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Aims and Scope

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Rising Motor Insurance Premiums and Policyholders' Attitude Towards Insurance Fraud in Sri Lanka

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ABSTRACT

Insurance fraud by policyholders is increasing in a global scale whereas insurance premiums are also rising while there is a decreasing trend in insurance claims. The purpose of this study was to identify whether the rising cost of motor insurance policies exerts an impact on committing motor insurance fraud. In addition to the major independent variable, the researcher identified two other controlling variables: perceived fairness and the number of years of driving experience. The regression results established that there is a significant positive relationship between the cost of motor insurance premiums and customer attitude to commit fraud. Further, it had been identified that the higher the perceived fairness, the lower the tendency to commit fraud. Moreover, the study could identify a positive relationship between the number of years of driving experience and attitude towards fraud.

Keywords: *Attitude, Motor Insurance, Perceived Fairness, Insurance fraud, Rising Premiums*

1. INTRODUCTION

Insurance fraud is a deliberate deception perpetrated against or by an insurance company or agent for the purpose of financial gain. It is reported that, globally, 10% of all insurance claims filed by consumers are fraudulent, with the insurer detecting only one-fifth of these false claims (CAIF, 2022). As per the Insurance Regulatory Commission of Sri Lanka (2019), the motor insurance business had the highest net earned premium, which amounted to LKR 58,753 million and represented 71.27% of the total net earned premium, indicating a 3.27% increase over the same period in 2018. Furthermore, the motor insurance business maintained its position as the largest subsector of net claims incurred in 2019 amounting to LKR 34,704 million, representing 59.39% (2018: 66.04%) of total claims incurred, resulting in a net claims ratio of 59.07% (2018: 60.96%). But in 2019, the net claims ratio has been reduced by 1.89%. However, compared to the four years of consecutive double-digit growth, motor insurance has reported the lowest growth rate of 2.20%. This was primarily due to a decrease in personal vehicle imports combined with an increased tax structure on most categories of personal vehicle imports in the Government Budget 2019.

Aside from the obvious economic impact on motorists, the cause of these increases in motor insurance costs is widely debated, with varying degrees of blame being assigned to various stakeholders such as insurers, the legal

profession, and government regulations such as import restriction policies, and fraudulent claimants. It was recently reported that motor insurance premiums are rising while the number of claims is decreasing (IRCSL, 2019). It may also give the impression that insurers are raising prices unfairly despite of falling cost of claims. These increases in automobile insurance premiums, combined with negative news stories about the insurance industry, appear to have harmed insurers' reputations. Previous research has shown that when people have a negative attitude toward the insurance industry, they are more tolerant of insurance fraud (Tonenciuc, 2015). Increased tolerance for insurance fraud is positively correlated with the frequency of motor injury claims (Cummins & Tennyson, 1992) which has a direct impact on motor insurance costs. However, there is a dearth of studies that capture the relationship between the cost of motor insurance to the policyholder and the attitude toward insurance fraud. Therefore, this study sought to assess whether rising motor insurance premiums have an impact on policyholders' attitudes toward insurance fraud. Accordingly, the researcher has identified the following research questions and research objectives.

Research Questions

- Is there an impact of the cost of motor insurance policy on customers' attitude to committing fraud?
- Does perceived fairness exert an impact on customers' attitudes to committing fraud?
- Is there an impact of the number of years of driving experience on customer attitude to commit fraud?

Research Objectives

- To examine the impact of the cost of motor insurance policy on customers' attitudes to commit fraud.
- To identify the impact of perceived fairness on customers' attitudes to commit fraud.
- To study the impact of the number of years of driving experience on customer attitude to commit fraud.

Previous studies found that policyholder attitudes toward insurance fraud support Adam`s equity theory and deductible premiums ratio. However, the claims ratios are going down but the insurance premiums are going up and it has been a huge problem in the insurance industry due to the economic crises. Based on the literature gap, this study proposed the first empirical investigation into the relationship between growing premiums and policyholders` attitudes toward insurance fraud in Sri Lanka. As per my knowledge, this study proposed the first empirical investigation into the relationship between growing premiums and policyholders` attitudes toward insurance fraud in Sri Lanka.

