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A STUDY OF RISK MANAGEMENT PROCESS AND FRAUD RISK EXPOSURE FACED BY INSURANCE COMPANIES

Tigade pallavi santosh,

Research Scholar, Dept. of Commerce & Management, Himalayan ***University***

Dr. Pankaj J.Gandhi,

Professor, Dept. of Commerce & Management, Himalayan University

ABSTRACT

Risk management is viewed as a corner stone of good corporate governance and therefore results in better service delivery, more efficient and effective use of scarce resources and better project management. It has to do with identification, analysis and control of such risks that threaten resources, assets, personnel and the earning capacity of a company. Risk management is: "a process of understanding and managing the risks that the entity is inevitably subject to in attempting to achieve its corporate objectives. For management purposes, risks are usually divided into categories such as operational, financial, legal compliance, information and personnel. One example of an integrated solution to risk management is enterprise risk management". The Institute of Risk Management also provided a more detailed definition of risk management as: the processes by which organizations methodologically address the risks to their activities with the goal of achieving sustained benefit within each activity and across the portfolioof all activities.

Risk management is an integral part of an organization's strategic management. Enterprise Risk management forays into an efficient Corporate Governance as a tool to measure the exposure of uncertainties and to design sensible mitigation plans.

KEY WORDS: RISK MANAGEMENT, STRATEGIES, CONSUMER SOCIETY, INSURANCE COMPANIES

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.

Risk Management is the process of measuring or assessing risk and then developing strategies to manage the risk. 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.

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.

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.

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. .

Insurance fraud is relatively simple to commit, easy to get away with, and seemingly considered ‘fair game’—and even legitimate—by a significant minority of the population. But it is illegal, costs the insurance companies millions of pounds, and is by no means ‘victimless’. (Gill 2001)

RESEARCH METHODOLOGY

Risk Management Process:

The Risk management is a process whereby Organizations' methodically address the risks attaching to their activities with the goal of achieving sustained benefit within each activity and across the portfolio of all activities.

The process flow discussed herewith and various case studies discussed later were deprived during the visits to life insurance branch.

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 willthen 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.

RESULTS AND DISCUSSION

Case Study

A proposal form was signed on 9/2/2006 was submitted at the branch on 14/2/2006. It reached underwriter's desk on 16/2/2006 and policy was issued on 20/2/2006. The policy was dispatched to the customer and was returned undelivered to head office. Hence it was resent to branch to be personally handed over to the customer. By that time, branch was intimated about the death of Life Assured. Life Assured died on 24/2/2006, just 4 daysafter the policy was issued.

Entire set of medical reports was submitted to the claims department s at the time of claim, which brought to light distressing facts. Life Assured was under treatment from as early as 27/12/2004 and she was tested HIV positive on 31/1/2005.

As per the proposal form she was keeping good health. Same was confirmed by the confidential report given by Advisor who knows LA for 7 years. The report was also countersigned by the sales manager. With Height 159 cms and weight 65 kgs, as mentioned in the proposal form, BMI was standard. But, the medical reports presented an altogether different picture regarding Life Assureds' weight. On 4/2/2006, she was weighing 37 kgs and on 9/2/2006, the day she signed proposal form, her weight was 36 kgs, making BMI as non standard. Moreover, the day the proposal form was signed i.e. 9/2/2006; Life Assured was under treatment in hospital.

Being a clear case of misrepresentation and non disclosure of material facts, the claim was repudiated and as a goodwill gesture fund value was paid to claimant.

Learning from the above case study is that one should make sure that discreet enquiries are made about the proposer before a policy is issued, so as to ensure fair selection of lives. In this case adviser knew LA for seven years and she was under treatment on the day proposal form was signed. Whenever, a countersign is done by sales manager, the sales manager should reconfirm the facts relating to health, age and occupation directly with the customer at least through a telephonic call. Not long ago, executives believed that a hallmark of the well-run enterprise was its ability to actively avoid risk while pursuing objectives devoid of danger. Today, most prudent leaders understand that risk cannot be avoided. However, significantly fewer realize that to achieve success, companies should not simply accept the inevitability of risk, but should actually embrace it.

With regard to this case, risk can be defined as the potential for loss or the diminished opportunity for gain caused by factors that can adversely affect the achievement of a company's objectives. Risks emerge from a potent mix of factors, including regulatory compliance, competitive pressure, environmental impacts, security and privacy concerns, business continuity, strategic planning, reporting protocols, operational processes, sustainability, and more. Companies of differing sizes, industries, and geographies will face a varied and unique arrangement of risk factors.

A perusal of history suggests negative events of all sorts will regularly occur, and businesses caught off guard will pay a price. However, the impact of bad things happening is less for those companies prepared to deal with a range of risks and opportunities simultaneously. The ability to handle multiple threats (such as a Hurricane creating both a supply chain and human resource disruption) while also capitalizing on immediate opportunities (such as being able to serve competitors' customers during an outage) constitutes an optimal risk management program.

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Risk management, as currently practiced, is often a one-time, internally disruptive event. Despite fancy analytical capability and dedicated professionals, many companies deploy a risk management system that is more theoretical than practical, based on subjective rather than empirical evidence, and one that is fragmented across jurisdictions, industries, and frameworks. The result is less risk management and more risk recognition. It's a good start but only a start.

Developing a Risk Strategy with reference to this case study is as under. Risk intelligence, on the other hand, requires a real time, ongoing process capable of engaging external risks and opportunities to fulfill stated company objectives within accepted risk- taking parameters. To attain this state requires, first, executives who actually understand the nature of risk and, second, a well defined strategy to guide an organization's risk management program.

Strategic risk management is not merely identifying risks, nor is it listing objectives to be achieved in dealing with identified risk. Both the identification and the elucidation are necessary-but not sufficient-to complete the optimum risk management program.

