

INSURANCE FRAUD

**It is required the emergence of a specialized entity at the level of the market
in the fight against insurance fraud?**

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Summary:

We all live in a world of more and more kneaded and growing challenges. On the background of globalization and computerization, the global economy and national economies are becoming more and more sophisticated and unpredictable. Risks are multiplying, some of which results in the large consequences. Between insurance and risks there is a strong causal connection and of course an economical one.

Over time, and especially in recent decades with increasing frequency and severity of risks, mankind has sought protection measures. One of these solutions is the insurance. Insurance - as a means of protection in terms of compensation point of view financial losses incurred by the insured - have expanded and diversified considerably in recent decades.

The essential purpose of insurance is therefore protection against risks. Yet, somehow paradoxically, insurance "carries with it" a hidden risk that is not easy to detect and counter. This is the risk of fraud that kneads increasingly more insurers.

Of course, we encounter fraud in most areas of activity: in the sphere of production, services, finance and banking, etc. In this article we intend to make a brief foray into the field of insurance fraud within the context of national and international evolution of the insurance market, without getting into the technical details of this phenomenon causing serious damage.

Keywords: fraud, insurance premiums, damage, criminality, distribution channels

JEL Classification: M40, M41

1. Insurance and fraud

It is well known (by those involved in the field) that fraud is becoming increasingly more worrying for the insurance industry.

In this article we aim to address some specific issues related to fraud.

Before going into specific issues we should look at the insurance activity at global and European level and to have an overview of the phenomenon.

Economic environment in which European insurers operate remained in recent years "challenging" despite improvements visible in the financial market. An interest rate that remains low and limited ability of most consumers to allocate funds for expenditure other than subsistence remained the turbulent two factors which the industry must cope.

2. European and global market in figures

Total gross premiums written in Europe in 2012 amounted to EUR 1,103 billion, fits easily in the decreasing trend of the last years of 0,3% / year, with the exception of 2011 when the decrease was 2,4%.

Premiums at European level in the area of non-life insurance amounted to EUR 451 billion in 2012 which was an increase of 1.1% compared to year 2011. Even in time of economic uncertainty, people are still buying insurance in order to protect what matters to them i.e. health, homes, property, cars, businesses etc. and this is reflected in a stream of premiums, mostly stable.

Auto insurance premiums were in the 134 billion Euros in 2012, representing a very slight increase of 0.1% over 2011 auto sector remains the main actor in the area of "Property & Casualty" (P & C) and accident, registering a total 30% of total non-life premiums. Property insurance premiums in 2012 reached an amount of 89 billion which represented an increase of 2.6% compared with figures for 2011¹.

¹ European Insurance in figures, <http://www.insuranceeurope.eu>

Benefits and claims paid by insurers to their policyholders in 2012 were 959 billion, up 1.4% over the previous year. This could be explained primarily due to increases in the benefits paid for life insurance policies. UK, Germany, France and Italy continue to record three quarters of payments benefits of life insurance policies at European level. Damage non life remain somewhat stable in 2012 totaling 313 billion Euros, with a greater impact from the damage of goods, balanced with a lower volume of automobile damage claims category.

The main distribution channels for life insurance are still banks (bancassurance) followed by brokers, agents and direct sales. For non life insurance agents continue to be the main distribution channel in Europe, followed by brokers, direct sales and bancassurance. Agents continue to be a provider of insurance products in Germany, Italy and Spain, while brokers dominate markets in the UK and Belgium, and direct sales are preferred in the Netherlands, Finland and Croatia.

