Other procedures and controls to consider are to:

- send policies and renewal documents direct to policyholders
- instruct intermediaries not to accept payments in cash
- make premium cheques payable to the insurer
- ensure sufficient safeguards over intermediary client accounts
- audits of intermediary's business

6. SUPPORTING ORGANISATIONAL MEASURES AND PROCEDURES

6. Supporting organisational measures and procedures

Training:

- should correspond with business process
- should reflect risks staff may encounter
- should at least explain anti-fraud policies, procedures and controls, including reporting of fraud
- more specific training for Board, Senior Managers and others to include relevant laws, fraud methods, detection methods and internal reporting

6. Supporting organisational measures and procedures

Reporting suspicions of fraud:

- report suspicions to a designated person
- those reporting should have adequate legal protection
- policies on keeping records of suspicions and cases
- policies for reporting suspicions to law enforcement
- policies and procedures to be communicated internally and externally
- notify supervisor of fraud related matters where the supervisor has an interest

6. Supporting organisational measures and procedures

Information exchange:

- fraudsters may target different insurers
- insurers should share information with each other
- this could be achieved by a database containing information about:
  - internal fraudsters
  - fraudulent policyholders, claimants, beneficiaries, fraudulent intermediaries and other third parties
- consider data protection and privacy laws

6. Supporting organisational measures and procedures

Information exchange (cont):

- fraudster may not just target insurers
- consider sharing information across the financial sector by, for example, linked databases
- consider data protection and privacy laws
- share knowledge on fraud risks, trends, policy issues, prevention and detection

7. THE SUPERVISOR’S ROLE

7. The supervisor's role

The supervisor should:

- have a thorough and comprehensive understanding of fraud risk
- identify main vulnerabilities
- consider fraud risks alongside other risk assessments
- understand the activities undertaken, products/services offered
- understand internal, policyholder, claims and intermediary fraud
- regularly assess potential fraud risk
- require insurers and intermediaries to take effective measures to address fraud risks

7. The supervisor's role

The supervisor should monitor and enforce compliance

- issue enforceable requirements with sanctions
- issue guidance
- resources to be sufficient
- staff to be skilled and trained
- fraud risk to be considered at each part of the supervisory process
- assessment of whether insurers/intermediaries have adequate fraud risk management
- use on-site inspection and off-site monitoring to enforce compliance
- power to take appropriate corrective and remedial action
- report suspected criminal activity to FIU or appropriate law enforcement agency

7. The supervisor's role

Supervisor to regularly review effectiveness of measures taken, covering for example

- risks of fraud in the insurance sector
- supervisory resources and training
- number and content of inspections
- adequacy of off-site and on-site supervision
- on-site inspection findings
- actions taken
- input from other authorities
- number and nature of requests for information by others
- adequacy of requirements/guidance

7. The supervisor's role

The supervisor should take necessary action to improve effectiveness

- consider contributing to anti-fraud initiatives
- consider conveying warning information to insurers/intermediaries if aware of substantiated suspicion of fraud
- maintain records on supervisory inspections relating to combating fraud and on sanctions issued

7. The supervisor's role

The supervisor should have effective mechanisms to cooperate, coordinate and exchange information

- with other competent authorities
- operational and policy cooperation, and coordination with/across anti-fraud authorities, where relevant
- provision of information to other authorities when suspected fraud identified
- obtain information on concerns by authorities and insurers/intermediaries
- consider the appointment of an anti-fraud contact
- maintain records on the number and nature of formal requests

Contact information

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