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MOTOR INSURANCE FRAUD AND ITS IMPACT ON THE INSURER'S FINANCIAL SECURITY

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ШАХРАЙСТВО В АВТОТРАНСПОРТНОМУ СТРАХУВАННІ ТА ЙОГО ВПЛИВ НА РІВЕНЬ ФІНАНСОВОЇ БЕЗПЕКИ СТРАХОВИКА

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МОШЕННИЧЕСТВО В АВТОТРАНСПОРТНОМ СТРАХОВАНИИ И ЕГО ВЛИЯНИЕ НА УРОВЕНЬ ФИНАНСОВОЙ БЕЗОПАСНОСТИ СТРАХОВЩИКА

The article is devoted to the formation of a systematic approach to identification of sources and possible fraudulent practices of insurers in motor insurance, which lead to the decrease of the level of financial security and financial stability. The research conducted indicates an increase in mistrust of policyholders towards insurers' activity because of improper insurance indemnities.

Key words: *insurance, insurer, insured, fraud, motor insurance, insurance policy, outsourcing, risk, security.*

Сформовано системний підхід до визначення джерел та напрямків ймовірних шахрайських дій страховиків у автотранспортному страхуванні, які призводять до зниження рівня фінансової безпеки і втрати фінансової стійкості. Проведене дослідження свідчить про збільшення рівня недовіри страхувальників до дій страховиків через неякісне здійснення страхових виплат.

Ключові слова: *страхування, страховик, страхувальник, шахрайство, автотранспортне страхування, страховий поліс, аутсорсинг, ризик, безпека.*

Сформирован системный подход к определению источников и направлений вероятных мошеннических действий страховщиков в автотранспортном страховании, которые приводят к снижению уровня финансовой безопасности и финансовой устойчивости. Проведенное исследование свидетельствует об увеличении уровня недоверия страхователей к действиям страховщиков из-за некачественного осуществления страховых выплат.

Ключевые слова: *страхование, страховщик, страхователь, мошенничество, автотранспортное страхование, страховой полис, аутсорсинг, риск, безопасность.*

Introduction. In terms of financial and economic instability, slow process of all the constituent elements of financial system, insurance is one of the strategic economic activities of the state. Despite its functioning even under such unfavourable conditions, Ukrainian insurance market has preserved the ability to accumulate and redistribute financial resources among market participants.

Motor insurance in Ukraine is one of the most common types of insurance among the population and it prevails in activity base of most insurers. Therefore, problems of motor insurance market are the quintessential of the problems of the insurance market in general. The necessity to study the problems of fraud on the insurance market is due to the increasing number of cases where fraud is committed by insurers, insurance agents, claims adjusters and law enforcement officials. Conseuently, this causes the need for systematization of possible areas of insurance fraud and assessment of its implications for the security of the insurer.

The studies of theoretical and practical issues of insurance fraud have been concucted by the following researchers as S. Osadets, H. Kozoriz, V. Plastun, A. Zaycha, A. Pervushkina, O. Zhabynets, T. Voytsenkovych, V. Bazylevych, A. Baranovskyy, N. Vnukova, J. Shumelda.

The article is a synthesis of existing types of insurance fraud and it determines the level of its impact on the financial security of insurers.

The main material research. Exploring the algorithm of motor insurance in all its multi-phase implementation, two most important and dangerous phases of the probability of fraud implementation can be singled out. The first phase is the process of concluding insurance contract that recognizes the basic relationship of the insurer and the insured. Second phase is connected with insurance payments. The quality of software control for these phases depends on the level of the insurer's financial security because violations that may occur in these phases, lead to excessive costs or even losses for insurer.

