Foiling fraud

Insurance fraud is rising in the Mena region, but measures can be taken to combat its growth

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FRAUD **FOCUS**

Insurance fraud accounts for an estimated 5-10% of the Mena region's $20bn insurance industry and shows no sign of abating given the lack of national databases, tough regulations and effective compliance oversight. The adoption of anti-money laundering regulations by central banks across Mena over the past decade has also meant that while banks are better regulated, the insurance sector has become more exposed to the risks of fraud and money laundering.

Estimated at between $1bn and $2bn a year, insurance fraud in the region is not on the same scale as in the US, where fraud costs the industry an estimated $30bn per annum. However, given how small the Mena insurance industry is by global standards, accounting for just 0.46% of total world premiums, according to Towers Watson research, fraud levels are high. With the sector in the Middle East forecast to experience a compound annual growth rate (CAGR) of 25% between 2010 and 2013 to cross the insurance premium of $80bn, according to a report by RNCOS, there will be a corresponding uptick in insurance-related fraud if global trends are anything to go by.

The global financial crisis has been a major contributor in the rise of fraud in general worldwide; for example, credit card fraud rose by 20% in the UAE in 2009 on the previous year, while in Britain fraud losses reached $61.9bn in 2010, up $13bn on 2009, and there was a 15% rise in detected insurance fraud losses, from $1.17bn in 2008 to $1.35bn in 2009, according to the National Fraud Authority and the Association of British Insurers respectively.

A survey on the changing role of internal audit departments in dealing with financial fraud, carried out by consultancy firm Deloitte in 2010, showed 63% of correspondents stating "their organisation's vulnerability to fraud risk has increased in the last 18 months"; of this group just under two thirds said there had been "an increase in the levels of both internal and external fraud." The uptick in insurance fraud in the Mena region has been noted by insurance companies.

According to an insurance expert who wanted to remain anonymous: "The financial crisis in 2008 in Dubai saw a significantly high number of insurance claims in the month of September, as well as during the following three months. If you go back that whole fiscal year you don't have this spike. It's easy to see what it was, fraudulent claims, and in cases of fire, it was arson."

Captain Zarir Irani, the Regional Director of the UK's International Institute of Marine Surveying (IIMS) and managing director of Constellation Marine Services in the UAE, says the global recession and the drop in demand for certain products, such as steel, has been causing concern for the insurance sector in general, not just maritime insurers.

"A lot of innovative ideas emerged to claim a legitimate or otherwise insurance claim. At a stage when steel imports had stagnated or virtually stopped, certain companies looked towards the underwritten risk to gain rewards to partially compensate for the dips in their business demands and/or restricted cash flows."

A source at a Middle Eastern central bank, who wanted to remain anonymous, added: "With banks more regulated than before, criminals will go for the weaker link – the insurance sector. It is not well supervised so there's always room for wrongdoing. There needs to be more regulation and supervision, and the creation of a regulatory culture in the region."

The insurance industry's exposure to money laundering does not affect all insurance policies. The most exposed are life settlements (also known as trade life policies), which is a prominent form of money laundering worldwide. This works through a client buying several life policies that are paid for with dirty cash over a number of years and then annulled before the policies mature. The full amount, bar a 10% early redemption fee imposed by the insurer, is then repaid to the client, thereby 'cleaning' the money.

"Life insurance is an easy way to clean cash and it is up to the regulatory bodies to enforce proper anti-money laundering procedures," says Ronald Chidiac, general manager of the Arab Reinsurance Company in Beirut. "Equally, having a single body regulating the entire financial industry would be much more efficient, like in Saudi Arabia for instance, instead of having one for banks and one for insurance companies."

While national and regional regulations and their implementation need to be improved, the private sector remains highly exposed unless it implements adequate procedures. In a regional climate of economic and political instability, the risks are higher than ever, and the possibility of fraud and money laundering is a real threat to the sector. Indeed, while international sanctions lists name terrorists, politically exposed persons (PEPs) and suspected criminals, such individuals will look to bypass these lists by using trusted and close associates. This requires greater vigilance, and the onus is on insurers to investigate and screen prospective clients. There also needs to be more extensive reporting of suspicious transactions, for agent and broker networks to be brought into 'know your customer' (KYC) procedures, and heightened detection capabilities. This is where improving training and awareness among insurance company employees is the key to reducing risk.

"The Mena insurance sector is doing its bit to mitigate risk, and the maritime sector appoints warrantee load out surveys and precautionary project cargo supervision, but much more needs to be done," says Irani. "The sector is waking up to the fact that training is of the utmost importance in a region which has one of the highest job retrench rates in the world. But how many insurance companies train their staff other than the risk managers?"

