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# BBB/FIDELITY & COMPUTER CRIME

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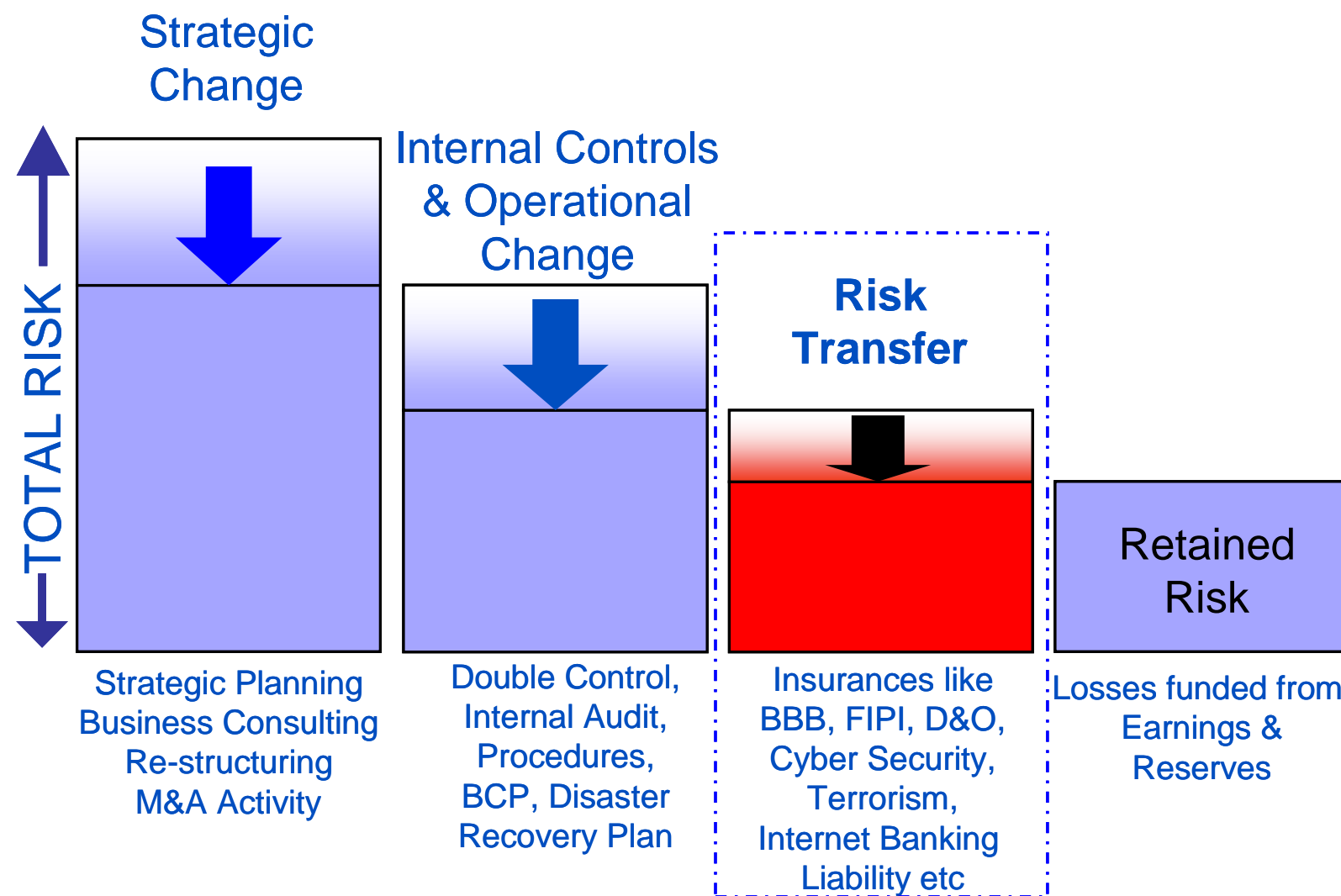
# Agenda

- Bankers Indemnity Insurance – ORM Framework
- Bankers Indemnity Insurance - Coverage
- Coverage Issues
- Underwriting Issues and Challenges
- Claim Examples
- Benchmarking & Marketing