Thus, a significant issue while concluding insurance contracts, in addition to the information concept, is the control of the use of forms of insurance contracts. The issues concerning inventory and usage of insurance forms are extremely important in motor insurance market. According to Motor (Transport) Insurance Bureau of Ukraine (MTIBU), about 160 thousand of forms of insurance policies of Compulsory Motor Third Party Liability Insurance (CMTPL) had been lost in the years of 2005-2010. During the first half of 2012 7194 forms of CMTPL insurance policies have been lost, including 1338 forms of insurance policies of 18 analyzed insurers[1] that equal to 18,6 % of insurance policies lost overall. These lost forms of insurance policies costitute 0,07 % of the concluded CMTPL insurance contracts in the analized insurance companies in the first half of 2012. Most of the lost forms of insurance policies belong to PJSC Insurance Group “TAS” in the amount of 555, PJSC "Ukrainian insurance company “Garant-Auto” in the amount of 500, PJSC Ukrainian Joint Stock Insurance Company “ASKA” in the amount of 153, representing respectively 0,21 %, 0,8 %, 0,15 % of concluded insurance contracts. Overall, this is the problem of total auto insurance market, not just the consequence of gaps in the internal control system of a single insurer. For example, 8 out of 17 insurers that lost membership at MTIBU in 2012 did not return forms of insurance policies of CMTPL to MTIBU. This means that the policyholder can purchase insurance product, concluding void insurance contract.

The relevance of this issue is that there is threat for insurance consumers of being not registered in insurer’s database even having purchased an insurance policy. Insurance agent may either provide an invalid form of insurance policy that is not registered in insurer’s database, or do not transfer data concerning purchase of insurance product to insurer. Accordingly, the insurance premiums received for the insurance policy are taken by an insurance agent. Since the responsibility for the activities of insurance agents is held by the insurer, it is the insurer who actually takes insurance liabilities before himself. This redunds financial load not only on insurer, but additionally on MTIBU, because insurance reserves for this insurance contract have not been formed. According to the League of Insurance Organizations of Ukraine, insurance companies incur losses from the actions of fraudsters in 10–15 % of collected insurance premiums in motor insurance and for some types of insurance up to 25 %. That is why the algorithm of “inventory of forms of insurance policies – registration of insurance contracts - the formation and preservation of the integrity of the clients’ database” is necessary for information security of insurer.

The problem of falsification of insurance contracts of motor insurance is an ongoing issue. However, most expert practitioners in insurance consider it as one of the options of insurance fraud, committed by either insured or insured in agreement with insurance agent. This is a unilateral vision, because it does not take into account the possibility of insured becoming a victim of purchase of fraudulent insurance products from insurer and its agents.

[1] PJSC “NSIC “Oranta”, PJST “Providna”, PJSC “Insurance Group “TAS”, PJSC “Knyazha Vienna Insurance Group”, PJSC “Garant-Auto”, PJSC “Ingo Ukraine”, PJSC “Prosto-Insurance”, PJSC “Insurance Company “Ukrainian Insurance Group”, PJSC”Unika”, PJSC “Universalna”, PJSC “ASKA”, PJSC “PZU Ukraine”, PJSC “AXA Insurance”, PJSC “Illichivske”, PJSC “Globus”, PJSC “UPSK”, PJSC “Alfa Insurance”, PJSC “Alfa-Garant”.

The total number of insurance claims by Ukrainian insurance product “Green Card” is increasing annually. In 2013 5149 insurance claims were registered which exceeds the amount registered in year 2004 by three times. At that time most reports on road traffic accidents on the territory of member countries of the system “Green Card”, in which false Ukrainian insurance contracts were presented, were recorded in years 2007–2009, including 156 false insurance policies in 2008. According to MTIBU, the number of road accidents with falsified insurance contracts of "Green Card" increased almost four times in 2008 compared to 2004, while the total number of inurants contracts for the same period decreased by 16 %. The amount of forgone insurance premiums for insurance contracts of international CMTPL “Green Card” due to fraud agreements was 13 million UAH in 2008 or 8,4 % of total gross premiums, collected for this type of insurance. There were positive trends to reduce this phenomenon on the market in years 2009–2010. In 2010–2011 the number of lost forms of insurance policies “Green Card” increased by 10 times from 4,3 thousand in 2010 to 43,9 thousand in 2011.

