International Journal of Management, IT & Engineering
Vol. 8 Issue 6, June 2018,
ISSN: 2249-0558
Impact Factor: 7.119Journal Homepage: http://www.ijmra.us, Email: editorijmie@gmail.com
Double-Blind Peer Reviewed Refereed Open Access International Journal - Included in the International Serial Directories Indexed & Listed at: Ulrich's Periodicals Directory ©, U.S.A., Open J-Gate as well as in Cabell's Directories of Publishing Opportunities, U.S.A

TO IDENTIFY FRAUD CONTROL MECHANISM AND DIFFERENT TYPES OF FRAUDS IN LIFE INSURANCE

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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 fraudrisk 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: LIFE INSURANCE INDUSTRY, FRAUD RISK, MANAGEMENT, BUSINESSLEADERS, COMPANY

INTRODUCTION

Life Insurance fraud

Practically all of the literature regarding insurer fraud is in the insurance trade press. Only in the trade press can one find stories detailing various types of insurer fraud and describing specific legal cases.

Impact of fraud

Economical impact of fraud

Dixon, M. (2019) clarified that effects of fraud on the industry in the USA has caused an overwhelming endorsement of the exchange of information not only between insurance companies but with Governmental and other organizations. If companies in the UK fail to follow their lead, this will no doubt result in an escalation of problems of insurance fraud in this country. Over the last 10 years, the Indian insurance industry has grown at a compounded annual growth rate of around 20%. However, with the exponential growth in the industry, there has also been an increased incidence of frauds. Insurance fraud encompasses a wide range of illicit practices and illegal acts involving intentional deception or misrepresentation. The industry has witnessed an increase in the number of fraud cases in the last one year. Organizations are waking up to the fact that frauds are driving up the overall costs of insurers and premiums for policyholders, which may threaten their viability and also have a bearing on their profitability. Hence, companies need a more vigorous fraud management framework. Although this survey focuses on retail insurance, frauds related to commercial insurance claims and third-party claims are also on the rise. The sophistication of fraudsters in the area of commercial insurance claims and third-party claims makes it all the more difficult for organizations to detect and control fraud in time.

Fraud control mechanism

The research will focus on curtailing fraud risk and therefore the emphasis is on life insurance fraud.

Fraud Risk Assessment

Jawaharlal, U. (2003) explained in detail the concept of fraud risk assessment. Life insurance Company's commitment to fraud control will be met by identifying opportunities for fraud, and implementing risk avoidance, prevention and minimization procedures in day to day operations.

Principles

- Fraud Risk is discussed openly and constructively at all levels to promote a positive risk management culture. Integrity, independence, and accountability are at all times visible and demonstrable. Management has responsibility for managing fraud risk; and the fraud risk management strategy is focused on outcomes, which assist the business to achieve their objectives. Fraud risk is assessed in the context of potential value (creation and destruction) and brand impact.
- Procedures must be in place to monitor activities and safeguard assets, particularly in high risk areas. These must be reviewed and updated on a regular basis, the recommended period being annually.
- Appropriate authorization policies for transactions must be established and maintained.
- Investigation of fraudulent and corrupt activity must be followed in all cases by a review of controls to ensure that existing controls are enhanced to reduce future vulnerability. Where appropriate, changes will be made to investigation and internal audit testing, training materials and policies and procedures.
- During system development, maintenance and enhancement, due consideration must be given to ensuring adequate fraud risk control mechanisms are incorporated within the system and associated procedures.
- Investigation records, which are capable of identifying trends in fraudulent and corrupt activity, must be maintained.

RESEARCH METHODOLOGY

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. External fraud can involve such schemes as fraudulent automobile, life, health or disability claims, the use of tax-advantaged insurance products for concealing the origins of illicit funds, or the negotiation of counterfeit checks. Internal frauds are those perpetrated against a company or its policyholders by agents, managers, executives, or other employees.

