

## **FRAUDULENT ACTIVITIES AND SURGE IN PUBLIC SERVICE VEHICLE CLAIMS IN INSURANCE INDUSTRY IN KENYA**

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### **ABSTRACT**

*In Kenya, all Public Service Vehicles are obligated to have third party liability cover hence motor insurance is key to the sector. The purpose of this study was to establish determinants of rise in PSV claims with reference to the leading PSV underwriters namely; Directline insurance company, Invesco insurance company, and Xplico insurance company. Specific objective was to establish the effect of fraudulent activities on PSV claims in Insurance Industry in Kenya. The study adopted a descriptive design with a sample size of 115 respondents from a target population of 382 employees. Data was collected via a questionnaire administered through electronic media. All ethical aspects were observed. Data was analyzed by SPSS version 21 software and the results presented in frequencies and other measurements. It was found that fraudulent activities significantly influenced PSV claims. The study also found that the number of claims in the sector kept rising. The study also revealed that many insured regard insurance as a victimless crime and some engage in fraudulent activities based on widespread perception that corruption is an acceptable norm. Some employees of insurance firms often aid outsiders in lodging false claims. False claims also arise situationally where alleged accident victims often report pre-accident losses and defects as if sustained during the accident. To rid the sector of this malpractice, the study recommended urgent measures be instituted by the regulator and stakeholders in the insurance industry to proactively eradicate fraudulent activities. Partnership between PSV operators, underwriters and stakeholders in the transport sector would greatly complement traffic rules.*

**Key words:** Fraudulent activities, misrepresentation, surge in PSV claims.

## INTRODUCTION

According to Weisbart, (2018) the insurance industry performs a crucial role in the political, social, and economic growth that impact on human life. The growth of this industry has gradually expanded as a result of people realizing the importance of insurance in the business world just like banking institution and stock market. In fact, insurance expenditures for developed countries are in the brackets of 8% to 11% and 2% to 4% for developing states (Din, Angappan, & Baker, 2017). Emerging states have seen an upward trend in insurance premiums over decades (Swiss-Re, 2016). Nearly every human endeavours both social and economic, are subject to inherent risks (Din *et al.*, 2017).

Insurance is a risk transfer mechanism whereby an economic entity can shift some of its uncertainties to some other entities. Insurance is premised on the idea of large numbers, risk pooling and loss transfer (Surminski, 2014). The function of insurance involves underwriting, receiving of the premium, management of claims, risk evaluation, creating awareness as well as risk management advisory (Paudel, Botzen & Aerts, 2012). Basically under the concept of insurance, all persons exposed to risk agree to pool together an agreed sum of money from which funds are drawn to indemnify any member of the pool that may suffer loss stemming from the risks insured against.

### Statement of the Problem

Performance of the motor line of Insurance business seems to be consistently below par yet the industry's significance to its stakeholders, the public and government cannot be underrated (Kollie, 2017). Motor insurance business in Kenya has been posting heavy losses across the industry for several years due to increasing claims (IRA, 2019). While some of the PSV insurers in Kenya have collapsed due to rising claims, others are faced with imminent collapse. Fraud has been quoted as a major cause of losses leading to the winding-up of insurance companies in the past decade (Wahome, 2010). It is against this backdrop that the researcher in a bid to improve performance of the sector finds sufficient conviction to investigate and possibly establish determinants of the rising trends in PSV claims in the Kenya insurance sector. Insurance Regulatory Authority (2019) report shows that incurred claims from commercial vehicles increased from Kshs 10.7 billion in 2014, to Kshs 12.7 billion in 2016 and to Kshs 13.6 billion in 2018. Moreover the Motor classes of insurance had the largest share of claims incurred at 49.0% (Insurance Regulatory Authority, 2019).

### Objective of the study

The key objective of the study was to establish the extent to which fraudulent activities influence public service vehicle claims in the insurance industry in Kenya.

### Significance of the study

The findings drawn from the study will provide regulators in the insurance industry as well as insurers with the much needed knowledge regarding causes of increase in PSV insurance claims. The study will also provide remedial information to managers in insurance companies that are not performing well as a consequence of rise in PSV claims. The findings will also help decision makers in the insurance industry in Kenya to develop acquire solid knowledge of the industry dynamics and formulate appropriate policies. It is also expected that the findings of the study will add value to other scholars and academicians since it will be a Launchpad for further research in this area.