2. LITERATURE REVIEW

According to Carris (1997), the second-largest white-collar crime is insurance claim fraud. It is nearly about 10% of all insurance claims made by consumers

are fraudulent while just one-fifth of these fraudulent claims are detected by the insurer(Ishida et al., 2016). The Association of British Insurers 2013 estimated that undetected insurance fraud was £1.3 billion a year (Leal et al., 2016). Insurance fraud varies due to the social and cultural situation of the country, while it is happening all around the world (Tonenciuc, 2015). Most of the recent Researchers have centered on, the reasons and perception of insurance fraud based on the specific market in the US and China, but there is research relating to Insurance fraud in Sri Lanka.

2.1. Typology of Insurance Fraud

Frauds are usually a personal or a group-led effort of fraudsters with the associated intention of inflating claims and finally making a profit out of a loss. Insurers pay giant effort and manpower in detecting fraud that as a net result not only drains the greenback amount from the insurer's side but boot adversely has an impression on the good risks that they underwrite. It's to boot a social risk as a result of it promotes cash crimes and penalizes society. Thereby defying the parable that "Fraud in insurance is victimless."

Tonenciuc (2015) found that different legislation in different countries, inconsistencies in the claim handling process, and concerns among insurers about disclosing the severity and scope of fraud they experience. However, a common theme running through these definitions is the deliberate deception of one or many parties to make a financial gain.

Literature on insurance fraud focuses on four groups; insurer fraud, internal fraud by employees of the insurance company, fraud by intermediaries such as brokers, and consumer fraud (Yusuf, 2011). From the initial quotation to the settlement of a claim, the insurer interacts with the consumer at several stages. Consumer insurance fraud can occur at any point along the way (Dehghanpour & Rezvani, 2015). Insurance application fraud occurs when facts are purposefully misrepresented to obtain cheaper insurance. For example, an individual may declare that they are only a named driver on their parent's auto insurance policy when, in fact, they are the primary driver of the vehicle.

Claim fraud is frequently divided into two categories: organized (or planned) fraud and opportunistic fraud (Dionne & Gagne, 2001). After a legitimate incident and the extent of damage or injury, opportunistic claim fraud occurs. Is purposefully exaggerated or 'padded' to make a more powerful claim, or the individual claims for things that aren't covered by the policy (Weisberg et al., 1998). Organized fraud, also known as 'hard' fraud, is often easier to prove and thus more prevalent. Prosecute as a criminal offense (Tennyson, 2002). Opportunistic fraud occurs when information about Even though an actual claim is exaggerated or falsified, it is often referred to as "soft" fraud. It is still considered a criminal (Viaene & Dedene, 2004)).

However, the following issue are dealing with different components such as Claims Fraud impacts underwriting tips and policies and deteriorates the insurance risk pool. Due to claim fraud, the prices of insurance go up as full. Unfair with actually meriting due to claim fraud usually even the worthy

claimants are either denied a claim or have to be compelled to offer any proof on a claim. Undetected fraud encourages tons of fraud, once to a triple-crown fraud propensity of individuals to additional like fraud can increase, thus encouraging tons of fraud. Loss in Reputation due to the Repetition of dishonorable claims for associate insurance firms causes a loss in market name thus inflicting a decline in a fight. Client Relationship: dishonorable claims adversely impact the insurer's relationship with its existing customers and with prospects. Regulative Compliance: perennial frauds or even a handful of major frauds might cause serious legal issues for associate insurers with the regulators. Loss of faith: due to dishonorable claims people's trust in insurance declines, which prejudices the growth of the insurance trade.

2.2. The Extent and Consequences of Insurance Fraud

Dehghanpour & Rezvani (2015) Despite being perceived as an immoral or illegal act by the majority of people, insurance fraud is a global problem (Brinkmann, 2006). However, measuring fraud is a difficult and error-prone process because it is difficult to know how much remains undetected (Tennyson, 2002). The problem is especially prevalent in car accident injury cases. According to a recent United Kingdom (UK) study, 40% of 100 cases reviewed by forensic psychiatrists raised suspicions of fraud due to exaggeration of injuries sustained (Cartwright & Roach, 2016). Because assessing a case is subjective, measuring insurance fraud has proven difficult Derrig et al., (2014) showed this by asking four independent individuals to analyze claim files and determine if they contained any dubious information. There was not a single example on which all reviewers concurred, even though they all classified about 10% of cases as suspicious.

