RISK MANAGEMENT IN LIFE INSURANCE WITH EMPHASIS ON LIFE INSURANCE FRAUD

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Abstract

A very essential challenge for the life insurance industry is due to the 'fraud risk'. Insurers are aware of the need to deal with this risk, but the problem is lack of an integrated approach to fraud risk management. The increasing cases of frauds and the growing level of risk insist that insurers regularly evaluate their policies, conduct checks and adopt advanced techniques to curtail such issues. However, no system can clean out such frauds, but a proactive approach can make a company ready to oppose fraudsters and gain a frame over its competitors. As India's insurance industry matures, fraud risk management is going to be a major concern for insurers and business leaders. Insurers will need to constantly reassess their processes and guidelines to manage and alleviate the risk of fraud.

Key words: *Insurance, fraud risk, risk management, insurance fraud*

INTRODUCTION

Risk Management has been gaining monumental importance, especially over the last few years, globally. Apart from the conventional areas that one has in mind with regard to risk management, there is just no end to the challenges that emerge afresh from hitherto unknown areas. It is this dynamic nature of business that puts an additional onus on risk management being thoroughly comprehensive. The corporate world has been gearing itself up for these new challenges; and their risk management strategies have been demonstrating the adoption of a wider coverage of business activity. As a natural consequence, the risk management strategies of insurers would also need to take a fresh look at how they are geared up for eventualities. There are various types of risks involved in life insurance which are discussed later; however the study focuses on fraud risk. Instances of life insurance fraud are increasing since few years and therefore there is a need to curtail life insurance fraud.

LITERATURE

There have been a number of valuable studies of insurance fraud (Gupta, A., & Venugopal, R. (2011), Lesch, W. C., & Brinkmann, J. (2011), Dedene, G., & Viaene, S. (2004) all of which present evidence of insurance fraud on the entire industry in

general. However, none of these studies considers only life insurance.

While there has been some research on fraudulent activities related to claims (Rose, S. (2008), Swaby, G. (2011), Miyazaki, A. D. (2009)**),** where in the focus is only on claims fraud and little has been written about all the fraudulent activities.

There are several papers which focus on measures to curtail insurance fraud (Dixon, M. I. (1996), Cooper, R., & Nakabayashi, M. (2010), Holmes, et al. (1999) but little focus is on what should be the fraud control mechanism for life insurance fraud or how to curtail fraud. Which are the characteristics for committing for insurance and insurer fraud, whether it is same for both and what should be the punishments to the perpetrators for life insurance fraud and drivers that contribute to fraudulent activity?
There are several papers which focus on risk management **(**George, E. (2003) in insurance but hardly any paper talk about the fraud risk, how to do fraud risk assessment and the risk management process for fraud prevention.

Risk Management is the process of measuring or assessing risk and then developing strategies to manage the risk (George, 2003; Harrington and Niehaus, 2004). Risk in life insurance could be associated with sales, underwriting, medical network, claims, operations and finance. Risk management is needed because of increasing instances of Fraud, to have a framework in place to battle risk and fraud issues, enhances company image, acts as a deterrent to frauds by its very existence and acts as a safety net for the organization.

India is one of the fastest growing economies and so is the case with the country's insurance sector. The significant role that fraud plays negatively affects the insurance sector is often under-reported or discounted. There is a general consensus in the market that fraud cases have been significantly increasing. Frauds increase the cost of insurance, resulting in insurers losing to their competitors, and at the same time, the policyholders end up paying higher premiums. As India's insurance industry matures, fraud risk management is going to be a major concern for all. Insurers will need to continuously reassess their processes and policies to manage and mitigate the risk of fraud. (Bali et al., 2010)

The amounts involved in insurance fraud have certainly increased as insurance made its transition into modern consumer society. The industry has been a problem of increasing prevalence and of sizeable proportions. Insurers who have long passed the cost of fraud onto their policyholders in the form of increased premium rates, as well as other stakeholders such as legislators, prosecutors, judges and consumer interest groups, have started to realize that the fraud problem can no longer be ignored.

(Dedene, G., & Viaene, S., 2004).

IMPORTANCE OF THE STUDY

The purpose of the study is to explore the magnitude of the problem including the industry's and regulatory authority's responses in tackling the menace in India. As mentioned in the literature review increase in life insurance fraud is hindering the revenues of insurance companies which in turn affect the growth of the industry and in turn to the economy as whole. At the sales level the competition is good in the insurance industry but insurance companies' needs to be united to fight the frauds. The main aim of this study is to analyze various types of life insurance frauds, evaluate the risks associated with these frauds and finally frame an ideal risk management strategy to curtail or minimize the frauds associated with life insurance. The existing literature on life insurance fraud is used to explore the fraud risk management and internal control system of various organizations.