## 2.0 LITERATURE REVIEW

### 2.1 Theoretical Literature Review

The study derived its foundation on information asymmetry theory. These theory has been extensively examined in order to guide the researcher in gaining an insight on the effect of fraud in the Kenyan insurance industry.

#### 2.1.1 Information Asymmetry theory

Information Asymmetry theory was first postulated by Akerlof (1970) in his paper titled "The Market for Lemons"; Quality, Uncertainty and Market Mechanism and later developed by economists Michael Spence (Spence, 1973) and Joseph Stiglitz (Stiglitz, 2000) to elaborate the implications and application of information asymmetry. It suggests that there exist information gap between buyers and sellers, where both high and low quality goods and services are

presented in the marketplace. The theory is concerned with the study of decision making in transactions in which one party has information advantage over the other. This often creates an imbalance in negotiating power between the parties in a transaction. In insurance, adverse selection occurs when the insurer has limited or no material information regarding the risk profile of the person proposing to be covered. Akerlof (1970) opines that insurance markets substantially suffer from informational asymmetry which largely affects the party with superior information in a trade in which both parties are expected to be on par before and after transacting the contract.

## 2.2 Empirical Literature Review

This section of the chapter provides a review of some of the relevant works that have been conducted and relate to the present study. It seeks to document other literature works that are in line with the current study with a special bias on investigating the influence of fraudulent activities on rise in public service vehicle claims in insurance industry in Kenya.

### 2.2.1 Fraudulent activities and Public Service Vehicle Insurance Claims

Fraud is generally an intentional act done with sole objective to deceive the victim. Motor insurance has become one of the avenues and a weakness in the fraud ridden insurance industry when compared to other lines of insurance business (Tseng & Kuo, 2014). Incidents of fraud may include concealing material facts at the point of applying for insurance cover, misrepresentation of material facts at the point of lodging a claim, back-dating an insurance cover, deliberate staging of an accident event and exaggerating a loss. Such behaviour is considered as fertile grounds that enhance policyholders' propensity to unfairly benefit from insurance. The behaviour is often influenced by factors such as exorbitant interest rates in the money market, high inflation rates and moral hazard. As part of the basic doctrines of insurance contracts, the insured is required to disclose all material facts of the risk being proposed as well as at the time of loss; per the principle of utmost good faith. In line with Harris and Daunt (2013), motor insurance fraud typically involves deliberate act of providing wrong information to an insurance entity in a bid to get money to which a person has no legal entitlement. Motor insurance fraud may involve claim padding which is essentially an exaggeration of the claim amount at the time of settling the loss. Furthermore, Ager and Ma (2013) lament that motor insurance fraud is more complex since some of the fraudulent acts such as lodging false claims involve employees of insurance firms who aid outsiders in filing the claims. In another work, Lotuiya (2014), noted that the whole process of claims settlement right from reporting, screening to processing the amount payable tend to provide avenues that are often exploited by fraudsters.

According to Li, Peng and Liu, (2013), concealment of material facts is a form of fraud which occurs when the insured is proposing for insurance cover and also a means to evade payment of adequate premium commensurate to the cover the individual needs in exchange of a consideration. For instance, so as to evade premium for a PSV insurance cover which is often high, a prospecting policyholder may apply for a private car cover which attracts relatively lower premium only for the insurer to discover that the vehicle was being used for commercial purpose when an accident occurs. Ngosiah (2012) opines that PSV insurance is often the greatest victim of fraudsters. IRA (2015) revealed that the Insurance Fraud Investigation Unit (IFIU) posted 29 fraud cases accumulating to a whopping Kshs 26.1 million with Kshs 13.05M being fraudulent motor claims paid by insurance firms while Kshs 10.52 million relate to theft cases involving staff within the insurance firms.

According to Neave (2012) lodging fraudulent claims is the most common type of fraud practiced in PSV insurance; this is mainly because it is thought by many that insurance fraud is a victimless crime and that all it does is to poke holes in the pockets of the 'big fat' corporations. In addition, other studies have shown that fraudsters in many instances attempt to justify their actions as acceptable norm since insurance fraud is often regarded as a victimless crime (Viaene & Dedene, 2014). Besides, Gill and Randall (2015), note that a portion of insurance customers are enticed to engage in fraudulent activities owing to the widespread misconception that corruption has been recognized and accepted as part of the society.