According to Tennyson's Tennyson (2002) argument, fraud compels insurers to enter into contracts with their clients that are more onerous, which in turn reduces the amount of coverage supplied and transfers the risk back to the insured. Other policyholders will be forced to pay higher rates as a result of insurance fraud, which could in certain circumstances drive people out of the market (Goel, 2014). The impact of insurance fraud on society as a whole is very significant, and it frequently serves as a means of funding further criminal activity (Tonenciuc, 2015). Due to the prevalence of insurance fraud, insurers must invest in the necessary tools to spot situations that are suspicious and require further fraud investigation. This fraud probe will cost money, which could hurt the insurer's bottom line or increase costs for other policyholders (Diamantopoulos et al., 2021). All types of personal insurance products are prone to insurance fraud, so insurers must make considerable staffing investments to look into the claims (Lesch & Byars, 2008). Customers will invariably pay more for insurance as a result of these expenditures.

2.3. Insurance Experience and Customer Fraud

The customer's expertise may well be designed on matching the customer's expectations. Meeting or prodigious the client's expectations for the experiences could yield loyalty, whereas a negative match could yield complaints and infidelity (Boulding et al., 1993). Within the business ethics studies, researchers

agree that individual expertise impacts moral decisions, whereas the analysis findings on the individual experts have been quite varied. Loe et al., (2000) have projected a review of individual experiences that affect moral judgments and selections. Within the analysis, psychological features ethical development, philosophy, education, and work experiences area unit the attributes that contribute to individual perceptions of moral issues. Personal experiences of associate degree moral quandary were tested in keeping with a (Jones & Kavanagh, 1996) study. Within the analysis, they argued that moral deciding varies in terms of how a private defines associate degree moral issues because of the ethical imperative during a scenario. He additionally posits that the quality of labor experiences is going to be considerably joined to a decision-maker's moral intention. The newer empirical studies have additionally found that nonpublic expertise could influence moral decisions. For instance, (Corley et al., 2016) found that old nurses could understand lower ethical distress than less old nurses, and this could be explained partly by the educational method and private experiences. (Sims & Felton, 2006) additionally argued that learning and private expertise could also be vital factors in informing.

2.4. Perception of Insurance Fraud

While the term "fraud" is frequently associated with an illegal activity that can result in prosecution, insurance fraud activities such as providing incorrect information to obtain cheaper insurance or exaggerating a claim or profit are not viewed in the same light (Derrig, 2002) This is perhaps best demonstrated by (Brinkmann, 2006) discovered that exaggerating an insurance claim was deemed less serious than stealing a can of cola from a supermarket. Insurance fraud is widely accepted by 'ordinary' people (Button et al., 2013). Even if an individual believes an activity is immoral or unethical, they may rationalize it if they believe the action is justified due to their perception of the particular situation (Murphy & Dacin, 2011). Recent insurance fraud literature has examined the perception of fairness and how it relates to the transaction of purchasing motor insurance (Tennyson, 1997). According to research, consumers may try to justify insurance fraud based on the amount of excess (also known as a deductible) they must pay on a claim before the insurer will pay out (Miyazaki, 2008). This is linked to (Adams, 1963) which considers whether the premium paid for insurance is a fair price for the coverage provided. Insurance claim fraud is not universally considered unethical (Tennyson, 2002). Indeed, according to research conducted by (Button et al., 2013)in the United Kingdom, 29% of those polled believed it was acceptable to fabricate an insurance claim and 40% believed it was acceptable to exaggerate an insurance claim. (Gino et al., 2009) discovered evidence that the decision to commit unethical actions is more influenced by social norms than by a cost-benefit analysis of the activity. According to their findings, individuals who witness their peers engaging in dishonest behavior are more likely to engage in dishonest behavior themselves. Previous research has shown that female respondents have a significantly lower tolerance for unethical behavior such as claim exaggeration than male respondents (Dean, 2004). Tolerance for insurance fraud has also been found to be lower in the elderly (Tennyson, 1997), but O'Fallon & Butterfield (2011)

argue that ethical decisions are not strongly correlated with age. Not all types of insurance fraud are treated the same way. According to Gino et al. (2009), people believe exaggerating symptoms of an actual injury to get a higher claim payment is more acceptable than claiming for a fictitious injury.