Effective strategic risk management should enable companies to state unequivocally and document clearly the organization's risk exposure. Most importantly, with an appropriate risk strategy in place, the decision to accept risk exposure will be informed, deliberate, and justified.

HYPOTHESIS

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

Life insurance fraud arises because of four major types of risk : Operational Risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, Insurance Risk refers generally to the uncertainty about the ultimate amount of net cash flows from premiums, commissions, claims and claims-settlement expenses emanating from a cession of contractually defined liabilities (Actuarial and Underwriting Risk) and the timing of the receipt and payment of those cash flows, Legal and Reputational Risk refers generally to the risk resulting from institution’s failure to enact appropriate policies, procedures, or controls to ensure it conforms to laws, regulations, contractual arrangements, and other legally binding agreements and requirements and Financial Risk refers generally to the risk resulting from having inadequate definition of accounting policies, material misstatement and cash defalcation. We wanted to check whether four key areas of risk exposure and the areas that needs more stringent anti fraud regulation are independent of each other. These four areas are operational risk, financial risk, legal and reputational risk and insurance risk. Respondents were asked two separate questions and requested to give ranking from one to four. Options for both questions were common. To check the hypothesis non-parametric test i.e. chi-square test of independence was applied at significance level of 0.05.

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.

Fraud is an operational risk common to all business areas. A core part of life insurance fraud risk management strategy is the development, and ongoing updating of a fraud risk profile. Each stream, in undertaking self assessments will contribute to the maintenance of the profile which will enable the business to cost effectively target the higher fraud risks to which we are exposed.

There should be a regular program of fraud risk assessment, with an independent review of business areas every two years in line with best practice. In line with the business risk framework, management should have the responsibility for managing operational risk (including fraud), therefore ongoing fraud risk strategy and assessment program includes self assessment of fraud risks every two years by business areas following the independent review.

The fraud risk assessment process should be consistent with the principles for managing risk in any life insurance company. Fraud risk needs to be discussed openly and constructively at all levels to promote a positive fraud risk management culture. The aim of a regular fraud risk assessment is to simplify the process and identify the higher level fraud risks for priority attention.

The fraud reporting procedures should be designed to encourage staff, to report suspected fraud without fear of retribution, unjust or other unfair treatment by management or other staff. Fraud investigation procedure should be such that investigation should be carried out and it is a very subjective matter and should be deal on by case on case basis. Life Insurance Company should continue to maintain a highly skilled internal audit capability, to ensure a focus is maintained on internal control as a fraud control strategy. An internal audit program that incorporates reviews of adherence to internal control will be maintained.

In developing internal audit programs Corporate Internal Audit will work closely with the Head-Finance/Company Secretary to identify and target high fraud risk areas for review. Programs will utilize advanced fraud detection testing tools and methodologies.

The strategy is a living document, which should be reviewed and monitored on a regular basis. Reviews will include ongoing assessment of performance against targets, re- assessment of targets and re-prioritization where necessary to address emerging issues. Where possible systems will be enhanced and new targets added to the strategy to strengthen our fraud prevention and control measures. There should be ongoing monitoring of implementation by the insurance company business risk committee and results will be communicated annually.

Fraud Risk Management Strategy and operational Plan should be presented and approved by the Control Committee of Life Insurance Company annually.

Fraud control principles are fundamental directives requiring compliance. The Principles describe the minimum requirements, which should be met in order to appropriately protect the company in line with the fraud control policy. They establish responsibilities and provide further guidance on the insurance company with the approach to prevent and detect life insurance fraud.

Mechanism used by life insurance companies to discover life insurancefraud

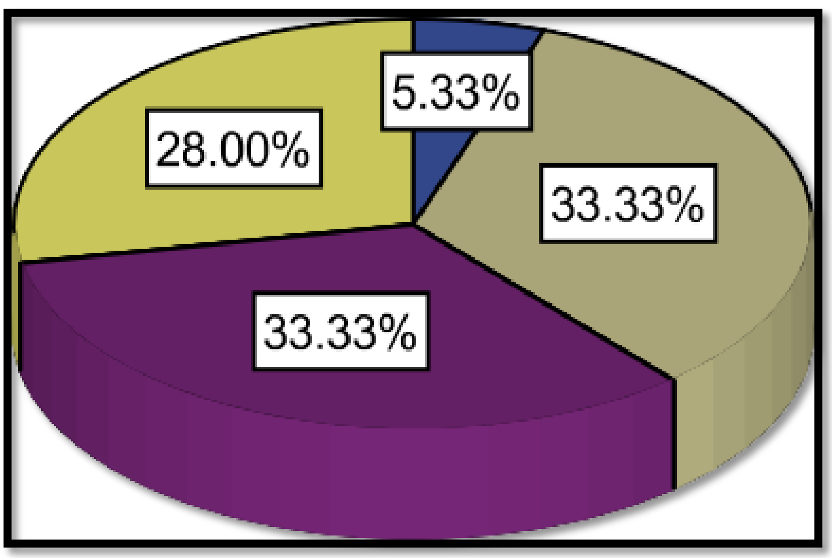
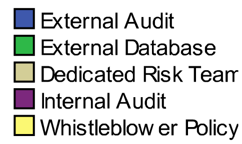


Figure: 1 Mechanism used by life insurance companies



CONCLUSION

It is very much important for any life insurance company to have a proper mechanism to discover life insurance fraud. It is evident from figure 2 that 33 percent of the respondents indicated that fraud risk assessment framework consisting of a dedicated risk department and internal audit both are the mostly used to discover fraud. It is followed by whistleblower policy i.e. 28 percent and 5 percent of the respondents expressed that external audit is used as a mechanism. None of the respondents have told that external database search is used to discover life insurance fraud.

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