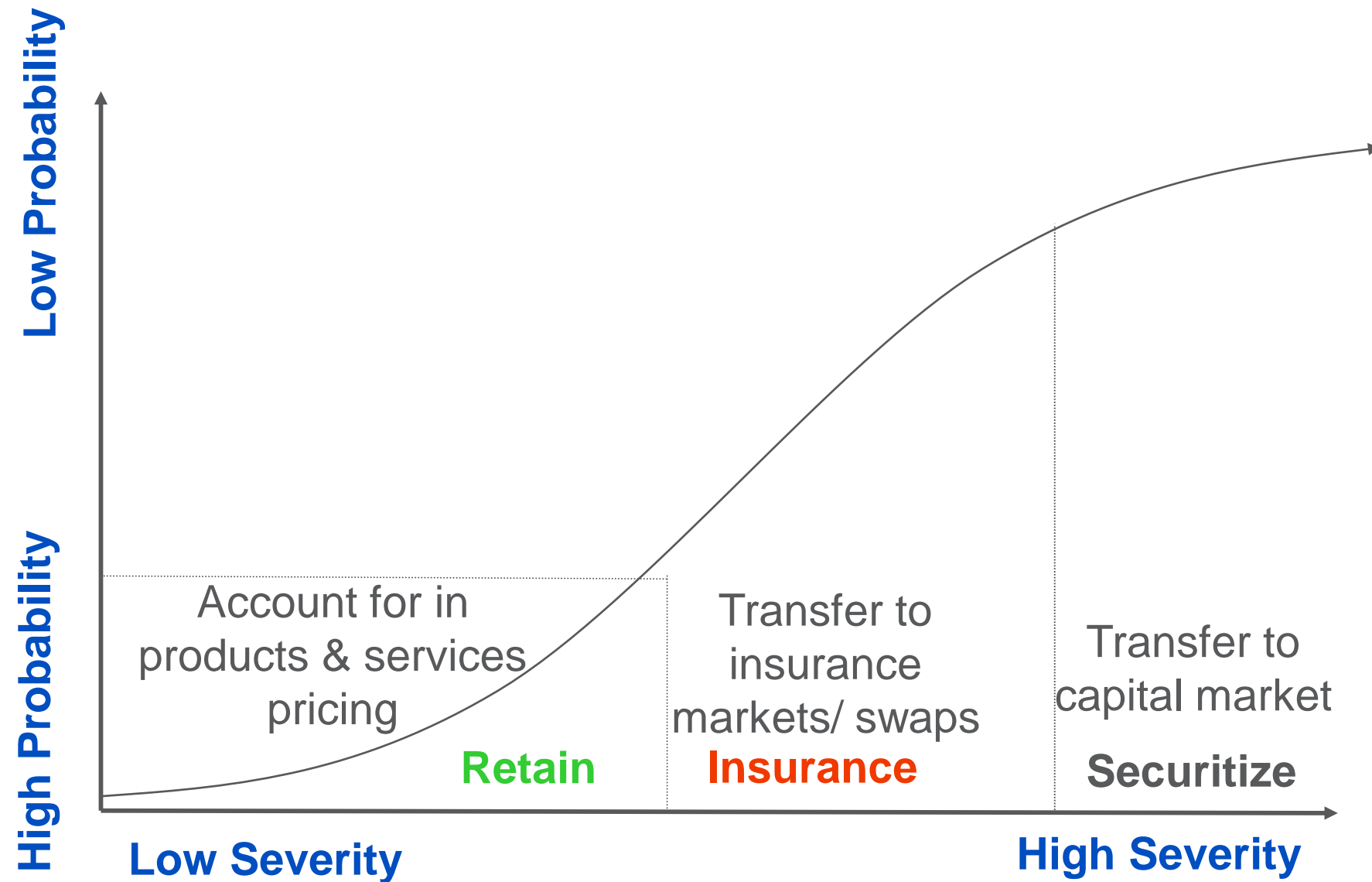
# Operational risk Management (ORM)

**Operational risk** is the risk of direct or indirect loss resulting from **inadequate or failed internal processes, people and systems** or from **external events**. Operational risks and losses can result from **fraud, employee errors, failure to properly document transactions** or to obtain proper internal authorization, failure to comply with regulatory requirements and conduct of business rules, equipment failures, natural disasters, acts of third parties or the failure of external systems.