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

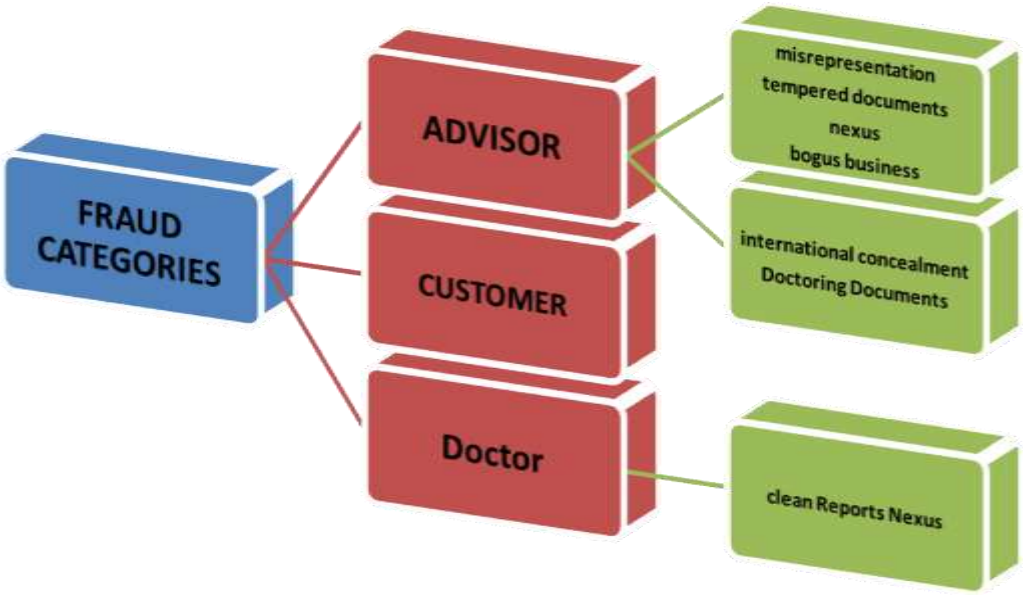

Figure 1 Types of Fraud

- **Non-Disclosure:** The failure by the insured or his broker to disclose a material fact or circumstance to the underwriter before entering into a policy.
- **Misrepresentation:** A 'misrepresentation' is a false statement of fact made by one party to another party and has the effect of inducing that party into the contract. For example, under certain circumstances, false statements or promises made by a seller of goods regarding the quality or nature of the product that the seller has may constitute misrepresentation.
- **Mis-selling:** The ethically questionable practice of a salesperson misrepresenting or misleading an investor about the characteristics of a product or

service In an effort to make a sale to a potential customer, a financial products salesperson could leave out certain information or describe a financial product as something the investor urgently needs, even though sound financial judgment would come to the opposite conclusion.

- A good example of misselling can be seen in the life insurance industry. Consider an investor who has a large amount of savings and investments but no dependent children and a deceased spouse. This investor would arguably have little need for whole life insurance and, therefore, an insurance salesperson describing the product as something the investor urgently needed to protect his or her assets in the event of death could be considered a case of misselling.
- **Cheque dishonor:** Where any cheque drawn by a person on an account maintained by him with a banker for payment of any amount of money to another person from out of that account for the discharge, in whole or in part, of any debt or other liability, is returned by the bank unpaid, either because of the amount of money standing to the credit of that account is insufficient to honor the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with that bank.
- **Paying premium for customers – rebating:** Giving a premium reduction or another financial advantage not stated in the policy as an inducement to purchase the policy. The offer of sharing commissions with the applicant is an inducement that is not part of the insurance policy and, therefore, is considered rebating. Rebates include not only cash but also personal services and items of value. Rebating is considered a violation of the Unfair Trade Practices Acts in most states.

RESULTS AND DISCUSSION

Life Insurance fraud – Defined

The term "fraud" carried the connotation that the activity was illegal and, hence, that prosecution and conviction were potential outcomes of a specific fraud. Accepting that premise allows us to adopt the legal definition of fraud in the insurance context and to examine the experience of dealing with insurance fraud in terms of property-liability insurance lines. Specifically, ten years of data on referrals and disposals of incidents of suspected fraud as processed by the Insurance Fraud Bureau of Massachusetts to provide estimates of the distribution of types of people who perpetrate a variety of insurance frauds were examined.

Table 1 Total Insurance fraud 2019

Insurance fraud	
INR-Billion	**US $ Billion**
304	6.16

Life insurance sector contributes maximum to the frauds i.e. 86 percent which is more than 6 times of General Insurance which contributes 14 percent as given in Table 2

Table 2 Comparison of Fraud in Life and Non-life Insurance

Insurance Fraud		Percentage	INR-Billion
Types of Life Insurance Fraud		**86%**	**261**
1	Misselling	36%	94
2	Fake Documentation	33%	86
3	Others	31%	81
General Insurance		**14%**	**43**
1	Falsification of documents	70%	30
2	Other fraud	30%	13

70 percent of the total frauds committed in the general insurance sector are of the natureof falsification of the documents. Medical Bills / Certificates top the list with 31 percent followed by Driving License (16 percent) and FIR (13 percent) which is actually a government document. It is depicted in Table 3

Table 3 Distortion of documents in General Insurance

Major contribution in falsification of documentsfor General Insurance Fraud		
	Percentage	**INR-Billion**
Medical billscertificate	31%	9
Driving license	16%	5
FIR	13%	4
Others	40%	12

CONCLUSIONS

FINDINGS RELATED TO TYPES OF FRAUD

There are two types of life insurance fraud internal and external. Internal frauds are those perpetrated against a company or its policyholders by agents, managers, executives, or other employees. External frauds are directed against the company by individual or entities as diverse as medical providers, policy holders, beneficiaries, vendors and career criminals.

FINDINGS RELATED TO 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. Agents are involved in committing life insurance fraud through misrepresentation of the facts, tampering of the documents and nexus with related parties, logging bogus business, cash defalcation and intentional concealment of the facts. Customers are involved in doctoring the documents, bogus business and intentional concealment of the facts. Doctor who is involved in helping the agents or policyholders provides clean medical reports.

FINDINGS RELATED TO FRAUD RISK EXPOSURE

The hypothesis of whether four key areas of risk exposure and the areas that needs more stringent anti fraud regulation are independent of each other was checked with the help of chi square test. Itis evident from H1o. Results depicted p value equal to 0.000 which is less than 0.05 and therefore null hypothesis is rejected. This means that key areas of risk exposure and the areas that need more stringent anti fraud regulation are dependent on each other.

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. Fraud risk in the insurance can originate from internal and external factors. Internal risk means the risk of employees' misappropriating confidential information and conspire with fraudsters is on the rise and therefore they need to put in place internal checks. External fraud risk can occur at various stages, e.g., registration of clients, reinsurance, underwriting, and the claims process.

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