“Crime Pays”
Recovering Employee-Dishonesty Claims.

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Today’s Speakers

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Introduction

The term *fraud* has come to encompass many forms of misconduct.

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Story Time !
The Cost of Occupational Fraud

The typical organization loses an estimated 5% of its annual revenues to occupational fraud.

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Topics

- Market Overview
  - Occupational Fraud in U.S./Global
  - Cyber Fraud
  - The Insurance Industry Response

- Discovery and Investigation
  - Immediate Steps
  - Building a Case on Liability

- Preparing and Resolving the Proof of Loss
  - Tips for Risk Managers
Market Overview

- Study conducted by the Association of Certified Fraud Examiners
- $3.7 Trillion in losses based on estimated ‘13 Gross World Product
- CFE’s estimate that occupational fraud amounts to 5% of gross revenues
- Median loss caused by occupational fraud was $145,000
- 22% involved losses of at least $1 million
- Typical fraud lasted 18 months
- Detection typically by tip 40% and 50% from “Hotlines”
- Anti-fraud controls significantly reduced loss exposure
  - Hotlines, surprise audits, anti-fraud training

Source: Association of Certified Fraud Examiners, 2014 Report to the Nations
Who Are the Perpetrators?

- Of the reported domestic cases
  - 46% committed by employees ($60k)
  - 37% committed by managers ($180k)
  - 17% committed by owners/executives ($485k)
- 65% men; 35% women (Canada only country with more women- Men-48/Women-51)
- Size of loss correlates with annual income level, tenure, age, education, level of collusion
- 87% were first-time offenders
  - 36% judged as “living beyond their means”
  - 27% experiencing financial difficulties

Source: Association of Certified Fraud Examiners
Duration of Fraud Scheme

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Risk Factors

- Incentive or pressure to perpetrate a fraud
  - Business (making the “number”)
  - Personal (usually financially motivated)

- Opportunity to carry out a fraud
  - Access to assets
  - Inadequate or nonexistent controls
  - Authority to dissuade detection

- Attitude and ability to rationalize fraudulent action
  - Management culture
  - Financial aggressiveness

Source: Association of Certified Fraud Examiners – The fraud triangle originated by Professor Donald Cressey
Gone Phishing!

- “Phishing” is an e-mail fraud in which the perpetrator sends out legitimate-looking email in an attempt to gather personal and financial information from recipients.
- The messages appear to come from well known and trustworthy Web sites.
- “Whale-Phishing” takes it to more serious and financially critical ends!!
- Phishing linked with extortion demands…FYI
The Insurance Marketplace

- 1.169b net written premium
- 45.0% loss ratio
- 57.8% loss + DCCE ratio
- Top three carriers write 49.02% of total premium
- Top ten carriers write 83.93% of total premium
- Historically:
  - Low premiums
  - Low deductibles
  - Limited Coverage
  - Profitable business

Note: DCC Ratio = Refers to defense and cost containment expense incurred. DCCE covers Most but not all of the expenses ascribed to loss Adjustment expenses.
Source: The Surety & Fidelity Association of America and Highline Media LLC. and AON
The Role of the Risk Manager

- The risk manager, in addition to the voices of security directors and internal auditors, must be heard by senior management

- Occupational fraud is clearly a risk management issue
  - Regardless of which figures are believed, the financial exposure is significant
  - The vast majority of losses are presently uninsured or underinsured
  - Who else within the organization is attempting to manage or finance this risk?

- Differentiating factors for RMs:
  - Experience, Access, Ability, and Relationships
What to Do When Suspicions Arise

- Locate and read the policy/consult your broker
- Conduct pre-notice investigation
- Give notice to crime and property carriers
  - Note time to file Proof of Loss
  - Note time to file suit against carrier
- Conduct thorough internal investigation
- Deal with employee issues
- Consider civil litigation
- Consider criminal prosecution
Privilege

- Consider retaining Outside Counsel
- Consider Fidelity and Policy experience
- Consider facility and familiarity with prosecutors

- Privilege- think down the road
- Consider having YOUR forensic accountants/investigators engaged thru Counsel
The Players

- The Risk Manager’s Team
  - In-house and outside counsel
  - Security and internal audit teams
  - Investigative specialist and forensic accountant
  - Broker claims advocate
  - Business representatives

- The Insurer’s Team
  - In-house adjuster (usually an attorney)
  - External counsel (acts as adjuster and potentially litigation counsel)
  - Forensic accountant (usually represents only insurers)

Continuous Involvement Leads to Successful Settlements
The Adjustment Process

- The Path Forward
  - Preliminary Investigation
  - Notice of potential claim
  - Establish facts (liability) and quantum (damages)
  - File sworn Proof of Loss
  - Insurer investigation and audit
  - Reconciliation of issues and differences
  - Negotiation and settlement
  - Potential subrogation
Managing Law Enforcement

- Advantages of Close Cooperation
  - They may conduct your investigation
  - $ savings
  - The power of immunity
  - Restitution may be obtained

- Potential Disadvantages
  - Lose control
  - Witnesses clam up
  - Unfavorable publicity
Managing Civil Litigation

- Discovery can be a valuable tool to establish existence and amount of loss
  - Vendor business records
  - Employee bank accounts
  - Shell company documents

- Typically, civil litigation follows the investigation in the form of a subrogation action by the carrier
  - If litigation is inevitable, sooner may be better
The Sworn Proof of Loss

- Policy requirement
  - Note time to file Proof and suit against carrier
  - Tolling is usually not a problem

- When is “enough” evidence enough?
  - Recognize that the insurer will incur considerable expense to validate and develop facts
  - Proof must be objective, credible, and persuasive
  - However, a comprehensive recitation of all facts is not required
  - Applicable standard of proof is “preponderance”
Damages Quantification and Proof

- Calculate -- do not estimate
  - Insurers have no incentive to pay “estimates”
  - Find creative ways to quantify damages
    - Use historical trends
    - Identify statistical anomalies
    - Prepare to defend any assumptions
Expect Pushback

- **Typical Conditions Defenses**
  - Failure to give prompt notice of loss
  - Prejudice subrogation rights
  - Failure to disclose prior acts of fraud or dishonesty
  - Involvement of officers in the fraudulent scheme
  - Failure to prove “manifest intent”

- **Typical Damages Defenses**
  - Loss not fully documented or proven
  - Claim includes indirect, consequential, or excluded losses (e.g., potential income)
  - Loss does not reflect credits for recovery
Risk Manager Resources

- Aon Dempsey Partners Publications
  - Ten Rules of Fidelity Claim Adjustment
  - Employee Dishonesty Case Studies

- ACFE Publications
  - 2014 Report to the Nations
  - Occupational Fraud: A Study of the Impact of an Economic Recession
  - Fraud Prevention Checklist
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