# Insurance as a risk mitigation Tool



# Insurance as Part of Risk Capital Management



**Insurance is effective tool for managing  
Unexpected Losses**

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# Bankers Blanket Bond (BBB)



# About BBB

**Q: What is Bankers Blanket Bond Insurance?**

**A:** “BBB” Insurance attempts to provide, under one insurance contract, coverage for money, negotiable, funds and other valuable property against CRIME RISKS such as theft (by employees or other parties), robbery, burglary.

# Policy Coverage

**A typical policy would have the following components:**

- **Preamble, or introduction**
- **Insuring clauses**
- **Conditions precedent to liability**
- **Definitions**
- **Exclusions**
- **Conditions**

# How it happens?

- **Employee embezzlement**
- **Hold ups**
- **Fraudulent invoices**
- **Transit of payroll**
- **Fraudulent purchasing of stock and other trading operations**
- **Expenses**
- **Loans**

# Insuring Clauses

1. Fidelity
2. On Premises
3. In Transit
4. Forgery/Securities
5. Counterfeit Currency
6. Damage to Offices and Contents

# 1. Infidelity of Employees

**Covers loss due to fraudulent or dishonest acts of an employee (with the manifest intent of making and/or resulting in improper personal gain) whether committed alone or in collusion with others.**

## 2. On Premises

**Loss of or Damage to Valuable Property (as defined) through theft, burglary, larceny, robbery, false pretence, hold-up, mysterious disappearance or damage by any cause whilst on**

**– The Assured's premises**

**– Any recognised place of safe deposit including the Assured correspondent bank**

## 3. In Transit

- **Covers for Loss or damage whilst in transit anywhere in the custody of:**
  - **An Employee of the Assured**
  - **A person designated by the Assured to have custody**
  - **A security armoured motor vehicle company**

# 4. Forgery and Alteration

**Covers Loss resulting from:**

- **Forgery or fraudulent alteration of, or in cheques, bill of exchange, acceptances, drafts, certificates of deposits, etc. (banking collateral instruments)**
- **When the Assured makes a payment or similar transaction in reliance upon a written instruction which either**
  - **Bears a forged signature, or**
  - **Has been fraudulently altered**



# Securities

**Covers Loss resulting from the Assured acting in good faith upon Securities which prove to be:**

**– Counterfeit**

**– Forged**

**– Fraudulently altered**

**– Lost or stolen**

## 5. Counterfeit Currency

Covers loss by reason of receipt by the insured in good faith of any counterfeit or altered paper currency or coin.

## 6. Offices & Contents

### Loss of or damage to

- **furnishings, fixtures, equipment (except computer equipment of any kind) caused by burglary, robbery, hold-up, theft or larceny, or any attempt thereat, or by vandalism or malicious mischief**
- **any office of the Assured caused by burglary, robbery, hold-up, theft or larceny, or any attempt thereat, or to the interior of any such office by vandalism or malicious mischief**

# Policy Definitions

- Acceptance
- Assured
- Bill of exchange
- Employee
- Cheque
- Certificate of deposit
- Draft
- Letter of credit
- Premises
- Promissory note
- Property
- Withdrawal receipt

# Exclusions

- Losses not discovered during the policy period
- Losses sustained prior to the retroactive date
- Acts of directors
- Default or non-payment of loans, etc.
- Uncollected items of deposit
- Erroneous crediting of funds
- Teller shortage
- Contents of safe-deposit boxes
- Radioactivity
- Surrender of property away from the premises
- Remote or off-premises manipulation
- Unsold travellers cheques
- Credit or charge cards
- Legal liability
- Interest loss
- Wear, tear, etc.
- Natural perils
- War
- Terrorism

# Information Requirement

- Underwriting information
  - Fresh Proposal Form
  - Five year Loss history
  - Risk management practice/survey etc.
- Policy Deductible or Cedent Retention

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# “DIRECT LOSS” UNDER FIDELITY BONDS

- a “direct loss” is one which is the proximate cause of the insured’s loss
- Under standard proximate cause analysis, a “but for” cause may be but one link in a causal chain between the initial act and the ultimate loss.
- Under this analysis, if the insured can establish that the type of act covered under the bond (e.g., dishonesty, forgery, etc.) was the initial action or had occurred anywhere in the causal chain, the insured should be entitled to collect if that chain leads to the ultimate loss.



# Infidelity of Employees

By reasons of and solely and **directly** caused by one or more dishonest or fraudulent acts of any of the Employees of the Assured, which are committed with the **manifest intent** of making, and which result in, **improper personal financial gain** for themselves wherever committed and whether committed alone or in collusion with others, including loss of Property through any such acts of any of such Employees. Salary, fees, commissions and other emoluments, including salary increases and promotions, shall not constitute improper personal financial gain.

