



Oregon RIMS

# **“Crime Pays: Recovering Employee Dishonesty Claims”**

PERK Presentation  
Multnomah Athletic Club  
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## Today's Speakers

- Jacques Talbot, Senior Manager, San Francisco, CA
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# Dempsey Partners, LLC



## Topics

- Market Overview
  - Occupational Fraud in US/Global
  - 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



Crime Pays: Recovering Employee Dishonesty Claims

## 'Trusted friend embezzles at least \$166,300'

- She swiped cash, wrote checks and used the company card for herself and her family.
- Embezzlement pushed Applied Plastics Machining to the brink of bankruptcy.





## Market Overview

2010 Report to the Nations

- Study conducted by the Association of Certified Fraud Examiners
- **\$3.5 Trillion** in losses based on estimated '11 Gross World Product
- CFE's estimate that occupational fraud amounts to 5% of gross revenues
- Median loss caused by occupational fraud was \$140,000
- 20% involved losses of at least \$1 million
- Typical fraud lasted two years
- Detection typically by **tip** 43% and 51% from "Hotlines"
- 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 (\$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



## 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

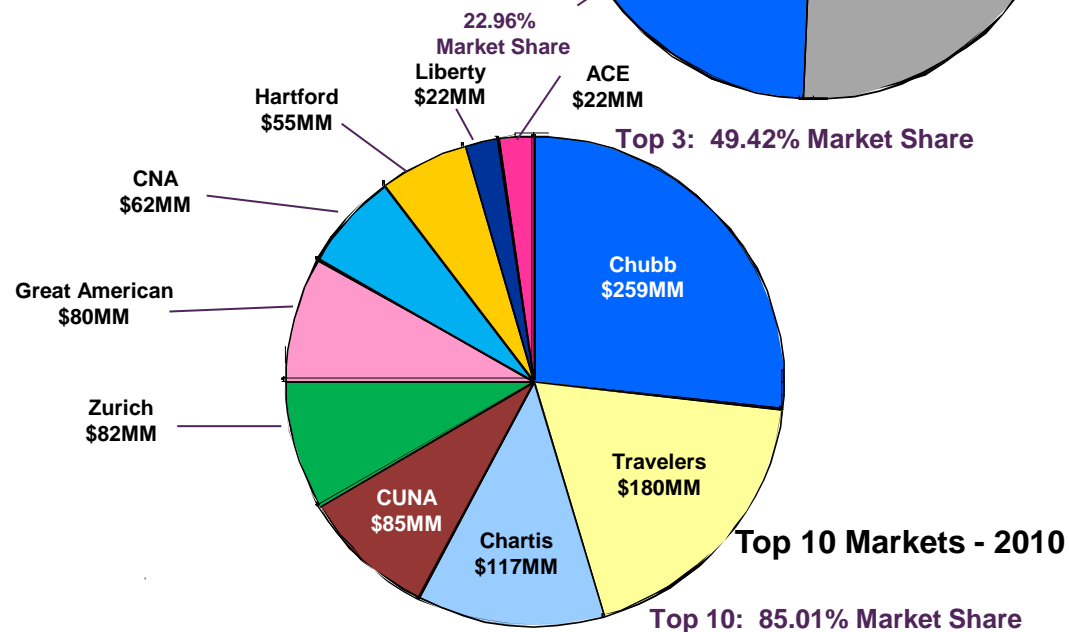
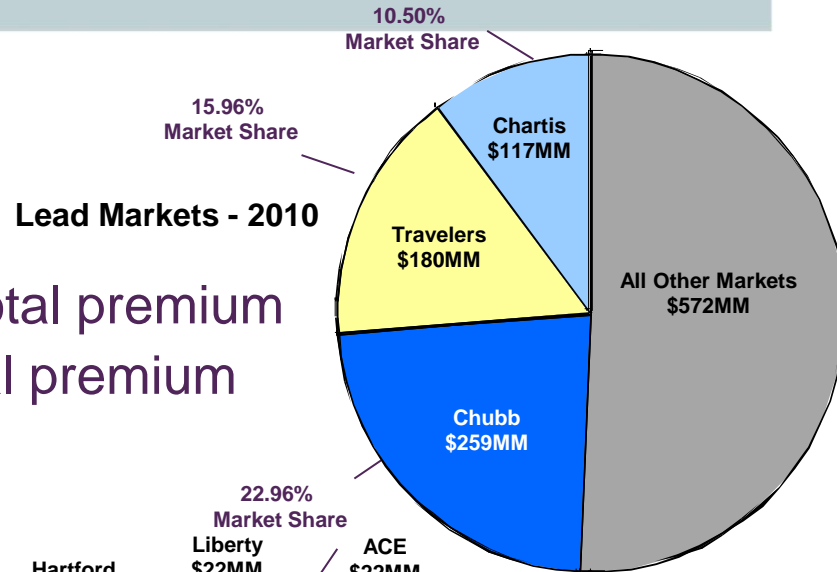
Conclusions From Our Experience

- Large Frauds Almost Always Involve **Collusion-**  
**always increases the quantum of loss**
  - High risk of detection
  - 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

- \$1.128b net written premium
- 54.2% loss ratio
- 57.8% loss + DCCE ratio
- Top three carriers write 49.42% of total premium
- Top ten carriers write 85.01% of total premium
- Historically:
  - Low premiums
  - Low deductibles
  - Limited Coverage
  - Profitable business



Note: DCCE Ratio = Refers to defense and cost containment expense incurred. DCCE covers most but not all of the expenses ascribed to loss adjustment expenses

Source: Maureen J. Richmond Senior Vice President  
Aon Financial Services Group (September 2011)



## 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)



## What to Do When Suspicions Arise

Continuous Involvement Leads to Successful Settlements

- 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



## 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



## The Adjustment Process

Continuous Involvement Leads to Successful Settlements

- The Path Forward
  - Establish facts (liability) and
  - Calculate the quantum (damages)
  - Prepare the supporting report for your Proof of Loss
  - Insurer investigation and audit
  - Reconciliation of issues and differences
  - Negotiation and settlement
  - Potential subrogation





## 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
  - 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



## Risk Manager Resources

Useful Documents to Prevent Occupational Fraud

- DP Publications
  - Ten Rules of Fidelity Claim Adjustment
  - Employee Dishonesty Case Studies
- ACFE Publications
  - 2012 Report to the Nations
  - Occupational Fraud: A Study of the Impact of an Economic Recession
  - Fraud Prevention Checklist

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