According to (Tennyson, 2002), exaggerating a claim to cover the policy excess is perceived as far more acceptable behavior than falsifying receipts to increase the claim amount. Dionne & Gagne (2001) showed that insurance fraud is more likely if an individual believes the insurance policy terms are unfair, and it is even more likely if the individual believes the chances of being caught are low. A survey of 2,000 people in the United States found that 19% thought it was acceptable to exaggerate a claim to cover previous years' insurance costs (Dean, 2004). Individuals with multiple insurance policies, such as auto, home, and life, as well as those who have recently filed a claim, are less tolerant of insurance fraud (Tennyson, 1997). Cummins & Tennyson (1992) found a strong correlation between tolerance for insurance fraud and the frequency of motor vehicle injury claims According to Viaene & Dedene (2004), historically, insurers often overlooked insurance fraud because they could simply pass on the cost of to their customers, which could have created a social acceptance of fraud.

2.5. Attitude towards Insurance Fraud

The ethical attitude is concerned with how an action is defined as right or wrong. Jean Piaget proposed the first ethical attitude research (1896). Piaget discovered that children of a certain age may go through a similar process of developing ethical attitudes. For example, some children of a certain age believe that rules are fixed and absolute (Killen, 2016). Aside from Piaget's research, sociologists Mead and Morris (1934) shared their perspectives on ethical behavior. According to Mead and Morris, the development of an ethical attitude is a process that an individual learns through social interactions. In business studies, Dubinsky & Loken (1989) hypothesized that the concern for outcomes would shape the attitude toward the ethical issue at hand. The issue at hand previous research has also found that customer attitudes toward insurance fraud are positively related to the customer's intent to commit the fraud (Brinkmann, 2006). Dean (2004) and Miyazaki (2008) discovered similar results in their studies. In conclusion, we believe that loss-premium comparisons may influence customers' attitudes toward insurance fraud.

2.6. Motivation for Committing Insurance Fraud

Previous research has shown that corporations with a good image are more likely to attract and retain a lot of customers, and they face higher acceptance of newly launched merchandise (Roberts & Dowling, 2002). However, it has also been discovered that companies with a bad reputation can increase (or decrease) the issues of client fraud (Gregg & Scott, 2014) within the insurance industry, The name of an insurance underwriter reflects the customers' perceptions of the insurer, built up over time and supported by how the purchasers perceived the insurer's performance and behavior (Brinkmann, 2005). According to Bing Crosby and Stephens (1987), an insurer's image is formed by market information (e.g., has the insurance underwriter refused or delayed paying claims) as well as

the insurer's previous actions. As previously stated, research on customers' acceptance of fraud has steadily increased. However, there is still a scarcity of dialogue about the relationship between the explanations customers accept for fraud and the severity of the fraud. We argue that the reasons for 1041 Customers' attitudes toward insurance fraud clients to simply accept fraud are associated with customer thoughts and feelings about the insurer's behaviors, which can result in dishonest behavior.

The most obvious motivation for committing insurance fraud is financial gain, which can be obtained by paying less premium or increasing the amount paid by an insurer for a claim. The fact that people are aware that insurance fraud is a crime or that it is simply unethical and/or immoral is a significant deterrent (Ishida et al., 2016). However, system flaws, such as minimal punishment for those caught committing insurance fraud, give those who want to commit fraud an advantage (Cartwright, 2016). The information asymmetry that exists between the claimant and the insurer is one reason frequently attributed to the level of insurance claim fraud perpetrated by (Belhadji et al., 2000; Cummins & Tennyson, 1992). Several studies have examined the relationship between an individual's opinion of their insurance provider and their acceptance of insurance fraud as acceptable behavior (Dean, 2004). In general, if an individual views the insurance company negatively, they are more tolerant of insurance fraud. Negative perceptions of insurance companies may be due to an individual's claim experience or, as Brinkmann (2005) discovered if the individual believed the insurer was charging too much for providing coverage. These findings are also supported by Schweitzer and Gibson (2008), who discovered that when people believe a situation is unfair, they are more likely to justify unethical behavior.

2.7. Monitoring and mitigating insurance fraud

Initially, the claim handler for the insurance company will attempt to gather relevant information from the claimant to narrow the information asymmetry that exists regarding the incident (Derrig, 2002). Meritorious claims can be resolved quickly, whereas suspicious claims are typically referred to a dedicated team for further investigation (Tennyson, 2002). Despite the presence of these restrictions, it might be challenging to spot suspicious activity because the procedure of filing a genuine claim is the same as making a fraudulent claim (Weisberg et al., 1998). A significant percentage of insurance fraud goes undetected, and even when it is suspected, it can be challenging to prove and bring the offender to justice (Dehghanpour & Rezvani, 2015).