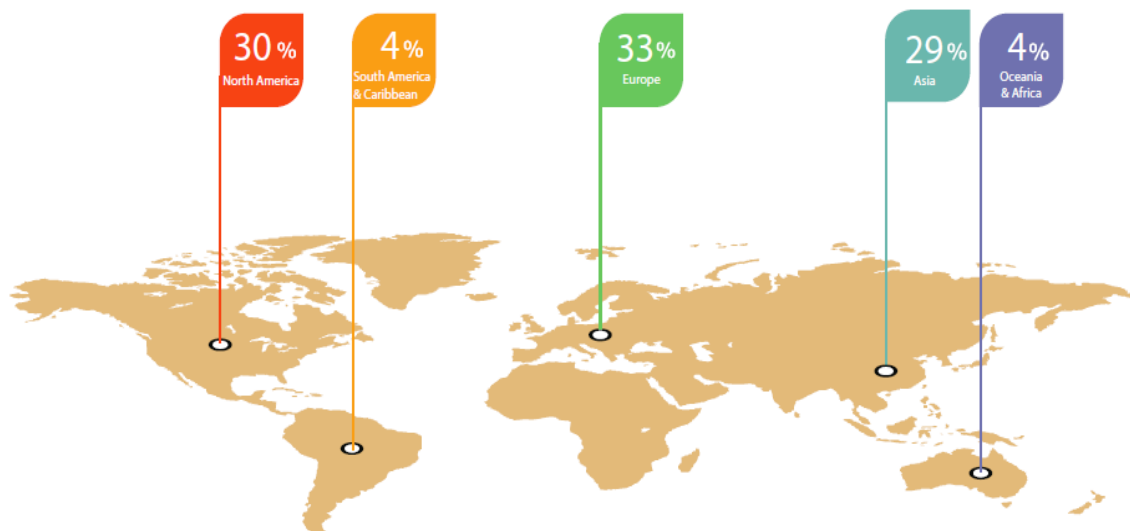
Synthetic situation in figures, within Europe, is the following:

Table 1: **Premiums written and claims and benefits paid in Europe in 2012**

Billions Euros		
Insurance category	Premiums	Claims and benefits
Life	651	646
Non Life	452	313
Total	1.103	959

Worldwide total volume of gross written premiums in 2012 amounted to over EUR 3.312 billion, of which in Europe have been subscribed 33%.

Figure 1: **Share of insurance premiums, by continents**

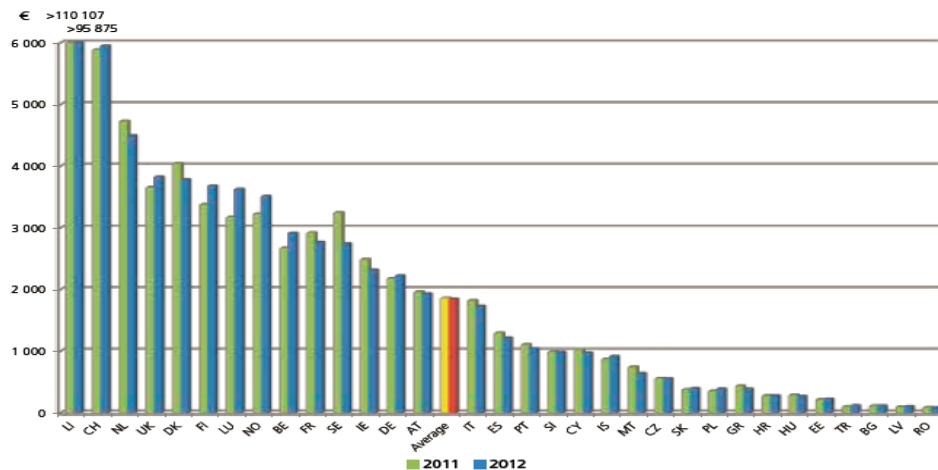


Source: Swiss Re Sigma

Note: Europe includes Russia and Ukraine (which together accounted for 1% of global premiums)

In 2012 an average amount of 1,843 Euros per capita was spent on insurance in the 32 member countries of Insurance Europe. Of this amount EUR 1,083 was spent on life insurance (a slight decrease from 1,102 Euros in 2011) and the remaining 760 Euros in non life insurance sector, of which euro 190 for health insurance. The figures appear to be relatively stable compared to other previous years. These figures representing insurance density are very different in Europe, starting from less than 100 Euros in Romania and going to 6,000 Euros in Switzerland. Lichtenstein is the exception because the huge number of closed life insurance abroad explains the total of 100,000 Euros per capita.

Chart No.1: **Total premiums per capita in Europe 2011 -2012 (Euros)**



Source: Insurance Europe:European Insurance – Key Facts august 2013

Notes:

- The calculations took into account a fixed exchange rate
- Finland and Germany have included pension funds
- Liechtenstein has included insurance taken out of the country

A finding commonly known is the fact that, as an insurance market is more developed and diversified, the level of fraud is higher.