The main factors that predetermined the fraud processes of insurance contracts and forms were improper control of insurers over the accuracy of concluded insurance contracts and the activities of insurance agents. The solution to the problem depends on internal and external factors. External factors include the presence of a single centralized database of contracts, cooperation of insurance companies with traffic police and MTIBU. Internal control of insurer at this stage lies in inventory of insurance policies. For this purpose the following control procedures should be applied:

1. Accounting of forms of insurance policies delivered to insurance agents, concluded insurance agreements and formsheets that remain in agent over a certain reference period.

2. Periodic sampling audit of the actual availability of forms of insurance policies in insurance agent coparing to data of insurer’s analytical records.

3. Timely delivery of concluded insurance contracts to insurer and evaluation of compliance with their execution in accordance with internal rules and regulations of insurer.

4. The correct application of insurance rate and discounts on insurance agreements.

5. Timely data entry about concluded insurance agreement to the information base of insurer and centralized database of MTIBU for CMTPL’ contracts.

6. The number of lost or damaged forms of insurance contracts by certain insurance agent, their frequency and appeal of the victim with the requirement of insurance payments under such insurance contract.

According to the study of audit company “Ernst & Young”, quarter of Ukrainian companies faced with the facts of corporate fraud in 2009 that increased during the crisis in Ukraine. This number is bigger than in Russia, where the indicator equaled 10 %, and Central and Eastern Europe, where level of fraud equaled 14 %. However, it is estimatated that internal audit and control reduce the risk of fraud by 64 % in Ukraine and 74 % worldwide. To reduce the risk of fraud on the stage of concluding an insurance contract, the following measures should be adhered to:

1) to disclose registration series and number of damaged, lost or invalid insurance contracts on insurer’ official website;

2) to provide for an insurant access to the information system of insurer and centralized database of MTIBU in order to check the status of the insurance contract on a certain date;

3) maintain a register of insurance agents by insurer, freely accessible to the consumer of insurance services;

4) provide access mode of insurance consumers to information systems of MTIBU, including the register of insurance agents deprived of the right to agency work in CMTPL.

The purpose of fraudulent practices in distribution of insurance products is to obtain illegal income from policyholders in the form of insurance payment by using damaged, invalid or

forged forms of insurance policies. Internal control procedures of insurer should aim to ensure the receipts of premiums by all concluded insurance agreements on behalf of insurer. For this purpose the insurance payment under the concluded insurance contract outside the isurer's office should be accomplished only within the payment system. The receipt confirming payment of the insurance premium along with the copy of signed insurance contract shoud delivered to the insured. This document must contain a registered series and number of the concluded insurance contract, the insurer's name and date of payment. It will confirm the insurance payment by the insurance contract for insured, while for insurer the recepits of insurance payment to form insurance reserves would be provided. The proposed recommendation should also help to reduce the number of cases related to the activities of pseudo agents in insurance services market. These agents do not have signed agency agreement with an insurance company, hovewer they sell insurance products on behalf of insurer, but do not transfer accumulated insurance premiums. In the event of occurance of insurance case under the insurance contract, determined by insurer as lost, and the insurance payment is not received by insurer, it is advisable to take recourse upon insurance agent or staff member who delivered to insured such a form of insurance policy.

Fraud of insurance intermediary occure in the process of concluding of insurance contract, hovewer the probability of their exposure is during contract support. If fraud is exposed when the insurance contract is in force, it is due to improperly concluded insurance contract or error. According to certain scientists' view, the problem is also the fact that the insurance agent may remain unpunished for misconduct. Even in case of penalty the loss to the insurance agent or employee of insurance company is no more than the profit from fraudulent behavior in case of its exposure, while for insurer the loss is bigger. It leads to worsening of company's image, loss of insurers, losses due to underpayment from operating activity, court cases with employees, excessive redistribution of funds on staff issues by reducing the financing of other activities of insurer. The consequences of insurer's fraudulent actions for insurance services consumer are terminating an insurance contract or failure of payment of insurance indemnities that means the loss of insurance coverage. That's why the comparability of information is important during the insurance contract supply.

