

## **Audit, Governance and Standards Committee**

2 May 2019

### **LONDON COUNTER FRAUD HUB**

Report by the Head of the South West London Fraud Partnership

#### **Purpose**

The report outlines the fraud prevention and detection opportunities that fraud hub membership brings, and an indication of the additional resources needed to realise the benefits from being a member. The London Counter Fraud Hub (LCFH) seeks to enhance fraud prevention and detection through the application of smart data analytics and improved collaborative working.

#### **Recommendation**

The Committee is recommended to note this report which outlines the proposals for utilizing smart data analytics as a fraud prevention measure under the remit of the London Counter Fraud Hub

### **SUMMARY**

1. London Councils have a good record in investigating fraud and with collaborating with others to enhance fraud prevention and detection but there is always the need to respond to technological developments. Innovation is important to fighting fraud, especially at a time of finite resources, and the use of smart analytics can improve the Council's ability to tackle fraudsters thus prevent resources being taken away from delivering services to those who need them.
2. The principles for maximising collaborative and smarter working through data sharing are behind the creation of the LCFH. This hub is intended to provide a powerful fraud detection solution, combining advanced data matching with intelligent analytics and local government counter fraud expertise.
3. The hub has passed the initial proof of concept stage, with the involvement of four pilot authorities, and is being prepared for roll out to all London Councils. Unlike the National Fraud Initiative (NFI) it does not have a statutory basis that requires all authorities to provide their data, so decision on whether to become a member of the hub is required from each Council.

4. This report outlines the fraud prevention and detection opportunities that fraud hub membership brings, and an indication of the additional resources needed to realise the benefits from being a member.

## BACKGROUND

5. The Local Government Fighting Fraud and Corruption Locally strategy (2016-2019) is based upon three core values, Acknowledge, Prevent, and Pursue, where:
  - **Acknowledge:** acknowledging and understanding fraud risks and committing support and resource to tackling fraud in order to maintain a robust anti-fraud response.
  - **Prevent:** preventing and detecting more fraud by making better use of information and technology, enhancing fraud controls and processes and developing a more effective anti-fraud culture.
  - **Pursue:** punishing fraudsters and recovering losses by prioritising the use of civil sanctions, developing capability and capacity to investigate fraudsters and developing a more collaborative and supportive law enforcement response.
6. Local authorities continue to face a significant fraud challenge and at a time when resources are becoming ever more scarce, all of us involved in delivering local public services are looking at ways of maximising the return on the time and resource invested. Acknowledging the risk of fraud and committing resources to tackle it through taking steps to prevent fraud and pursuing offenders is part of the answer. In 2014 the Audit Commission estimated that fraud costs local authorities over £2.1bn a year, broken down into the following areas (these figures do not take into account the indirect costs of responding to and dealing with fraud and exclude some potentially significant areas of fraud loss):

Housing Tenancy Fraud	£845m
Procurement Fraud	£876m
Payroll Fraud	£154m
Council Tax Fraud	£133m
Blue Badge Scheme Misuse	£46m
Grant Fraud	£35m
Pension Fraud	£7m

7. Every £1 that a local authority loses to fraud is £1 that it cannot spend on supporting the community. Fraudsters are constantly revising and sharpening their techniques and local authorities need to do the same. There is a need to maintain a tough stance against fraud. This includes tackling cross boundary and organised fraud and corruption attempts, as well as addressing new risks and utilising technology to detect and prevent fraud.

**Data sharing to detect and prevent fraud:**

8. For many years local authorities have funded and participated in the National Fraud Initiative (NFI); a periodic data matching exercise that identifies potential fraud cases for local authorities to investigate. Whilst successful NFI only occurs every two years, leaving local authorities pursuing further opportunities to use their data to prevent and detect fraud, to take advantage of changes in technology and to take advantage of an appetite of other organisations willing to collaborate.
9. London Councils have a good record in investigating fraud and in collaboration to counter and prevent fraud but now need to respond to technological developments as innovation is as important in fighting fraud as any area of council activity to keep ahead of fraudsters and prevent resources being taken away from delivering services to those who need them.