Akomea-Frimpong, Andoh and Ofosu-Hene (2016) examined the extent and effects of insurance fraud on the financial performance of insurance companies in Ghana. The study explored the causes and measures that can be employed to curb insurance fraud. The study relied on both primary and secondary data collected from 39 insurance companies which was analyzed using regression analysis. The regression analysis results established that there is a negative and statistically significant association between insurance fraud and claims and subsequently on the financial performance of insurance firms in Ghana. The study further established that some of the key causes of fraud in insurance firms were, employees' pay, inadequate training of insurance brokers, weak internal controls, falsification of documents and

deliberate fraudulent acts by policyholders. The study recommended the need to put in place effective internal fraud controls to ensure there is strict and keen review of insurance covers and claims handling procedures. It was also recommended that insurance fraud can be curbed by adequately training insurance brokers and employing efficient technology. In Kenya, Lotuiya (2014) conducted a study on the challenges faced in PSV insurance sector in insurance industry in Kenya. The study sought to analyze the causes of the challenges faced, and further make inquiry on the adequacy of the applicable law. Both primary and secondary data were collected whereby primary data was gathered from three major institutions (College of insurance, IRA and Invesco Insurance Company), and also from the police commandant and the chairman of Matatu Owners Association. Secondary data was gathered from books and articles. The study established that some of the challenges facing the industry were in form of fraudulent claims perpetrated by collusions between policyholders and insurance company staff. Other challenges were arbitrary court compensation awards and improper risks distribution. The study further found that fraudulent and false insurance claims occur when some victims tend to exaggerate injuries whenever an accident happens. When they succeed, the insurer unjustifiably pays for injuries that were not sustained at all or that were not sustained in the course of the accident. The study recommended that the Insurance Act be amended to give IRA statutory mandate to regulate financial service fraud in insurance industry in Kenya. Co-ordination among the various stakeholders in the industry would go a long way in eliminating fraudulent activities in the industry. Finally, the study observed that there is need to formulate additional legal policies that would assist to eliminate the problem of arbitrary court awards on insurance claims.

Kuria and Moronge (2014) investigated the effects of insurance fraud control mechanism on the growth of the insurance industry. The study adopted a descriptive survey design and collected data from managers and risk managers of 49 insurance companies in Kenya. A census method was adopted. Data was collected through questionnaires and the results showed that 40 percent of insurance claims paid by insurance companies in Kenya were fraudulent. It was also found that the regulator does not help the industry in controlling fraudulent activities and that no effective technology was being used to curb fraudulent activities. The study recommended that the regulator should incorporate fraud control mechanisms in their guidelines to stakeholders in a and Moronge (2014) does not fill in the gap as intended to by this study as it did not show how fraudulent activities influence rise in public service vehicle claims in insurance industry in Kenya. Besides, the scope of the study by Kuria and Moronge (2014) focused on the entire insurance industry and not on a few leading companies that underwrite PSV risks as is the case for this study.

### **Rise in Public Service Vehicle Claims**

In Kenya there is evidence that there is a high rise in fraudulent insurance claims which are paid out; the claims have completely reduced the profitability of insurance firms thereby threatening their survival. Fraud has been cited as one of the leading problems that have led to the rise in insurance claims. Fraudulent claims have been increasing despite the presence of the internal control systems (Kilemi, 2018).

A study by Lotuiya (2014) on the Challenges Faced in PSV Insurance sector in Kenya confirms the concern about the increase in magnitude and value of PSV insurance claims. The study revealed that among the most serious problems facing the insurance industry was fraudulent claims, collusions and arbitrary court awards. This had led to collapse of some insurance companies such as United Insurance Company and Lake Star Insurance Company, sometimes with pending unpaid claims. The author acknowledges that this problem is yet to be adequately addressed.