OBJECTIVES

1) To identify different types of frauds in life insurance
2) To review existing fraud control mechanism in life insurance
3) Perception of fraud by customers in the market

Methodology

Exploratory Research: This comprises of secondary data analysis as well as primary. Primary data comprise of qualitative research – expert interview and advice was taken. These experts comprised of manager and above cadre (risk profile) from life insurance companies as well as investigating agencies which were 6 in number and also 4 academicians' interview were taken. Questionnaire was circulated via email to industry experts and proof checking of the content of the questionnaire was done and the questions were modified as per the expert's advice. This helped us to gather information such as actual practices followed by them to review fraud and the measures taken by them to control it.

Descriptive Research: Two surveys i.e. employees and consumer survey was conducted in order to study the customer's perception and practices followed by the life insurance companies. This helped us to know how a customer would rate their company as well as agent, personal experience of the consumer with fraud, curtailing and punishing fraud. Detail description is given below.

Sampling Technique

Survey 1 - Method of sampling used was judgmental and convenience. Survey 2 - method of sampling was convenience.

Sample selection procedure

Survey 1 - Total seven life insurance companies (LIC, Reliance, Bajaj, ICICI, Kotak, Aviva and Birla) were selected on the basis of status of grievances reported for the year 2010-11 in the annual report of IRDA. Three departments were taken i.e. risk/audit and compliance, claims and operation working in Ahmedabad, Mumbai, Delhi and Chennai.

Survey 2 – Respondents were selected and mostly walk in customers in the insurance companies and banks were taken.

Data Collection Tools

The secondary data was collected from various online database, journals and books available in the library. Primary data was collected through survey by administering questionnaire. Personal as well as telephonic interview were taken of experts. Telephonic mode was selected in order to meet wider geographic reach. Online as well as personal survey was taken. Online was again selected in order to meet wider geographic reach.

Mode of data collection

Data pertaining to research has been collected with the help of questionnaire

Method for data analysis

Statistical tool i.e. SPSS is used in order to analyse the data. Various statistical tests were used i.e. frequency distribution, cross tab, chi-square test, one sample independent t test, two sample independent t-test, correlation and regression were applied.

Data Analysis

This study discusses about the analysis done i.e secondary and primary. First the secondary data analysis is discussed. Brief description about risk management process:

The risk management process starts with key incident reporting which means receipt of Case / Issue /Incident. The process starts with receiving request from Referee Unit for Investigation. Referee unit will be one who will refer the case. It can be operations team while processing the application, claims team while processing the claims, risk

team while conducting the branch audit, doctor audit, mystery shopping or complaints. Further step of the process is to assign the case for investigation to the risk consultant. Investigation is then conducted with the help of outsourced team. Risk consultant will then receive the report and will give final recommendation on the basis of report. Side by side it is also forwarded to control committee to plan risk mitigation and present it to control committee. Risk management process which is explained above is inferred from the below mentioned diagram. This process map was made after meeting various industry experts during the visit to company.

Types of Fraud

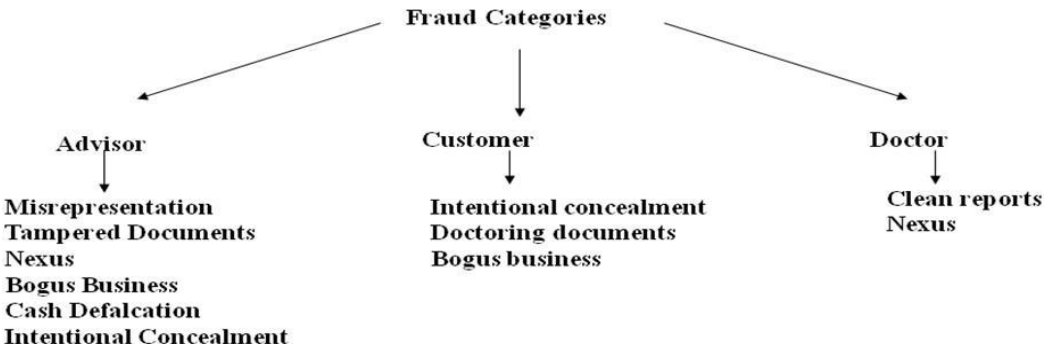
Thus from the literature review available and experience the types of fraud can be broadly divided as follows:

Internal Fraud: Internal frauds are those perpetrated against a company or its policyholders by agents, managers, executives, or other employees.

External Fraud: External frauds are directed against the company by individual or entities as diverse as medical providers, policy holders, beneficiaries, vendors and career criminals. An internal fraud often involves theft of proprietary information, improper relationships with vendors or consultants involving conflicts of interest, diversion of policyholder or company funds by employees, use of confidential information for investment purposes, intentional misrepresentation by agents to prospective customers about the characteristics or future performance of company products and any other unethical activity that might put the business interest at risk.

Typical fraud categories

There are three major parties involved in perpetrating life insurance fraud. One is the internal employees or the agents of the company, second is the policyholder i.e. the customers and third is not direct fraud but indirect fraud i.e. involvement of doctors. Figure 1 depicts the types of fraud committed by the perpetrators



Control on Life Insurance fraud

This study focuses on the primary survey done with the industry experts. The assessment was done in two phases. The first phase involved selection of variables, selection of scale of measurement and designing questionnaire, testing and piloting of the questionnaire. The second phase involved online and telephonic survey based on the questionnaire, cross checking, data entry, data analysis and preparation of final report. A set of variables were selected on the basis of literature review and discussion with the risk personnel of different life insurance companies. The sampling profile displays 32 percent of the valid responses falls in risk profile. 28 percent fall in operations profile and 20 percent fall in both claims and audit or compliance.