The estimated value of insurance fraud in the UK, as specified by the IFB (Insurance Fraud Bureau) was of 1.3 billion pounds that is 0.5% of the total Euro 250.4 billion gross premiums for the year 2012.

Returning to our country every year we see how the costs of insurance premiums rise, one of the reasons being the increased rate of crime among the insurance market in Romania mainly among auto insurance. Among these we mention and enclose both the voluntary insurance and the mandatory ones (auto civil liability). Recent estimates of the former ISC (now FSA) consider insurance fraud threshold to a rate of 1.5% based on the entire market in Romania. This percentage has a different impact to each insurance company and focus on the specifics of each type of insurance. Actual impact being felt in increased insurance premiums.

Amounts of information available are indicating levels of fraud quite different from one country to another and from one continent to another. In Europe it is spoken of a level of fraud between 0.35% and 1.7% of total gross insurance premiums. Globally, the levels indicated by different sources are more heterogeneous but speaking of percentages the range is between 0.5% and 2.3% of total gross insurance premiums. An average percentage is to be considered hazardous. If, however, solely for the purpose of this modest analysis we consider an average for Europe of 0.4% of total premiums in 2012, the fraud would be more than 4.4 billion euros. These figures show how important is the subject of fraud for insurers and insured, for authorities and society.

Starting from the consideration that insurance is pervasive; we must accept that its multiple valences it generates along common interests also divergent group or individual interests. Each party has an interest in gaining from the business called insurance. Insurers desire to maximize profits, often require rigid insurance conditions and their interpretation is in their own interest.

Insurers, state authorities and civil society should not tolerate the desire of people who threaten the insurance funds through fraud. They join the insurance mechanism as a consequence of a loss that had incurred to an uninsured property. There are situations determined by the desire of individuals to "reconvert" in the insurance industry by deception, forgery and documents, abuse of office and forgery.

3. Fraud: brief legal and economic approach

Fraud is defined as committing acts in bad faith to obtain benefits, damaging to another person, in the same time could be called simply "theft". Fraud is distinguished first in XIV as specific deception done intentionally in order to deceive another person with the purpose to receive undue benefits.

By committing a crime or committing a crime we understand committing any of the offenses punishable by the criminal law, as consumed or attempted crimes, as well as participating to their committing as an author, instigator or accomplice. The content of the concept of insurance fraud includes all human conduct prohibited by the criminal law, that all actions required by law to be qualified as crimes which affect the security system. In terms of audit, fraud refers to intentional action undertaken by one or more individuals among management, employees or third parties.

Insurance fraud occurs according to the crime. Thus we are dealing with actual fraud, legal and apparent. **The real fraud** is all criminal offenses committed in a given territory, in a period of time. **Apparent fraud** includes

all crimes from insurance economy reported to the criminal justice and recorded as such. **Legal fraud** includes all cases referred to the Court, where the court has pronounced judgments of conviction that remained final and irrevocable. Fraud may involve manipulation, falsification or alteration of records or documents; misallocation of assets; removing or omitting the effects of transactions from records or documents; recording of transactions without substance; misapplication of accounting policies.

To avoid fraud, we consider appropriate to amend the legislation for insurance and the regulations of crimes. It will be necessary to clearly define the concept of offense, to treat in a new way the field of active subjects of contravention, contravention sanctions and remedies including contravention procedure.

To remember is that currently there are no viable mechanisms to prevent fraud if the insurer gives compensations to the injured party within 15 days after the accident, and after the payment of compensation, the culprit of the accident, which is in the same time, insured for motor third party liability, challenges in court the record of the offense and gets cancellation of the effects. In these circumstances the insurer has paid the compensation that was in his responsibility, but, by decision, the court exonerated him from liability. After cancellation of the crime any part involved in the offense (guilty, injured, witnesses) will have no proprietary interest and no financial loss. Not having interest they do not disclose the effects of the court decision to the insurer for it to recover the compensation paid. The culprit was declared innocent and did not pay the damage, while the injured party has repaired the damaged property being compensated by the third party liability insurer. In practice such cases are numerous and the court has no obligation to quote the insurer in the event of an appeal to the protocol and does not even know that was paid compensation based on the protocol it will cancel.