A study by Ngosiah (2013) examined the rise in fraudulent claims with a purpose of coming up with an integrated framework to control fraud in the Kenyan insurance industry. The study reviewed the current fraud detection mechanism through an indepth analysis. Two theories were applied in the study, namely, the Mass Detection Tool (MDT) and Bayesian Inference Approach which were applied in seeking to review comprehensive motor insurance claims fraud management with respect to the insurance industry in Kenya. The study found out that fraud in claims was rife in insurance industry in Kenya. Moreover, 65 percent of claims processors considered the motor sector as susceptible to fraud and only a paltry 15 per cent of the professionals in the industry employ technology to efficiently manage problem. The study recommended that a framework be developed on the basis of Mass Detection Tool (MDT) which will provide the needed solution in order to identify or curb fraud-related claims in the Kenyan insurance industry.

### **Summary of Research gap**

The theoretical and empirical underpinnings found fraudulent activities to have a significant effect on the rise in PSV claims and thus management of claims is important for insurance business sustainability. The theory of information asymmetry analyzed has attempted to explain how rise in claims arise and perhaps how the process can be used to

control invalid claims. However most of the past studies in the insurance industry in Kenya have not specifically focused on the influence of fraudulent activities on the rise in public service vehicles claims but rather attempted to examine claims in the Kenya insurance industry as a whole. From the literature reviewed, the main determinants of rise in public service vehicle claims in the Kenya insurance industry is fraudulent activities that lead to a gap hence the need for further research study.

### Conceptual Framework

A conceptual framework shows the hypothesized relationship between variables of a study. In this study, conceptual framework illustrated the relationship between fraudulent activities as an independent variable and rise in public service vehicle claims as a dependent variable.



### Research Methodology

Descriptive research design aided the researchers to collect and analyze data for the influence of fraudulent activities on rise in public service vehicle claims in the insurance industry in Kenya. The study population comprised of 382 employees drawn from the three major insurers offering PSV covers in Kenya, namely; Directline Assurance Company, Invesco Insurance Company and Xplico Insurance Company Limited. The study utilized stratified sampling technique to select 115 respondents who included business development managers, claims managers, risk managers, loss assessors and technical supervisors. The respondents provided the required data for the study, by completing a questionnaire that contained closed questions and a Likert scale clearly depicting the extent to which fraudulent activities influenced public service vehicle claims in the Kenya insurance industry. The questionnaire was primarily administered through emails and other electronic media such as google-docs and in some cases through physical drop-points to comply with the World Health Organization and Ministry Of Health Covid-19 pandemic protocols. Prior to actual data collection, the researcher carried out a pilot study involving 20 random respondents to establish the reliability of the questionnaire. In order to ensure validity, the researcher sought opinions and views of lecturers and peers and incorporated them in the questionnaire. Reliability was determined by use of Cronbach's alpha with a reliability threshold of  $\alpha \geq 0.7$  which is normally perceived to be reliable in the construct according to Mugenda & Mugenda (2003). The study data was keyed into a spread sheet and was analyzed using SPSS version 21. Both descriptive and inferential statistics were relied upon in undertaking the analysis and the findings were presented in tables.

### The Findings

**Table 1: Fraudulent Activities and Surge in PSV Claims**

Statement	Mean	Std. Dev
Fraudulent activities constitute a heavy burden and cost to insurance firms	4.32	1.094
Many insured regard lodging false insurance claims as a victimless crime	3.60	1.105
Some insured engage in fraud on perception that corruption is acceptable	3.53	0.986
Companies have effective investigation that detect and fraudulent activities	3.24	1.355
Employees of insurance firms often aid outsiders in lodging false claims	3.46	1.076
Some insured use motor fraud to recoup some of their financial obligations	3.94	0.981
Fraud is the most common type of claims practiced in PSV insurance	3.78	1.072
Fraudulent claims also occur where alleged victims of accidents report pre-accident or post-defects loss as if sustained during the accident	3.79	1.153

The findings of the study showed that fraudulent activities constitute a heavy cost burden to insurance firms (M=4.32 SD=1.094), most insured tend to perceive motor insurance fraud as a means to recoup some of their financial obligations (M=3.94 SD =0.981). and that fraudulent and false insurance claims also occur in situational cases where alleged victims of accidents often report pre-accident loss as if sustained during the accident (M=3.79 SD=1.153), fraudulent claims is the most common type of fraud practiced in PSV insurance (M=3.78 SD=1.072), many insured regard insurance as a victimless crime (M=3.60 SD=1.105),some insured engage in fraudulent activities based on perception that corruption is an acceptable norm in the society (M=3.53 SD=0.986),some insurance employees often aid outsiders in lodging false claims (M=3.46 SD=1.076).