It is difficult to define availability and impact of corporate fraud on efficiency of cross-checking of claims settlements because of corporate secret of insurer. The activity of PJSC Insurance Company "Ukrainian Insurance Group", PJSC Insurance Company "AXA Insurance" and PJSC Insurance Company "Garant-Auto" has been analyzed. Amount of insurance indemnities has been settled in special department at PJSC Insurance Company "Ukrainian Insurance Group", while PJSC Insurance Company "AXA Insurance" has cooperated with vehicle service stations in that issue and PJSC Insurance Company "Garant-Auto" has involved assisting company. According to estimation, the number of complaints of policyholders received by PJSC Insurance Company "Ukrainian Insurance Group" in 2013 is twice as big as ones reported to PJSC Insurance Company "AXA Insurance". However, due to the significant number of complaints reported to PJSC Insurance Company "Garant-Auto" in 2011-2013, the option of involving an assisting company has more likelyhood of biased assessment of insurance loss or delay of payment of insurance indemnities. Violation of procedures and terms of settlement of insurance losses were the main issues in policyholder's complaints. The problem is in insurer's control over the procedures of insurance losses adjustment by assisting company.

Insurance claim settelements on the terms of outsouring contains increased risk for fulfillment of insurance liabilities due to the lack of direct control of insurer over the procedures for its implementation. There is a probability of unfair assessment of amount of indemnity (operational risk), violation of terms of claim settlement (risk of violation of the law), unqua-

lified and low-level service provided to insurant and victim of insured accident (risk of qualified personnel, reputational risk). Firstly, these risks are the source of complaints on insurers reported by insured. Secondly, dissatisfaction with the results of claims settlement causes the failure to cooperate with that insurer in future.

According to experts of Russian motor insurance market, every fifth insured meets with such practice. Hence, there is a necessity of information access to the loss adjustment procedures of outsourcing company in order to monitor its compliance with insurer's policy and objective estimation of the size of insured loss (table 1).

Table 1

Control procedures of the application outsourcing

Internal Control	
of insurer	**of insurer over the company that provides outsourcing services**
• monitoring compliance methodologies, standards and ethics at the stage of loss adjustment; • monitoring the accuracy of loss adjustment and assessing its level	• compliance with the insurer's policies and decisions; • registration of reported claims; • compliance with the insurance legislation during claim settlement; • timely claims handling; • correct estimation of the value of loss; • timely delivering of information on insured event to insurer

In order to estimate the proper amount of insurance indemnity, it is advisable to exersice control, firstly, over the insurance contracts from which it was revealed reduced insurance payment or fraudulent activities of insurance agents during distribution of insurance product. Secondly, the control over insurance contracts for which the amount of insurance indemnity is higher or lower than average level of insurance benefits for this type of insurance in insurance company for a specified period of time. Thirdly, the control over insurance contracts governed by claims adjuster, if the ratio of the number of settled insurance claims to the amount of insurance indemnities set to payment is beyond the level of insurance indemnities estimated by other claims adjusters (fig.).