**Using data analytics to detect and prevent fraud:**

10. These include advanced data analytics, having an availability to include third party data whilst addressing new fraud risks associated with the channel shift within local authorities towards increased online customer contact. Funding for the procurement of a London Counter Fraud Hub (LCFH) came from a grant awarded to the London Borough of Ealing (the lead authority) by the (then) Department for Communities and Local Government (£430,400). In 2015 Kingston signed a Memorandum of Understanding, signed by all London local authorities, making a non-binding commitment to the project.
11. Following a detailed specification and competitive procurement exercise, LB Ealing let a nine-year contract (December 2016) to CIPFA to operate the hub. This hub is intended to provide a powerful fraud detection and prevention solution, combining advanced data matching with intelligent analytics and local government counter fraud expertise. The enhanced data analytics have been designed to reduce the number of false positives associated with traditional data matching exercises resulting in more focused cases of high risk fraud being highlighted for investigation.
12. The core service consists of a data integration and analytics solutions which facilitate data sharing and risk analysis, combining multiple data sources to create richer data sets for detecting multiple fraud types whilst building a picture of potential fraud, the entities involved and a network of their relationships. The intended solution will provide a comprehensive holistic view of identified risks to assist investigators with rapid referral triage and decision making. It has the potential to include automated detection and alert generation that can be embedded into Council business processes to enable maximum exploitation of the capability for fraud detection and prevention.

13. Initially the hub will tackle three fraud types, single person discount (SPD), tenancy fraud, and business rate but it is intended that this will be expanded during the life of the contract to address all significant fraud risk to Councils. As with all new initiatives this is likely to generate a significant volume of smart referral in the first instance which will reduce to a more manageable level over time. New fraud match types will be rolled out to ensure the hub remains an effective fraud detection and prevention tool.
14. The hub passed the initial proof of concept stage, having successfully concluded with all minimum contract standards achieved with the four initial pilot authorities (Camden, Croydon, Ealing and Islington) and is ready to be rolled out across all London Councils, a copy of the pilot evaluation report has been circulated to all London Councils Finance Directors. Testing carried out by the 4 pilot authorities suggest that if all 33 boroughs were to sign up, in the first year of operation London would save a net £15m (worst case) to £30m (best case) and recover circa. 1,500 council homes that are currently illegally sub-let.
15. In order to move forward to the next stage, and as planned within the initial tender, the hub provider (CIPFA) now need to formally obtain commitments from Council that will join the service.

**Fraud risks addressed by the hub:**

16. The national strategy for councils on fighting fraud, 'Fighting Fraud and Corruption Locally' recommends the use of data analytics as a tool for detecting and preventing fraud. Councils are vulnerable to fraudsters claiming discounts on services and local taxation that they are not entitled to, and fraudsters are constantly revising and sharpening their techniques meaning local authorities need to do the same. Taking a tougher stance against fraudsters includes using technology to tackle cross boundary and organised fraud and corruption attempts, as well as addressing new risks. The hub has been developed to provide a response to the current and future threat of losses from fraud. The pilot focussed on three types of fraud perpetrated against councils: council tax single person discount fraud, business rates fraud, and council housing fraud.
17. The hub serves to increase the local tax base by removing fraudulently claimed discounts and reliefs (e.g. single person discount on council tax, small business rate relief), and, for business rates, additionally identifying property not yet in rating. Kingston Council already successfully delivers counter fraud work in relation to these areas, with details reported to this Committee. The hub has been designed to provide a further source of leads to follow up, leading in turn to the identification of more Fraud.

### **Invest to Save:**

18. As is common with most new initiatives there are some initial costs and resource implications to ensure that the Council can benefit from participation within the LCFH. The proposed model is based upon an invest to save scheme, with Council's able to offset the initial additional resource input against future cashable savings.
19. To benefit from joining, some additional review and investigation resources will be required to manage this initial surge in referral output, until the real time matching and volume of referrals falls to a manageable level. Where Councils' are unable to provide this additional resource, under the contract, CIPFA offer an investigation service based upon a fixed fee charge per fraud investigation.

