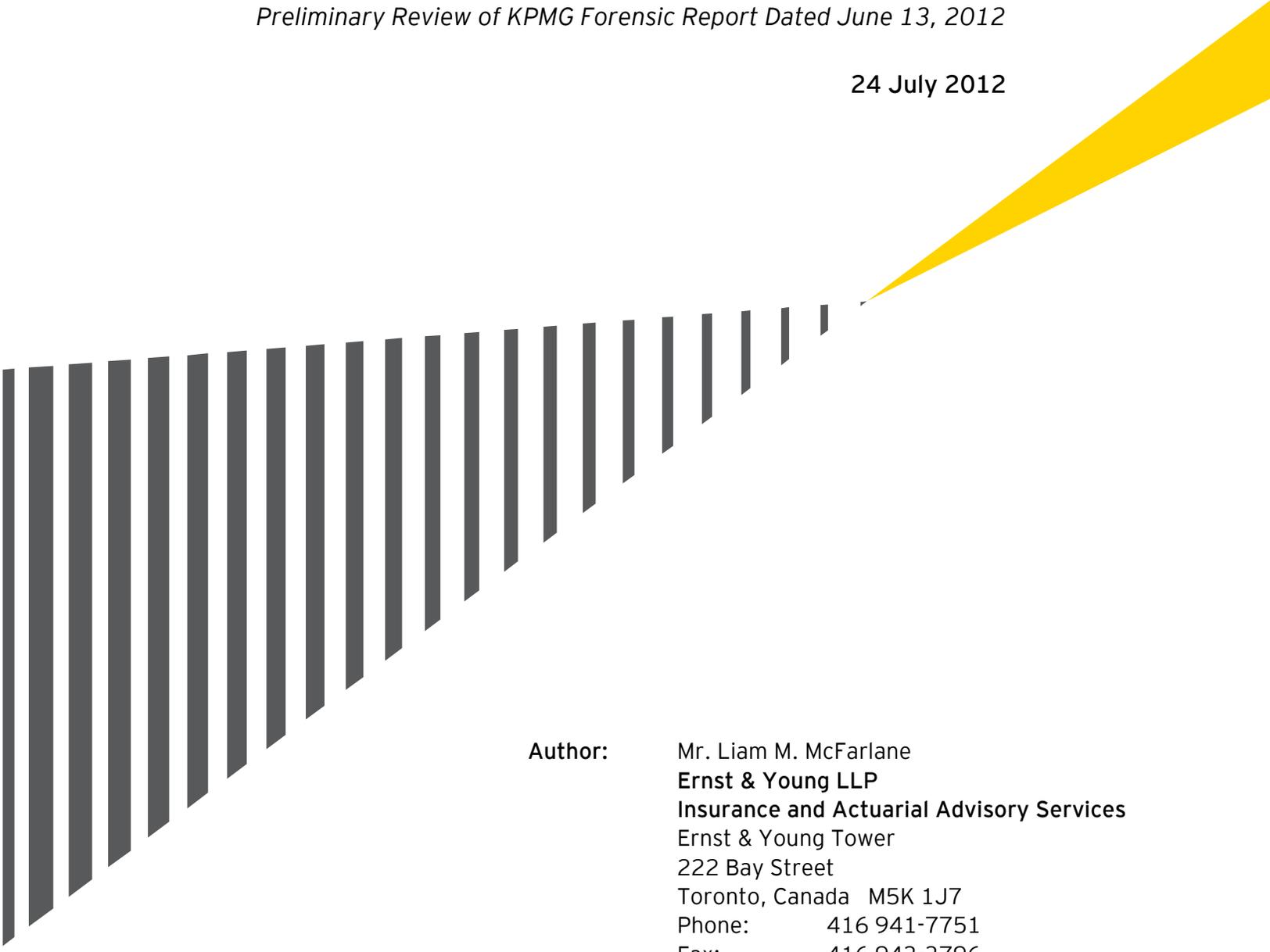


Ontario Automobile Insurance Anti-Fraud Task Force

Preliminary Review of KPMG Forensic Report Dated June 13, 2012

24 July 2012



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24 July 2012

**Preliminary Review of KPMG Forensic Report
Dated June 13, 2012**

Dear Alvaro,

Enclosed is our Preliminary Report on our Review of the KPMG Forensic Report Dated June 13, 2012 relating to automobile insurance fraud in Ontario.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Liam McFarlane'.