A delay in claiming a complaint seems to be another major red sign. According to research, a delay between the occurrence of the incident and its reporting to the insurance company is commonly an indication of some fraudulent conduct on the claim (Weisberg et al., 1998). A claim handler for an automobile accident is trained to detect abnormal conduct that confuses. Viaene & Dedene (2004) identified that elements such as the number of vehicles involved in an accident and declaration behavior are beneficial in detecting fraudulent motor claims (Tonenciuc, 2015).

According to Okura (2013), having fraud detection systems has an indirect effect in that people will try to lower their risk of getting into an accident if they are aware that their insurance provider is increasing its expenditure on these fraud instruments.

The amount of insurance fraud discovered has risen dramatically, even though it is difficult to determine how much of this is linked to an increase in the same kind of behavior or improvement in the fraud detection tools and procedures cl aims handlers employ to detect suspected claims (Dehghanpour & Rezvani, 2015).

Whereas insurance fraud is a widespread problem (Brinkmann, 2006), extant literature shows that perceptions of insurance fraud vary by country. According to Tennyson (2002), 7.87 % believed insurance fraud was acceptable. In contrast, Button et al., (2013) indicated that 40% of those surveyed believed inflating an insurance claim was acceptable and that 29% of those surveyed believed falsifying an insurance claim was acceptable.

The literature review of this study reveals a gap in the base of information about attitudes toward insurance fraud in Sri Lanka, which this study will intend to fill.

3. METHODOLOGY

The study used primary data to assess the association between the cost of motor insurance to the policyholder and attitude towards fraud. Qualitative research techniques were used to collect data. An online questionnaire was designed using Google Forms and distributed along with a cover note. The questionnaire contained several sections from demographic information to information and perceptions related to motor insurance policies. The non-probability convenience sampling strategy was used to gather data, which is advised when time and money are limited (Saunders et al., 2008). The population of the study was all the motor insurance policyholders in Sri Lanka whereas the sample size was limited to 391 online survey respondents.(Krejcie et al.,1996) Morgan Table was used to determine the sample size.

The attitude to commit insurance fraud is the dependent variable and it was measured using several questions about the perceptions of customers towards committing insurance-related fraud. One Independent variable of the study is the cost of motor insurance to the policyholder as measured by the value of the policy based on the vehicle to be insured. The other independent variable; Perceived fairness was measured using six questions which later were converted to a single variable using factor loading. The third independent variable was the number of years of driving experience.

Figure 01 shows the conceptual framework used by the researcher to analyze the relationship between growing motor insurance premiums and policyholders` attitudes toward insurance fraud.

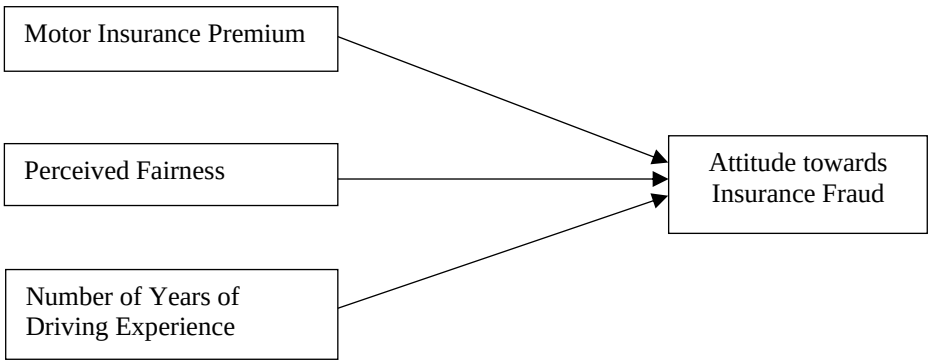

Figure 4. Conceptual Framework

Hypotheses

To test the research questions, the following hypotheses have been developed.

H1: There is an impact of the cost of motor insurance policy on customers' attitude to commit fraud.
H2: There is an impact of perceived fairness on customers' attitudes to commit fraud.
H3: There is an impact of the number of years of driving experience on customer attitude to commit fraud.