## **The criteria required by the insuring clause.**

The act must be carried out by an employee as defined within the policy.

The loss must be caused by a dishonest, fraudulent or malicious act.

The act must be committed with the intent to either make an improper financial gain or cause loss to the employer.

# Retroactive date and series of loss

**ABCO Premium Financing LLC v. American International Group, Inc.** affirmed an award of summary judgment to the insurer. The insured was a premium-financing company that made loans to individuals who could not afford to pay premiums on their insurance policies.

The insured purchased a policy protecting it against loss resulting from employee dishonesty. One of its employees had been regularly processing fraudulent loan applications. He would keep the proceeds of these new “loans” for himself, and simply create more fraudulent loans to make just enough payments on the old “loans” that it did not appear suspicious. When this eventually came to light, the insured sought coverage from its insurer.

But the policy contained a Retroactive Date Rider which precluded coverage unless “acts or omissions causing or contributing to [the] single loss . . . occur after the Retroactive Date.”. It also stated that the “Single Loss” had to be sustained “in its entirety” after the Retroactive Date. The evidence was undisputed that the dishonest employee had been engaged in his scheme long

# Security guards

- Contracted guards are deemed to be employee or outsiders for Bank?
- Do Security guard service providers carry own insurance policy?

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# What are the challenges in this class?

- Information!!!
- Paper based proposal forms with basic questions only address procedures at ONE point in time
- Policies & procedures do not define a fraud/crime risk
- Technology advancements almost make most proposal form sets redundant
- Crime is a human risk => psychological, culture, supervision
- Supervision procedures are KEY but even these can be circumvented easily
- Crime is infrequently discovered and as such many Insurers walk into issues by virtue of naivety



# What should a crime assessment look like?



- Risk surveys => desktop and onsite
- Financial crime risk assessments (FCRA) used to not only assess but monitor perceived risks and mitigate
- Work closely with Op Risk teams to identify patterns of key risk events to assist with thematic reviews
- Health-checks on fraud prevention systems (Falcon, Hunter, Prism etc.)

*Crime underwriting should not be a 'dart throwing' exercise*



# Do clients understand their exposure?

## 2 distinct Groups

- Many believe they know it all & cant be told
- Many assume they have it all under control
- But most DO NOT



To save time, assume I know everything.



- Many Insureds are insecure about admitting vulnerability (similar to cyber)
- Very secretive
- Won't allow UW's access to do job properly



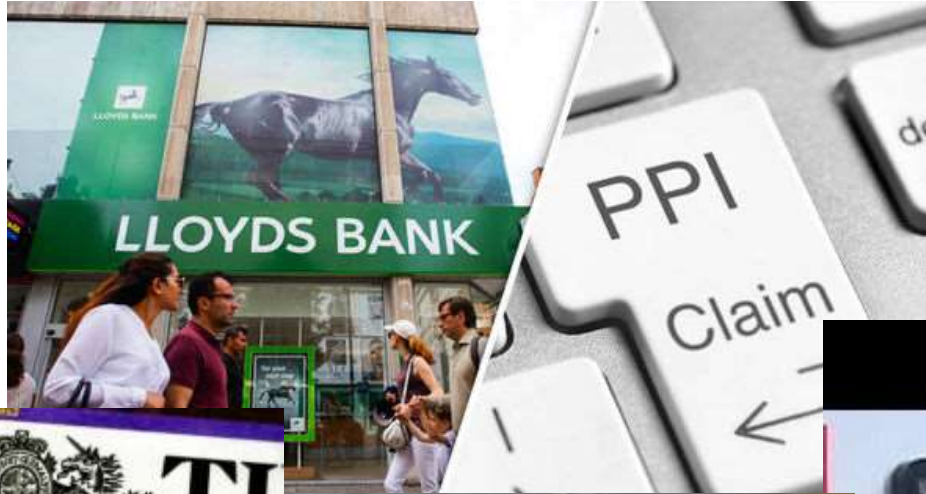
# Is the market in Pakistan sustainable?