However, the study neither agreed nor disagreed that companies have established effective investigative process that can detect and stop fraudulent activities (M=3.24 SD 1.355). The findings partly confirm the assertion by Gill and Randall(2015), who observed that insurance customers are often enticed to engage in fraudulent activities owing to the widespread misconception that corruption is generally acceptable.

**Table showing the level of fraudulent activities involving PSV claims in Kenya;**

Statement	Frequency	Per cent
Non- existent	1	1.10
Low	8	9.20
Moderate	21	24.10
High	15	17.20
Very high	42	48.30
<b>Total</b>	<b>87</b>	<b>100.0</b>

The results in table above indicate that a sizeable number of respondents at 48.30% agreed that the level of fraudulent activities involving PSV claims was very high while 17.20% of the respondents indicated the level of fraudulent activities involving PSV claims was high. Moreover, 24.10% of the respondents were of the view that the level of fraudulent activities involving PSV claims was moderate. However, while 9.20% of the respondents felt that the level of fraudulent activities involving PSV claims was low, a paltry 1.10% indicated that fraudulent activities were non-existent.

### Rise in Public Service Vehicle Claims

The study purposed to establish the extent to which fraudulent activities affect PSV claims in the Kenya insurance industry. The findings are shown in Table below;

**Table 3:**

Statement	Mean	Std. Dev
Fraudulent activities constitute a heavy cost burden to insurance firms	4.32	1.094
Many insured regard insurance as a victimless crime	3.60	1.105
Some insured engage in fraudulent activities based on perception that corruption is an acceptable norm	3.53	0.986
Companies have established an effective investigative process that detect and stop fraudulent activities	3.24	1.355
Employees of insurance firms often aid outsiders in lodging false claims	3.46	1.076
Some insured perceive motor fraud claims as a means to recoup some of their financial obligations.	3.94	0.981
Fraud is the most common type of claims practiced in PSV insurance	3.78	1.072
Fraudulent and false claims also occur when alleged victims of accidents report pre-accident or post-defects loss as if sustained during the accident	3.79	1.153

After analyzing the data obtained through the questionnaire, the following discussions, conclusion and recommendations were extracted in line with research objectives. The responses were based on the objectives of the study. The researcher had purposed to obtain and analyze data to establish the extent to which fraudulent activities influenced public service vehicle claims in the Kenya insurance industry.

## Summary of Findings

### The Influence of Fraudulent Activities on Public Service Vehicle Claims

On the aspect of fraudulent activities, the study established the presence of significant relationship and test regression results show that a unit change in fraudulent activities other thing held constant would positively change surge in claims by a factor of 0.023. The study revealed that the level of fraudulent activities involving PSV claims was very high, and that fraudulent activities constitute a heavy cost burden to insurance firms. On the other hand, the study found that most insured tend to perceive motor vehicle insurance fraud as a means to recoup some of their financial obligations. Fraudulent and false insurance claims also occur in situational cases where alleged victims of accidents often report pre-accident or post-defects as if sustained during the accident. The study also established that lodging fraudulent claims is the most common type of fraud practiced in PSV insurance. Many policyholders regard insurance as a victimless crime hence decide to engage in fraudulent activities based widespread perception that corruption is an acceptable norm in the society.

### Conclusion and Recommendations

From the results of the study, it was noted that there is a positive and statistically insignificant association between fraudulent Activities and rise in Public Service Vehicle claims. The study recommended that insurance regulator as well as the PSV underwriters should proactively attempt to eradicate fraudulent activities in the sector through fraud detection and deterrence mechanisms. Public Service Vehicle operators should partner with stakeholders in the transport industry such as National Transport and Safety Authority and PSV Saccos to sensitize drivers on safety awareness programs. Finally, the researcher recommends that through Association of Kenya Insurers insurance firms should develop sound underwriting guidelines, internal procedures and controls for effective risks identification, evaluation and selection to guarantee a balanced business distribution.

### Suggestion for further studies

Based on the findings of this study the researcher suggests the need for another study involving all insurance firms that provide PSV cover in the Kenya rather only three major PSV insurers in order to establish the causes of fraudulent activities in PSV insurance sector.

Another study with a larger target population and larger sample size should be carried for more accurate results.

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