Research Hypothesis

H1o: Fraud risk exposure faced by insurance companies and areas that need more stringent anti- fraud regulation are independent of each other

Customer's perception

This study focuses on the perception of customer with regard to life insurance fraud. Customer survey was conducted to know their perception with regard to life insurance fraud. Direct survey as well as online Survey was conducted for the same using the website esurveyspro.com. Data collection for the same is done and data analysis is under process. The collected data was edited, coded, tabulated, grouped and organized according to the requirement of the study and then it was entered into SPSS (statistical package for social sciences) for analysis.

This study was conducted to gain insight on why public tolerance of insurance fraud seems to be increasing. Both qualitative and quantitative research was used to attempt to understand how public attitudes about fraud are formed and what factors influence them. Among the areas explored in the survey include opinions about insurance fraud and insurance providers. The frequency distribution displays 45 percent female and 55 percent male respondents.

Reasons for life insurance fraud

Respondents were asked to rate on liker scale of 1 to 5 that to what degree they agree for the reasons which compel people to commit life insurance fraud. The average of each reason shows the following results: 1) Fraudsters think they can get away with insurance fraud 3.204 , 2) Fraudsters need money 3.308, 3) Fraudsters think they are paying excessively for insurance 3.020, 4) Fraudsters want to compensate for the deductible expenses they would have to pay 2.636 , 5) Their insurance agents, friends,

family or doctor(s) influence them 2.508 , 6) Insurers make undue profits 2.704 , 7) Everybody lies on applications or everybody is not honest with their applications 2.668

The respondents have shown a higher amount of disagreement for the last four reasons. Last four reasons are ranging from 40 to 50 percent of disagreement. Also the averages of all these reasons are less than 3. So we can conclude that first three are the major reasons which would compel one to commit life insurance fraud. The last reason i.e. fraudsters think they can get away with life insurance fraud is a serious point to be taken into consideration. It indicates that there are loopholes in the fraud detection technique of life insurance and it also indicates lack of internal control system of the insurance companies. That is why the fraudsters think that they can easily get away with life insurance fraud.

Ways insurance companies should prevent fraud

Various possible ways were identified which would help in preventing life insurance fraud. The ways are: -

1. Fraud warnings are a useful tool – these warnings will help the insurer to curtail fraud as people will be afraid of these warnings.
2. Management involvement – Unless and until the management involves in curtailing the life insurance fraud, it will be indeed very difficult for any insurer to prevent life insurance fraud. If the management is only concerned about its sales growth and is not getting involved in these practices then it will hinder its own business.
3. Stringent action on fraud identified: This is the most effective way of preventing fraud. As the perpetrators will come to know that action such as warning or termination is given for doing the fraud then they themselves will not get into such practices.
4. Awareness and training workshops: This will be a whistleblower policy wherein it will sensitize the employees regarding the risk factor of life insurance fraud
5. Enabling employees to report and deal with fraud: This will enable the employees to report and deal with fraud which will in turn help in preventing life insurance fraud

Punishments for life insurance fraud

The study also focuses on the possible consequences or punishments to be given to the perpetrators for committing life insurance fraud. Four punishments or consequences to be given to perpetrators for committing life insurance fraud are prosecute for lying and submitting wrong information, rejecting unjustified portion of claim; pay the remainder, rejecting insurance to claimants who have filed false claims, rejecting all

claims in cases of fraud applications. We wanted to check whether there are significant differences in the punishments with regard to gender.

FINDINGS

There are two types of life insurance fraud internal and external. Insurer fraud complaints are received from within the organization and insurance fraud complaints are received from external sources. The major reasons as per customer's perception for life insurance fraud are paying excessively for premiums, perpetrators need money and fraudsters think they can get away with fraud. The last reason i.e. fraudsters think they can get away with life insurance fraud is a serious point to be taken into consideration. The study recognized life insurance fraud as a serious fault, and insurers are striving to place effective measures to identify, penalize, and more importantly, avert this kind of practice. Life insurance risk exposure from insurance risk is a major issue for all the industry players. Respondents have highlighted the need for anti-fraud regulations in the area of insurance risk. The internal audit and a dedicated risk department of the company were considered to be the chief mechanism utilized for detecting life insurance fraud. The truth was that insurer fraud was more complex and involved more defiance of internal control mechanisms.

CONCLUSION

The focal point of the study is risk management in life insurance with emphasis on life insurance fraud. Increase in number of life insurance fraud hinders the business and therefore there is a need to focus on risk management. Risk management will not only help in discovering life insurance frauds but it will also help in controlling. Broadly the objectives of the study are to find out the types of life insurance fraud, understand the fraud control mechanism, measures to prevent life insurance fraud and to understand the customer's perception with regard to life insurance fraud. The following chapters deal in details about the study.

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