**No!**

- Pakistan market is poorly UW
- Much work needs to be done to educate
- Patient players will win in the end

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**UBS** **'DEFECTIVE'**

- £5.6m Revenue for trading desk in 2010
- £46m Revenue for first half of 2010
- £1.4bn Adoboli's trading loss
- £34m Bonuses clawed back from staff

# Global Bank Losses – Not avoidable anywhere

- **Deutsche Bank - US\$20 million Fraud**

A routine audit resulted in the arrest of the bank's then head of Foreign Exchange, together with a customer in Nuremburg on suspicion of a DM28 million (US\$20 million) fraud involving US dollar options.

- **Mehran Bank, Karachi - GBP 120 million Embezzlement**

The Chief of Operations was jailed for 10 years for fraud involving at least GBP 120 million during his career.

Part of the money was apparently used to pay off politicians and army generals who diverted public money into banks he worked for or ran.

- **HSBC - US\$42 million Fraud**

The bank fell victim to a US\$42 million loss at its Jakarta branch. The fraud was believed to involve fake telegraphic transfers from Swiss Bank to Deutsche Bank.

- **Allied Bank - USD 6 million Bank Heist**

A private security company guard deputed at a bank in Karachi, carried out the biggest bank robbery in the country's history, escaping with foreign currency.

# Global Bank Losses – Not avoidable anywhere

- **Central bank, Fortaleza - \$70 million**

heist, carried out by tunneling 260 feet under the ground and into the vault of a Brazilian central bank branch in the northern city of Fortaleza.

- **ACLEDA Bank - US\$500,000 loss**

ACLEDA Bank is a reputed Microfinance company in Cambodia and a senior official defrauded in year 2009.

- **Nationalised bank daylight heist in Ahmadabad**

four armed men looted 6.1 million rupees from two nationalised bank employees while they were carrying the money to their bank's headquarters.

- **ICICI bank – Rs. 50 million**

In year 2008, Maoist rebels hijacked bank van and looted Rs.50 million and one kg gold.

.....**List is endless**

# Bank Losses – Key Trend

- Credit Card

A global cyber crime ring stole \$45 million from two Middle Eastern banks by hacking into credit card processing firms and withdrawing money from ATMs in 27 countries

What's clear is the sheer scope and speed of the crimes:

In just over 10 hours, \$40 million was raided from ATMs in 24 countries involving 36,000 transactions.

# Bangladesh Bank – SWIFT Issue

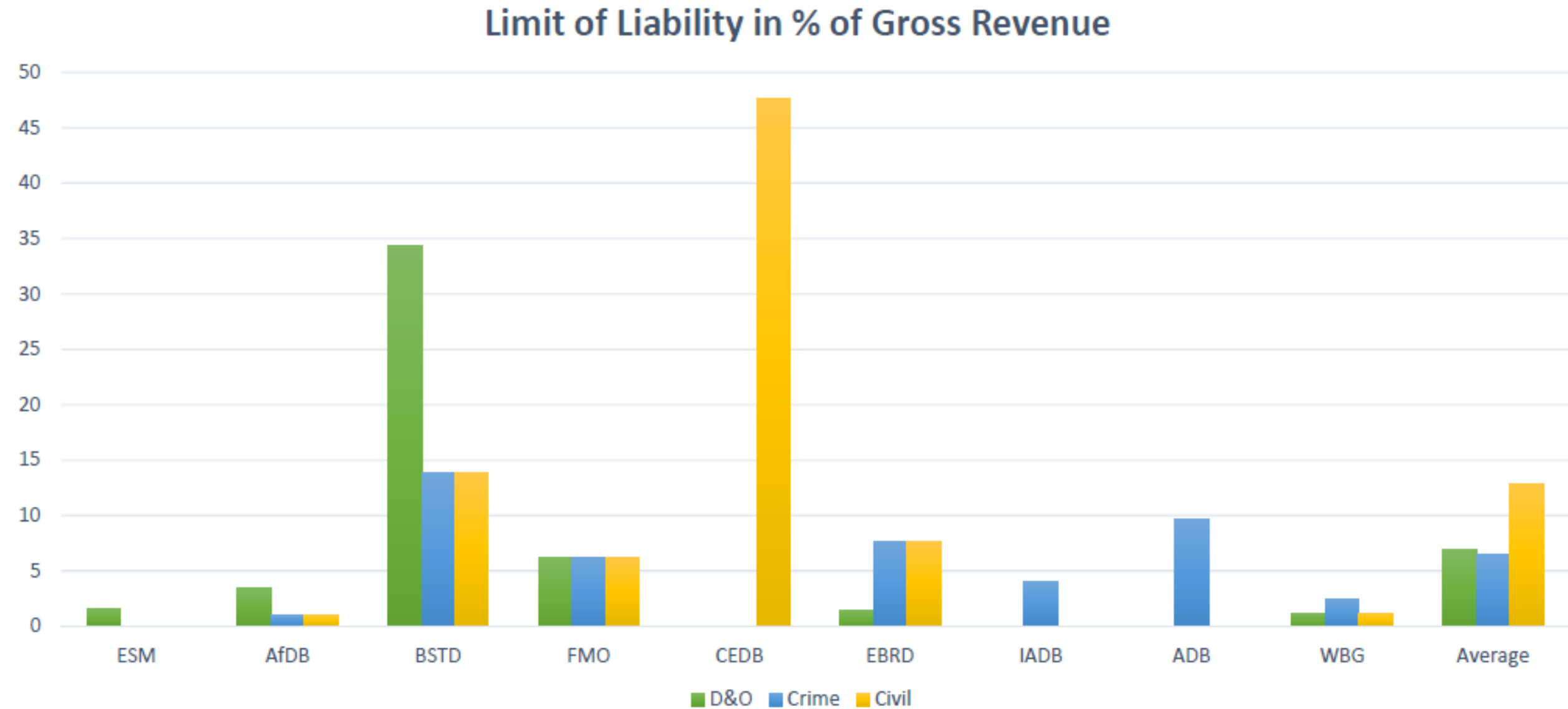
- Hackers breached Bangladesh Bank's systems in early 2016 and tricked the Federal Reserve Bank of New York into sending as much as \$81 million to accounts at Rizal Commercial Banking Corp (RCBC) in the Philippines.
- The accounts were held in fake names and most of the money disappeared into casinos in Manila
- Bangladesh bank is looking to sue SWIFT as well as RCBC for possible recovery
- No contractual relationship with RCBC