Liam McFarlane, FCIA, FCAS
Consulting Actuary

1. Executive Summary

KPMG estimates automobile insurance fraud in Ontario to be between \$769 million to \$1,560 million.

We believe that the application of the estimated percentage of Opportunistic Fraud selected by KPMG should be restricted to injury claims only as opposed to all claims since the studies relied upon involved injury claims only. In addition, KPMG has not considered Premeditated Fraud in their estimate of automobile insurance fraud.

We concur with KPMG in their assertion that the impact of Organized Fraud is likely understated due to the limitations inherent in the Proof of Concepts reviewed in their study.

If revisions were made to KPMG's estimates to reflect (i) Premeditated Fraud (ii) the correct treatment of non-injury claims and (iii) a more fulsome estimate of Organized Fraud, then we believe that KPMG's estimate of automobile insurance fraud is not unreasonable.

2. Introduction

Ernst & Young (“EY”) was retained by the Ontario Ministry of Finance (“MoF”) to provide consulting services to the Automobile Insurance Anti-Fraud Task Force (“the Task Force”) in their mandate to determine the nature and scope of automobile insurance fraud in Ontario. Specifically EY was asked by the MoF to:

- Complete a comprehensive review of the report on automobile insurance fraud in Ontario prepared by KPMG (“the KPMG Report”) for the Insurance Bureau of Canada (“IBC”)
- Complete a comprehensive review of three (3) other reports on automobile insurance fraud as directed by the Task Force

In the interest of time, it was agreed with the Task Force that EY would produce two reports (i) a Preliminary Report which focuses on the estimate of automobile insurance fraud in Ontario contained in the KPMG Report, and (ii) a Final Report which, in addition to the content included in the Preliminary Report, would provide additional commentary relating to the comprehensiveness of the methodology used, the objectivity of the conclusions reached and gaps in KPMG’s approach. The Final Report would also include a review of the other reports as directed by the Task Force.

This document is our Preliminary Report as described above.

2.1 Use and Distribution

This report and the opinions and conclusions contained herein were prepared for the use of the Task Force and were based on information supplied by the Task Force. It is not intended or necessarily suitable for any other purpose.

No further distribution of this report may be made without the prior permission of both Ernst & Young LLP and the Task Force. The Task Force and Ernst & Young LLP should be notified immediately following any requests for disclosure of any part of this report. Should the report be disclosed, it must be provided in its entirety.

2.2 Restrictions

The information and findings included in this report are based on information that was provided to us to the date of this report. We reserve the right to review our comments and modify this report should additional information become available to us subsequent to the date of this report.

We understand that the Task Force may publicly communicate the findings of this report. EY

will not assume any responsibility or liability for any costs, damages, losses, liabilities or expenses incurred by anyone as a result of circulation, publication, reproduction, use of or reliance on this report. Comments in our report are not intended, nor should they be interpreted to be, legal advice or opinion as we are not qualified to provide such advice or opinion.

3. Fraud Definition

Insurance fraud can take many forms and consequently, in defining insurance fraud, the Task Force uses three categories:

1. Organized Fraud which involves multiple participants
2. Premeditated Fraud where one individual defrauds the system
3. Opportunistic Fraud where an individual inflates an otherwise legitimate claim

4. KPMG Quantification

The following chart summarizes the annual estimate of automobile insurance fraud in Ontario produced by KPMG¹.

Type of Fraud	(\$millions)	
	Low Estimate	High Estimate
Opportunistic Fraud	\$ 594	\$ 1,285
Organized Fraud	\$ 175	\$ 275
Total Fraud	\$ 769	\$ 1,560
%age of Total Claims Cost	9%	18%

As illustrated in the foregoing table, KPMG has not considered Premeditated Fraud in arriving at their estimate of automobile insurance fraud in Ontario. In what follows, we will discuss the estimate of automobile insurance fraud produced by KPMG.

4.1 Opportunistic Fraud

KPMG considers it Opportunistic Fraud when an individual “pads” an otherwise legitimate claim. This is consistent with the definition used by the Task Force.

