

# Misrepresentation and Fraudulent claims



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CASE STUDY

Non-Disclosure and Fraudulent claims are major concerns in Insurance Industry, a significant percentage of all reported claims are fraudulent in one way or another.

Insured “Mr A” (Dealer of High Valued accessories) approached Insurance Company B through an independent agent to get insurance of his outlet stocks, which was pledged with the bank. As per agent, there wasn’t any loss and Underwriter issued the terms. Insured accepted the terms and asked to issue the policy documents.

After few months, Fire broke out in the outlet and Insured lodged Fire/ Theft claim. Insurance Company appointed a surveyor for further proceedings. As per Insured’s initial statement, high valued accessories worth PKR 20 million were stolen subsequent to the fire, Surveyor got the written statement and informed the Insured after the consent of the Insurance company that “Theft after Fire” loss is not payable under the standard Fire Policy. Insured immediately changed his statement and declared that those accessories were damaged due to fire, but failed to produce any salvage. Also Insured didn’t produce any purchase evidence of claimed accessories.

On inquiring about the client after the claim, It was brought to the knowledge of the Company that Insured is habitual in making fraudulent claims and prior to moving to Company B recovered a major claim from another Insurance Company because of his strong political influence.

Insurance company rejected the claim and Insured filed a suit against the insurance company.

## Questions

1. How can underwriter avoid underwriting such insured
2. What actions Insurance Industry should take to discourage such Insured

## Answers

1. Underwriting business without knowing the risk or insured can be disastrous for any underwriter. Underwriter needs to be more cautious when the insured is switching insurance companies on regular basis, Also following practices can help underwriter in decision making;
  - 1.1 **Know your customer (KYC)** is the process of identifying and verifying the history of the Insured. This can help understanding the background and financial soundness of the Insured. KYC is now a must thing in many financial industries, but unfortunately this practice is not yet matured in Insurance, as the only legal or regulatory requirement for KYC is regarding “Anti Money Laundering”. If the Underwriter knew about the Political/ Moral background of the Insured, he might not underwrite that business. So companies should amend their practices regarding Customer Due Diligence (CDD)/ Know Your Customer (KYC) to fulfill both legal and underwriting requirements.
  - 1.2 **Proposal Form** carries all required information about the proposed risk and forms basis of Policy Preamble. Any misrepresentation or concealment of material facts can lead to policy cancellation or rejection of a particular claim. Unfortunately due to many reasons, like lack of awareness, budgetary pressures, lack of staff trainings etc this important document is overlooked. If duly filled proposal form was available at the time of the proposal stage, Underwriter would have been aware about the loss history, previous insurer and other material information, which could help him to make a prudent decision. So Underwriter should always ask for the duly signed and stamped proposal form prior to issuing any terms.
  - 1.3 **General Inquires about Insured** can also help Underwriter to know about the Insured. Underwriter should develop good communication links with other companies’ underwriters, so they can cross have a better idea about Insured/ Risk prior to issuing the terms. A general inquiry about the insured can help him knowing the Insured and the risk.
  - 1.4 **Knowing Political Background** is an important factor in all underdeveloped countries, where undue influence can result in fraudulent claims settlements. So knowing the political affiliation level of the insured can help underwriters to avoid unfavorable conditions at the time of claim.

- 1.5 **Verified Loss History** is key information in making underwriting decisions regarding pricing and risk acceptability. Unfortunately in soft markets or in underdeveloped countries, there isn't any practice to share/required verified claim histories with other Insurers. Underwriter should require verified Claim History from the existing insurer to know the claim frequency/ severity and rate the risk accordingly. There should be special discounts/ loadings based on claim history.
  - 1.6 **Knowledge about Agent** can also help underwriter in making prudent decisions. Underwriter must be more careful in accepting business when it is coming from a source which is not well known or known for placing foul businesses.
2. Insurance industry needs to take many collective and corrective measures for overall betterment, like
- 2.1 **Fraudulent Client Database** can help in lowering claims cost and identifying Insured with Mal-intentions. As per ABI website, UK insurer uncovered 130,000 fraudulent claims worth £ 1.32 Billion across all insurance products in 2014. In addition to improving their own anti-fraud systems, insurance firms fund industry initiatives, like Insurance Fraud Bureau (IFB), Insurance Fraud Enforcement Department (IFED), Insurance Fraud Register (IFR) and My License data of UK Insurance industry. Such sort of initiatives can help industry in identifying and minimizing fraudulent claims costs.
  - 2.2 **Effective Litigation** against fraudsters can avoid or minimize fraud claims. Normally companies prefer not to indulge in litigation because of lengthy and costly procedures, but if litigation is managed at Insurance Association level and pursued effectively than this can discourage others from committing frauds.
  - 2.3 **Agent Training** can help in mitigating fraudulent claims. Though there is a statutory requirement of agents training, companies can also start trainings of other skills like effective communication, product knowledge, customer handling and others, so that there isn't any miscommunication at agents' end. Further, there should be incentive for agents to produce good and profitable business for the company.
  - 2.4 **General Public Awareness** programs can change the overall thinking of the public. At the moment, most people take insurance to meet compulsory requirements and they consider insurance to be an additional expense only. Awareness should be created at all the levels to educate the public about the benefits and importance of insurance products. Also, industry needs effective lobbying for legislation against fraud and implementation of these laws.
  - 2.5 **Human Resource Development**, Human resource is a key factor in any industry's success or failure. Unfortunately, there are very few education and training opportunities available at local level. Also there is a huge brain drain in Insurance. Industry need to offer fair packages, in line with other financial industries, to stop this brain drain and also to develop trained and effective resources for the future.