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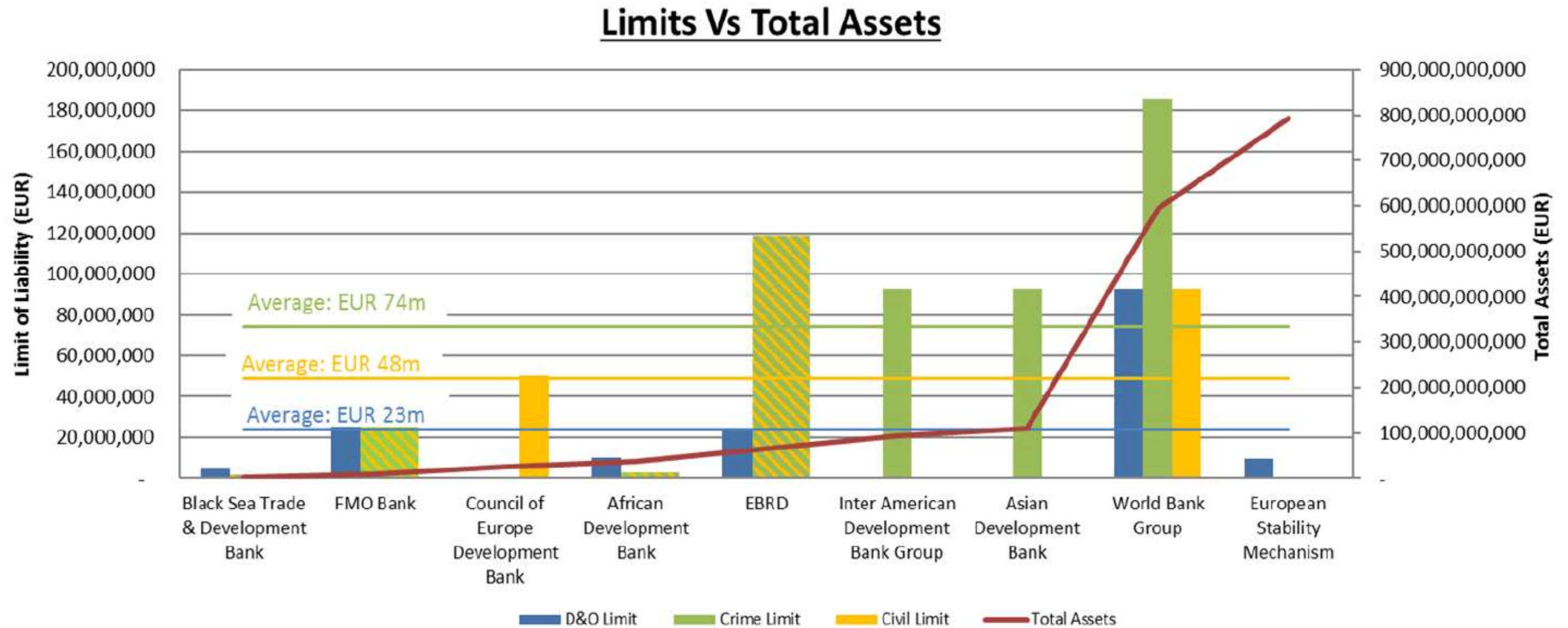