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While the financial crisis has caused a spike in insurance fraud, it is not a new phenomenon in the region. Health insurance is particularly exposed, with an estimated 15% of the sector subject to fraud, such as through identity theft and by physicians and healthcare providers prescribing unnecessary pharmaceuticals or surgery to clients to gain higher fees and business. "In Lebanon, there is 20% more surgery than is needed, if not more, pushing the in-hospital frequency to reach extremely high levels," says the anonymous insurance expert.

According to a report in Saudi Arabian newspaper *Al-Hayat*, health insurance companies in the Kingdom are losing up to $320m a year, or 15% of annual revenues, to fraudulent claims and hospitals misusing insurance card holders' identities. The problem has become particularly acute since Saudi Arabia introduced compulsory health insurance for expatriates, private sector workers and foreign pilgrims in 2006. Health insurance now accounts for half of the country's insurance industry, but has resulted in a flourishing black market for fake health insurance cards.

An estimated 7-9% of the Mena region's motor insurance sector is also fraudulent, easily done through inflating repair costs at mechanics as Mena insurance companies do not require clients to go to specific repair shops, with which insurers have established a transparent relationship.

Raed Haddadin, deputy director general of the Insurance Commission of Jordan (ICJ) and a member of the International Association of Insurance Fraud Agencies, said that the primary cases of insurance fraud in Jordan revolve around arson, false theft of vehicles, presenting false treatment bills, and abusing medical care services by using others insurance documents.

"Examples of intermediaries' fraud in insurance include stealing premiums by the intermediary, which results in absence of insurance coverage. In other cases, the premiums would be stolen by an intermediary with a binding authority; therefore, insurance coverage would be available, yet without premiums being paid for the insurers," says Haddadin.

With insurance penetration rates expected to rise in coming years, this brings heightened exposure to fraud and related financial risk. The current low penetration rates pose a risk for the sector as awareness of insurance – how it works and how it can benefit people – is low, but there is also a lack of knowledge about potential insurance scams, as well as consumers' legal rights.

Furthermore, fighting fraud comes from not only having the adequate compliance, due diligence and relevant departments in insurance companies and at the regulatory level, but also by consumers knowing about fraud and reporting cases to the relevant authorities.

The Arab Forum of Insurance Regulatory Commissions (AFIRC) was only established in 2006. In a recent report by consultancy firm Booz & Co. for AFIRC, the strategic long-term goals that need to be implemented show the uphill climb the industry has to get up to speed, namely: "foster the development of regulatory authorities' supervisory capabilities... support the harmonized legal frameworks in the Arab world... and promote the launch of key market initiatives."

The report highlighted the need to "achieve uniform understanding of regulatory topics and harmonize key regulatory procedures". It recognised a clear and immediate need to set accreditation and qualification standards throughout the region's jurisdictions.

Haddadin thinks an anti-fraud bureau for the region should be established "to assume the responsibility of setting mutual goals for anti-fraud activities, which would give more impetus to combating fraud in insurance activities".

He adds: "To have maximum impact, anti-fraud regulations should have a regional scope so that the efforts of supervisors and regulators across the region can become better co-ordinated and consolidated."

He added that the ICJ has drafted a new Insurance Regulatory Act for Jordan that will establish an anti-fraud unit in the commission.

Jordan is making moves to tackle fraud. Saudi Arabia has also updated its regulation of insurers, with the regulator operating under the mandate of the Kingdom's central bank, while Oman's central bank issued new anti-fraud guidelines in March. In Lebanon, the compliance unit of the Special Investigation Commission at the Central Bank examined 34 insurance companies in 2010 compared to 20 in 2009, while in the UAE, the state-owned medical insurer Daman has cracked down on fraud.

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In 2009, Daman reported that it had recovered more than $1.6m in fraudulent claims from clinics, with more than half of the reclaimed money coming from a single dental practice that had been submitting fake claims. The Dubai Health Authority has also used undercover agents posing as 'mystery shoppers' to uncover fraud in the healthcare sector.

For the fight against fraud to be more effective, national and regional insurance databases need to be established to better monitor clients and the sector in general.

"There are no genuine central databases in the region, except for Saudi Arabia where medical policies have to be sent to the Council of Cooperative Health Insurance server. Hopefully, one day some of the information could be shared with the insurance industry," says Chidiac.

"There are also no automatic penalties or premium increases on claims due to information asymmetry. If a client has a number of claims, the premium should go up, but that is not always the case here; on the contrary, we see a substantial number of technically unexplained discounts. In Turkey they have a central database, so if a customer moves from one company to another they have the client's history. We need national databases that can be shared. This would help reduce abuses and fraud." ■