Research Model

The attitude toward insurance fraud is determined by the cost of the motor insurance policy, the perceived fairness of the policyholder, and the number of years of driving experience of the policyholder. Accordingly, the model can be written as follows.

$$FA_i = \beta_0 + \beta_1 CP + \beta_2 PF + \beta_3 DE + \varepsilon$$

Where;

FA = Customer Attitude to Commit a Fraud

CP = Cost of Motor Insurance Premium

PF = Perceived Fairness

DE = Number of years of Driving Experience

E = Error Term

4. RESULTS AND DISCUSSION

The researcher used Regression Analysis, ANOVA, validity, and reliability tests. To measure the reliability of the variables of this study, the researcher used "Cronbach's Alpha" separately for the independent variable of perceived fairness as well as for the dependent variable of Customer attitude towards insurance fraud. Cronbach's Alpha value for perceived fairness and Customer

attitude towards insurance fraud are 0.768 and 0.875, respectively. This indicates that the responses of the survey respondents are reliable as per the statistic.

Further to the inter-rater reliability, correlation analysis was also conducted to measure the direction and the degree of the association between considered independent and dependent variables. As per the correlation analysis, Perceived Fairness has a negative correlation with the dependent variable whereas the cost of the motor insurance premium and the number of years of driving experience have a positive correlation with the attitude toward insurance fraud. The study by Walker & Baker (2000) supports this conclusion.

Table 01 presents the descriptive statistics for all variables adopted in estimating the impact between growing motor insurance premiums and attitudes towards insurance fraud.

Table 8. Descriptive statistics of the variable

	CP	PF	DE	FA
Median	3.0000	3.2000	3.2000	3.0000
Range	2.60	2.20	2.80	3.17
Variance	.354	.262	.375	.450
Mean	3.0719	3.1948	3.2328	3.0838
Std. Deviation	.59488	.51177	.61255	.67079
N	391	391	391	391

Source: Survey Data (2022)

The independent variables of cost of motor insurance premium perceived fairness, and the number of years of driving experience were found to be statistically significant in explaining the attitude towards insurance fraud. The Number of years of driving experience is the most significant variable in the estimated model. The Durbin-Watson statistic is 2.100, which is approximately equal to the + 02 thereby implying that there is no autocorrelation between variables. Moreover, the tolerance of each variable is greater than 0.10 and VIF less than 10. These results indicate that there is no multicollinearity of independent variables. P_ value is less than 0.05 (05%) and hence it is evident that the overall goodness of the formula exists. The model can explain 75.2% (R squared) of variation out of the total variation of the model. Further, when adjusted for the number of variables, the model can explain 75.2% of the total variation.

As per the results of the regression analysis in Table 2, the following model can be developed.

$$FA = 0.268 + 0.419\,CP - 0.254\,PF + 0.943\,DE + \varepsilon$$

Table 2. Regression Analysis

Variable	Coefficient	Std. Error	t	Sig.	Hypothesis	Decision
(Constant)	.268	.110	2.448	.015		
Motor insurance premium	.419	.080	5.218	.000	H1	Accepted
Perceived Fairness	-.254	.064	-3.963	.000	H2	Accepted

Number of years driving experience	.943	.065	14.446	.000	H3	Accepted

The results of this model are similar to the findings of Jones & Kavanagh (1996), in which it can be concluded that the higher the cost of the policy holder greater the inclination towards committing fraud. Further, when the number of years of driving experience increases, policyholders are more prone to commit insurance fraud. However, when the perceived fairness of the policyholder is higher, it will reduce the probability of committing insurance fraud.

5. CONCLUSION

The purpose of this study was to identify whether the rising cost of motor insurance policies exerts an impact on committing motor insurance fraud. In addition to the major independent variable, the researcher identified two other controlling variables: perceived fairness and the number of years of driving experience. The results established that there is a significant positive relationship between the cost of motor insurance premiums and customer attitude. Further, it had been identified that the higher the perceived fairness, the lower the tendency to commit fraud. Moreover, the study could identify a positive relationship between the number of years of driving experience and attitude towards fraud.

Traditional predictors of the customer attitude such as growing motor insurance premiums still have a powerful impact on the customer attitude. The attitudes of the policyholders could be a significant issue that not solely forces the behavior to not stay fraudulent with the organization but, to the extent to which a policyholder is loyal to a particular insurer. Hence, the insurance industry must consider these factors in its pricing and marketing decision-making. Future research could be carried out to excavate the other factors that have an impact on the fraudulent behavior of policyholders.

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