# Benchmarking – Global Institutions



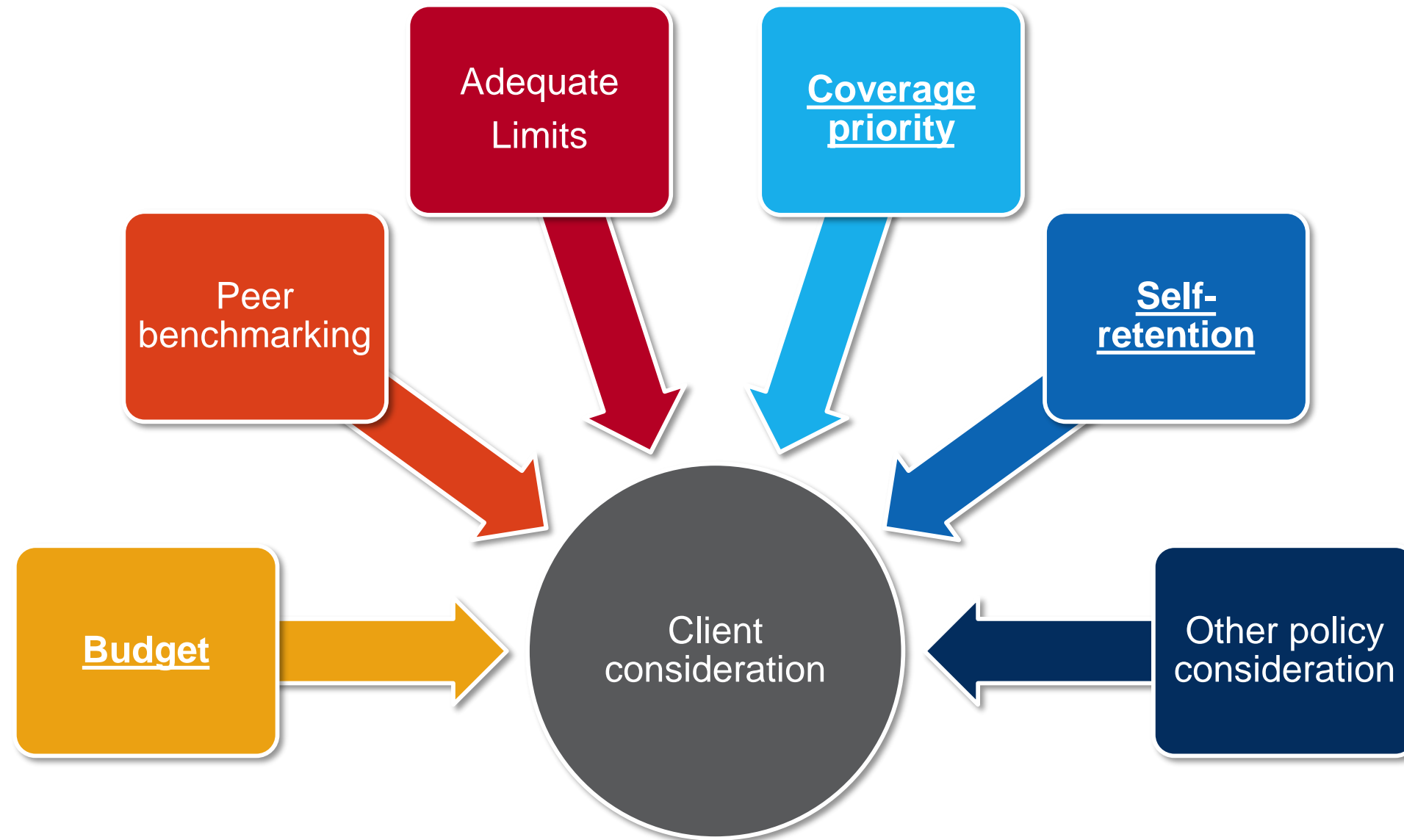
Source: IFC benchmark study of portfolio companies