KPMG selects percentages of opportunistic fraud for both the low and high end of the range from two closed claims studies. The low end of the range is selected from a 2007 closed claim study prepared by the Insurance Research Council (“IRC”) relating to Automobile Injury Insurance Fraud in the United States and the high end of the range is selected from a 2001 closed claim study completed by the Canadian Coalition Against Insurance Fraud (“CCAIF”).

¹ KPMG Forensic Report Dated June 13, 2012, Page 58

3.1.1 2007 IRC Report

The 2007 IRC Report relates to automobile *injury* insurance fraud. The focus of the study was the coverages of Bodily Injury, Personal Injury Protection, Medical Payment, Uninsured and Underinsured Motorist. Fraud in automobile physical damage coverages such as Collision and Comprehensive insurance is not considered in this study.

The 2007 IRC Report is a comprehensive study that included a significant number of closed claims. The IRC regularly completes studies of this nature and hence we have no reason to question the results contained in this report.

The study distinguishes between “fraud” and “buildup” where fraud is defined as deliberate misrepresentation of a material aspect of a claim and buildup is the inflation of some aspect of an otherwise legitimate claim. KPMG considers buildup claims to be what the Task Force has considered to be Opportunistic Fraud which we think is a reasonable assumption.

Given the nature of the insurance injury coverages provided in Ontario we believe it is reasonable to assume that the low value of buildup claims calculated (6.8% of claims paid) could apply to insurance injury coverages in the Ontario environment.

In KPMG’s calculation of the low estimate of Opportunistic Fraud they applied the 6.8% to the estimate of ultimate claims for all coverages (injury and non-injury) for Ontario Private Passenger (Excluding Farmers) Accident Year 2010 (\$8,739,000,000) as estimated by the General Insurance Statistical Agency (“GISA”). This assumes that the level of Opportunistic Fraud in the non-injury coverages is the same as the injury coverages. We are not convinced that this is an appropriate assumption. Of the \$8.8 billion of Ontario automobile claims referred to by KPMG, approximately \$6.6 billion relates to injury claims and \$2.2 billion to non-injury claims. If the low factor was applied to injury claims only, the estimated amount of insurance injury fraud would be \$449 million which is \$145 million lower than the \$594 million estimated by KPMG.

3.1.2 2001 CCAIF Report

The 2001 CCAIF Report relates to automobile *injury* insurance fraud. The focus of the study was the coverages of Bodily Injury and Accident Benefits. Fraud in automobile physical damage coverages such as Collision and Comprehensive insurance is not considered in this study.

The 2001 CCAIF Report is a comprehensive study that included a reasonably significant number of closed claims. The authors of the CCAIF study appear to be credentialed to conduct studies of this nature and hence we have no reason to question the results contained in this report. The study was a national study, however due to the size of the automobile insurance

market in Ontario a separate appendix was created which deals with this province specifically.

This study was designed to measure the incidence of Premeditated and Opportunistic fraud. Premeditated fraud was defined as “any action or commission resulting in illicit collection of property and casualty insurance benefits” and opportunistic fraud was defined as “the inflation of otherwise legitimate expenses that result from a real injury.” This definition of Opportunistic Fraud is consistent with that as defined by the Task Force.

Since this study included an Ontario specific element we believe it is reasonable to assume that the high value of Opportunistic Fraud claims calculated (14.7% of claims paid) would apply to insurance injury coverages in the current Ontario environment.

In KPMG’s calculation of the high estimate of Opportunistic Fraud they applied the 14.7% to the estimate of ultimate claims for all coverages for Ontario Private Passenger (Excluding Farmers) Accident Year 2010 (\$8,739,000,000) as estimated by GISA. This assumes that the level of opportunistic fraud in the non-injury coverages is the same as the injury coverages. We are not convinced that this is an appropriate assumption. Again, if the high factor was applied to injury claims only the estimated amount of insurance injury fraud would be \$970 million which is \$314 million lower than the \$1,285 million estimated by KPMG.

4.2 Organized Fraud

KPMG considers Organized Fraud to be when a group of individuals act in concert to take advantage of the insurance system. On the other hand, Premeditated Fraud involves the purposeful claiming of insurance claim benefits by an individual (rather than a group). These definitions are consistent with those of the Task Force.

