



Crime Pays: Recovering Employee Dishonesty Claims

Southern Alberta RIMS

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Today's Speakers

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Topics

- Market Overview
 - Occupational Fraud in the U.S.
 - 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

What's Happening in Your Neck of the Woods?

Edmonton woman jailed for \$530,000 embezzlement

- Used a machine that processes refunds to credit cards and debit cards to credit funds to herself
- Tried to avoid getting caught by claiming she was sleeping with the boss

Fraudster gets 3-1/2 years prison for embezzling \$634,000 from province

- Set up bogus contracts to divert cash into his own pockets
- “He is a leopard who has not changed his spots. He attempted to put some makeup on his spots, but the makeup has come off”

Oil industry advocacy group's ex-director accused of embezzling

- Alleged to have stolen \$315,000 between August 2004 and December 2007



Market Overview

2010 Report to the Nations

- Study conducted by the Association of Certified Fraud Examiners
- 1,843 cases examined around the world (aprox. 1,000 in N.A.)
- **\$2.9 Trillion** in losses based on estimated '09 Gross World Product
- CFE's estimate that occupational fraud amounts to 5% of gross revenues
- Median loss caused by occupational fraud was \$160,000
- 25% involved losses of at least \$1 million
- Typical fraud lasted two years
- Detection typically by **tip** (38%), even in post-Sarbanes world
- Anti-fraud controls significantly reduced loss exposure
 - Hotlines, surprise audits, anti-fraud training



Who Are the Perpetrators?

2010 Report to the Nations

- Of the reported domestic cases
 - 46% committed by employees (\$50k)
 - 37% committed by managers (\$150k)
 - 17% committed by owners/executives (\$485k)
- 57% men; 43% women
- Size of loss correlates with annual income level, tenure, age, education, level of collusion
- 86% were first-time offenders
 - 45% judged as “living beyond their means”
 - 45% experiencing financial difficulties



Risk Factors

2010 Report to the Nations

- 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



Other Observations

Conclusions From Our Experience

- Large Frauds Almost Always Involve **Collusion**
 - High risk of detection
 - Enron, Tyco, WorldCom, Adelphia -- Madoff?
 - The frauds permeate operations
- Small Frauds Can Be Carried Out by **Individuals**
 - Activities are under the radar screen
 - Unwitting accomplices
 - Few individuals are willing to report potential fraud

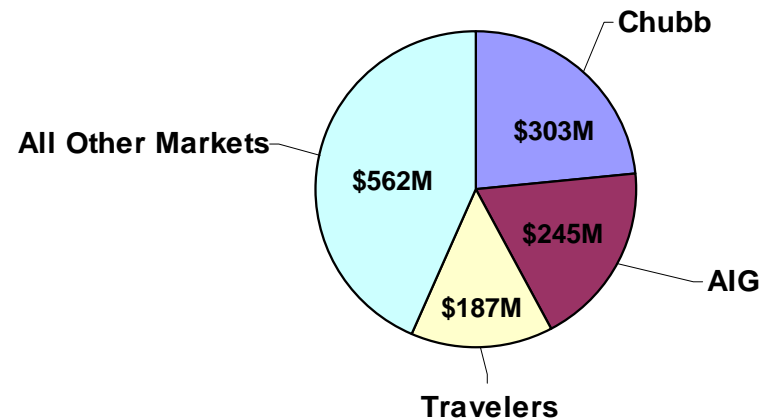


The Insurance Marketplace

Insurance Provides Minimal Protection -- Today

- \$1.3b net written premium
 - Small fraction of true exposure
- 36% loss ratio
- 76% combined ratio
- Top three carriers write 57% of total premium
- Historically:
 - Low premiums
 - Low deductibles
 - Limited coverage
 - Profitable business

Lead Markets - 2007





The Role of the Risk Manager

Continuous Involvement Leads to Successful Settlements

- 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**



The Players

Continuous Involvement Leads to Successful Settlements

- 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)



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What to Do When Suspicions Arise

Continuous Involvement Leads to Successful Settlements

- Locate and read the policy
- 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



The Adjustment Process

Continuous Involvement Leads to Successful Settlements

- 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



The Internal Investigation

Conducting an Internal Investigation

- What are the objectives?
 - Factual determination of events
 - Preliminary quantification of damages
 - Determination of coverage and probable recovery
- Who conducts?
 - In-house counsel and internal audit staff
 - External counsel and investigative specialists including forensic accountant



The Internal Investigation

Conducting an Internal Investigation

- Leadership Roles
 - Risk Manager oversees process and communicates with brokers and carriers
 - In-house counsel manages investigation, litigation, law enforcement activities, and controls costs
 - Investigator and forensic accountant conduct investigation under external counsel umbrella



Ongoing Business Concerns

Conducting an Internal Investigation

- Employee morale
- Management sensitivity
- Time required of operations people
- Cost
- Delays
- Periodic progress reports to management



Managing Law Enforcement

Conducting an Internal Investigation

- 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

Conducting an Internal Investigation

- 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

Loss Adjustment and Settlement

- 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

Loss Adjustment and Settlement

- 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

Loss Adjustment and Settlement

- 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



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War Stories We Love

Actual Cases from our Archives

- Embezzlement
 - Recycling
 - Check frauds
- South of Border fraud
 - Cooking the books
- Contractor/Vendor fraud
 - Hurricane remediation fraud



Risk Manager Resources

Useful Documents to Prevent Occupational Fraud

- DP Publications
 - Ten Rules of Fidelity Claim Adjustment
 - Employee Dishonesty Case Studies
- ACFE Publications
 - 2010 Report to the Nations
 - Occupational Fraud: A Study of the Impact of an Economic Recession
 - Fraud Prevention Checklist

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