# Benchmarking – Global Institutions

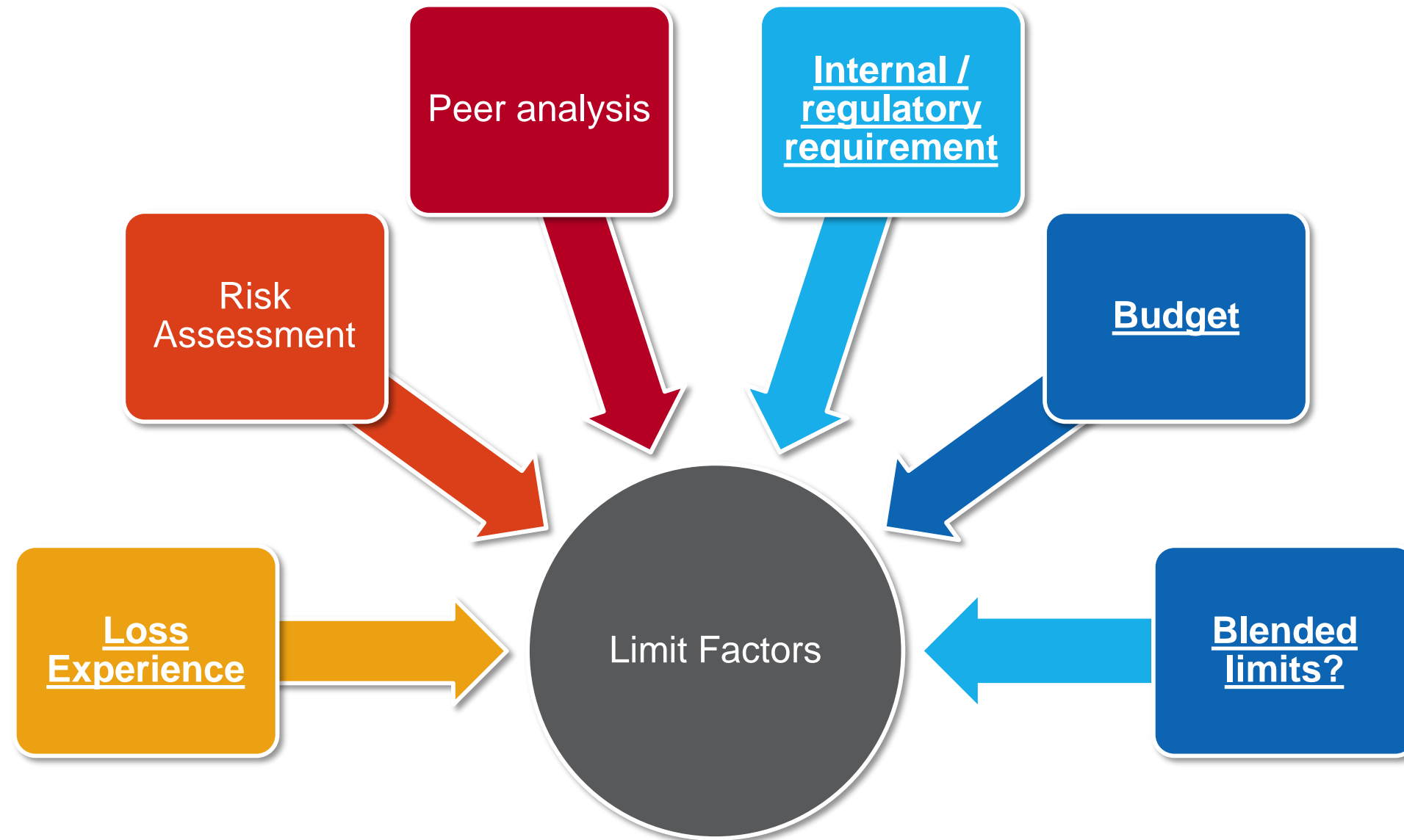


Source: IFC benchmark study of portfolio companies

# Policy Considerations



# Policy Limit Considerations





thank  
you

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