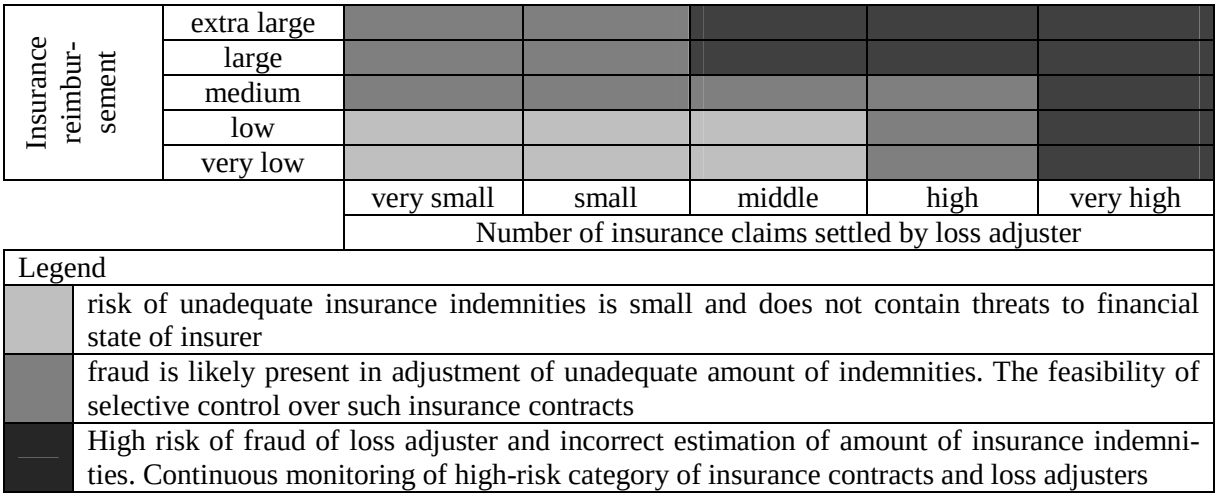

Fig. Fraud Risk in Adjustment of Insurance Claims

Such insurance contracts as well as insurance claims settled by loss adjusters require additional monitoring to verify the accuracy of the data.

Taking into consideration the experience of Polish insurance company "Warta" (TUiR Warta SA), the main control measures for fraud risk reduction in insurance loss adjustment is based on crossed control of insurer's departments over reliability of assessment data for claim

settlements and exchange of information between insurers on insurance cases (table 2). As a result, the insurer can approve payment or refuse the insurance indemnity.

Table 2

Internal Control over Fraudulent Actions in Insurance Loss Adjustment

Methods	Analytical basis	Procedures
Manual	insurance act; procedure data of insurance loss adjustment; database of traffic police	analysis of information in insurance acts; comparison of experts' opinions on insured event; evaluation of photographic documentation for insurance claims; analysis of claims of victims or insured to traffic police and decisions of traffic police on the claims; comparison of witnesses' testimony on insurance claims; check the submitted documents (invoice on the purchase of materials and spare parts, repairs)
Automatic	information database of insurer	analysis of insurance history of policyholder on available accidents in recent years, their frequency and loss, frequency of complaints regarding the insured event, the number of complaints; network analysis of linked insurance cases or linked insurance claims
Automatic	MTIBU database	access to the database of MTIBU on the number of insurance claims towards which there are decisions on insurance indemnities
Selective manual	information database of other insurers	requests to other insurers to confirm the absence of claim of injured or policyholder on insured event

The amount of insurance indemnity could be readjusted if the policyholder does not agree with the result of insurance claim settlement under the insurance contract and makes complaint against unfair claim practice. According to the data of MTIBU on insurers' performance indicators in 2011, published in accordance with the Decision of the Presidium of MTIBU dated 15.03.2012, about one third of insurers that are members of MTIBU have problems with the settlement of insurance claims. Half of the members of MTIBU have satisfactory and unsatisfactory level of administration and settlement of complaints of policyholders. Most of insurers have substantial revenues.

Conclusion. The correct estimation of the adequate level of insurance indemnities, similar to its efficiency is an important aspect of the stage of settlement of insurance losses. If the amount of insurance reimburrsement is higher or lower comparing to the set amount of indemnities on similar insurance cases of other claims adjusters, there is probabability of bias in estimation. One of the reasons for unfair claim practice is corporate fraud in insurance company. It results in increasing of inadequacy of insurance reserves and insolvency of insurer. When the amount of insurance indemnities is undervalued in comparison to the objective value of insurance loss, insurers are not interested in implementation of additional control to ensure the accuracy of data because it improves the results of their operational activity and has no risk to fulfillment of insurance liabilities. However, such kind of insurer's policy is incorrect because failure to fulfill insurance liabilities in whole under an insurance contract causes the complaints of policyholders and injured as well as increase of court and legal expenses.

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