As part of their review KPMG considered three “Proof of Concepts” (“POCs”) which used data analytic tools for the identification of claims that have indicators of fraudulent activity. The POCs were not undertaken for the purpose of quantifying the extent of fraud in the Ontario automobile insurance market, however extrapolations of potential fraud by two of the POCs was used by KPMG in their report. The POCs were used to provide estimates of Organized Fraud and not Premeditated Fraud, however some elements of Premeditated Fraud may be included in the estimates derived from the POCs.

The low estimate of the annual impact of automobile insurance fraud in Ontario was selected from the POC labelled by KPMG as POC-2 for confidentiality reasons and the high estimate was selected from that labelled POC-1.

4.2.1 POC-1

The data used in POC-1 consisted of approximately 233,000 Ontario automobile claims (injury and non-injury) with a value of \$6.8 billion from the six year period of 2005 to 2010.

This data was processed using analytics software which identified approximately 56,000 claims with \$1.6 billion of payments that contained some indicators of potential fraud. These claims were then further filtered to identify some 222 “clusters” of connected groups with a total of 2,600 claims which received \$54 million in payments. According to those involved with POC-1 a review of these claims indicated that previously identified organized insurance fraud groups were flagged.

The extrapolation completed by those involved with POC-1 provided an estimated range of annual Ontario automobile insurance fraud of \$200 million to \$275 million. These estimates would be consistent with an extrapolation of the Ontario figures above to total Ontario industry statistics as published by GISA.

4.2.2 POC-2

The data used in POC-2 consisted of approximately 1.2 million claims (injury and non-injury) with a value of \$4.5 billion from the period of May 2008 to May 2011. The Ontario data set consisted of approximately 0.8 million claims with a value of \$3.3 billion. The data analytic process used a scoring approach and applying this to the Ontario data produced 6,298 claims with a value of \$89 million that were considered as suspicious.

The extrapolation completed by those involved with POC-2 provided an estimated range of annual Ontario automobile insurance fraud of \$175 million to \$203 million. These estimates would be consistent with an extrapolation of the Ontario figures above to total Ontario industry statistics as published by GISA.

The POCs focused on Organized Fraud where more than one entity was involved in a claim. As a result the extrapolations made by the POCs do not include Opportunistic Fraud and may have limited elements of Premeditated Fraud. There are a number of reasons enumerated by KPMG as to why they believe the POCs may produce an estimate of Organized Fraud that is understated including

- Only a sampling of industry data was used and hence if all industry information was included it is likely that more “relationships” would have been identified increasing the number of potential Organized Fraud claims;
- Only a limited period of data was included. Again, a longer experience period would likely increase the number of “relationships” detected.

We agree with KPMG that it is likely that their estimate of Organized Fraud is understated by the data analytics software.

4.3 Premeditated Fraud

KPMG has not included Premeditated Fraud in their estimate of total fraud in Ontario. We note that the 2001 CCAIF Report, which was used to select the high estimate of Opportunistic Fraud, also addressed Premeditated Fraud with respect to injury claims. The 2001 CCAIF Report classified claims as:

- (i) Staged Accident
- (ii) Caused Accident
- (iii) Fictitious Injury
- (iv) Other Premeditated Fraud
- (v) Opportunistic Fraud Only
- (vi) Fully Legitimate

KPMG used item (v) in their estimate of Opportunistic Fraud and used the POC's for estimating Organized Fraud. If we assume that Organized Fraud equates to items (i), (ii) and (iii) above then we believe that item (iv) provides a possible estimate of Premeditated Fraud for injury claims. This would imply a range of between 2% to 4% of injury claims or between \$130 million to \$260 million of Premeditated Fraud related to Ontario automobile injury claims.

4.4 Summary Comments Relating to KPMG Quantification

We conclude the following relating to the quantification completed by KPMG.

1. We believe the percentage values of Opportunistic Fraud selected by KPMG are reasonable, however we believe that these percentages should be applied to injury claims only since the studies from which the values were extracted related to injury claims only;
2. We believe that the omission of Premeditated Fraud has the potential to materially underestimate total automobile insurance fraud in Ontario;
3. We agree with KPMG that the level of Organized Fraud in Ontario is likely greater than that estimated by the POC's referred to in KPMG's report;
4. If revisions were made to KPMG's estimates to reflect (i) Premeditated Fraud (ii) the correct treatment of non-injury claims and (iii) a more fulsome estimate of Organized Fraud, then we believe that KPMG's estimate of automobile insurance fraud is not unreasonable.