Uninsured people often unwittingly participate to the fraud, either as witnesses or as supporters of the idea of recovery of a loss that a friend has incurred. In most cases they are supportive to the persons involved and not to the spirit of justice and legality regarding the guilt of the accident.

State budget is implicitly affected by insurance fraud primarily because of the allowances in circulation, and secondly because of the reduction of the profit of the insurance companies, respectively of the profit tax payable by them.

Fraud also affects the employees of the insurance companies who will receive a much lower salary fund, a result of higher, unjustified, costs. Sometimes they pay a social cost by cutting jobs and restructuring unprofitable subunits. For a small number of cases of fraud caused by criminals, insurers come to suspect unduly other social partners: insured, injured parties, loyal employees.

4. About the need for specialized organizations and some legislative adjustments in combating and preventing fraud in Romania

4.1 Current Circumstances

In line with international trends, where every year the fight against insurance fraud is intensifying and in Romania it is necessary firstly to set up an organization, due to non-existence of an organized collaboration at the market level with the final purpose - the punishment of criminals. With the establishment of this organization would be required also the reviewing of the legislation so that the flow and timing of the investigations to be as short and efficient.

At this point it should be mentioned that in Romania there is not:

- A unique database nationwide encompassing all auto damage at market level with access for insurers;
- An organized collaboration between insurance companies;
- A compilation of all fraud;
- A report on these frauds and calculation of the economic impact on citizens;
- A plan and a system of prevention;
- A proper coverage of the effects that fraud can have on the average consumer;
- An accurate informing both for insurance companies and the market as to what is happening internationally;
- Consistent and ongoing training systems and training of staff in the insurance on the insurance fraud.

The appearance of insurance fraud is tied to the emergence and development of insurance. The need for insurance is always seconded by the action of unscrupulous individuals. To the accomplishment of fraud are involved other persons, besides criminals.

Fraud affects the whole spectrum of society, directly and indirectly, insurers, every individual, insured or not, **including state institutions and the state budget.**

As is known, the present legal framework in Romania on insurance / reinsurance is governed by Law 136/95, Law 32/2000 and the rules CSA (now FSA) on the regulation of compulsory motor insurance business and in the general plan the Civil and Criminal Procedure Code.

In EU countries and in the USA, there are special formations dedicated to the fight against fraud as well as specialized legislation. Among the most mediated we remind IFB (Insurance Fraud Bureau), ACFE (Association of Certified Fraud Examinators).

Legal principles of civil law, contract law, tax law and criminal law provide guidelines and principles of insurance law and relevant legal definitions of fraud represent a very important aspect. Some governments have enacted national anti-fraud rules on social security and the private insurance system; almost all encourage disclosure by so-called reward system "whistle-blowing". At the level of the national legal framework we should define the responsibility for insurance fraud by adopting actual regulations and in the future the regulations should be updated.

4.2 A brief approach to anti-fraud law even in the social insurance

Some entities and individuals, who practice fraud taking advantage of weaknesses in the work of social insurance procedures, result in loss of social security funds. To some extent, this type of behavior will have a negative impact to the social security system unless the authorities react effectively.

4.3 The need to define the concept of "insurance fraud"

More accurate definition of the term insurance fraud will result in an easier definition of the charges against the persons attempting defrauding the insurance companies.

Although, recently, the term insurance fraud can be found in the criminal code, however, a clarification and extension of the concept and definition is required.

In this respect, any request for moral damages, related to an event covered by MTPL policy, where the amount requested exceeds EUR 100,000 per claim / case can be considered an attempt to defraud from the perspective of this request as being unreasonable amount (from the point of view of the practices of the European Court and the European directives and regulations in insurance) in relation to the event and coverage of third party liability insurance policy.

In this respect, the new entity will be able to investigate the case, including in terms of representation in court of the insurer, also recommending the level of reserve that should be established for the open file of the insurer. If the insurer does not desire for the representation in court to be supported by the specialized entity it will be done through their legal department or his lawyers.

The question of whether the market and the authorities will consider both necessary and appropriate the development of a new legal entity and the corresponding adjustments to help insurers in the fight against insurance fraud still remains.

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