### **LCFH Membership - cost and responsibilities:**

20. The investment in technology was financed with private sector risk capital, and almost certainly could never have been achieved if councils had been asked to provide the capital themselves. However, to make the arrangement commercially viable, 26 of the 33 local authorities in London need to join. It is anticipated that the hub will expand over time to include authorities bordering London, housing associations and other public sector bodies. The project has a profile with Cabinet Office and MHCLG and is an opportunity to demonstrate that London is delivering data sharing and collaboration.
21. To become a LCFH Member, each Council's is required to pay a one-off on-boarding fee of £75k, an annual subscription fee of £70k and are requested to sign a Deed of Adherence to the LB Ealing contract with CIPFA. There will be a reduction in the annual subscription fee, still to be confirmed, for Council's without a Housing Revenue Account (HRA).
22. The initial contract was let for nine-years so Councils will be signing up for the remainder of the contract, for seven-years commencing 1<sup>st</sup> April 2019. The intention is that membership of the LCFH and the investigation of the hub output will not cost Councils as membership and investigation resource inputs can be accrued and offset against future fraud savings once realised.
23. The contract contains an exclusivity clause that will prevent Councils from entering into new data-matching agreements but will not require them to terminate any pre-existing data matching contracts. This is to support a co-ordinated approach to using data matching technology and data analytics to identify and prevent other existing fraud risks and to tackle new emerging fraud risks. It would however restrict any small local third party or small business from providing new fraud risk data-matching initiatives.
24. Council's will be required to provide the requested data-sets on a regular basis. For the initial three fraud types, seven data-sets have been requested and once fully on-boarded it is intended that these will be provided monthly.

### Additional resource input and return on investment (ROI):

25. CIPFA and the London Borough of Ealing have developed value for money (VFM) forecasts, based around information that Councils provide through statistical returns and the expected outputs extrapolated from the four pilot Councils results obtained during the proof of concept stage. The forecast provides a ROI that is based around assumed savings as a percentage of the cost LCFH membership and additional investigated resource. The VFM forecast provide a best and worst case scenario, in terms of the expected hub referral outputs, see Table 1 below.

Table 1: Hub referral outputs, worst and best case scenario

	Council Tax (SPD)		Housing - Tenancy		Business Rates	
	Worst	Best	Worst	Best	Charities	SBR*
<b>KINGSTON</b>	193	787	18	30	0.8	20
Merton	230	939	0	0	1.3	21
Richmond	250	1,021	0	0	1.4	24
Sutton	276	1,125	23	38	0.7	21
Wandsworth	447	1,825	65	109	1.6	32
<b>TOTAL</b>	<b>1,396</b>	<b>5,697</b>	<b>106</b>	<b>177</b>	<b>5.8</b>	<b>118</b>

26. Table 2 below provides details on the return on investment for each Council within the Shared Fraud Partnership. Investigation costs assume that all SPD matches will go direct to and be dealt with by the Council Tax Revenue Teams and that the investigations for the Housing Tenancy and Business Rate referrals will be undertaken by the Shared Fraud Partnership. This allows for efficiency savings in the management and supervision of investigations.

Table 2: Year-1 ROI for smart referrals for the five Councils included within the South West London Fraud Partnership

	Worst Case				Best Case			
	Estimate savings £ (A)	Investigation & Hub Costs £ (B)	Residual Savings £ (C = A-B)	ROI % (C/B)	Estimate savings £ (D)	Investigation & Hub Costs £ (E)	Residual savings £ (F=D-E)	ROI % (F/E)
<b>Kingston</b>	<b>271,793</b>	<b>133,522</b>	<b>138,271</b>	<b>103.6%</b>	<b>600,596</b>	<b>149,854</b>	<b>450,742</b>	<b>300.8%</b>
Merton *	174,452	97,065	77,387	79.7%	426,208	97,065	329,143	339.1%
Richmond *	209,437	101,284	108,153	106.8%	525,149	101,284	423,865	418.5%
Sutton	264,137	141,552	122,585	86.6%	634,975	161,967	473,008	292.0%
Wandsworth	539,994	214,910	325,084	151.3%	990,296	274,794	715,502	260.4%
<b>TOTAL</b>	<b>1,459,813</b>	<b>688,333</b>	<b>771,480</b>	<b>112.1%</b>	<b>3,177,224</b>	<b>784,964</b>	<b>2,392,260</b>	<b>304.8%</b>

NB \* Estimate £14,000 annual subscription deduction for Councils without HRAs, exact reduction still to be confirmed.

27. Council Tax – SPD: The savings estimates take account of the impact of differing council tax charges by each authority and include an assumption that the bulk of the additional staffing resource will be met by existing council tax revenue teams with no call upon the Shared Fraud Partnership. However, like most new initiatives the savings achieved from the first-year matches are likely to be higher than those obtained in future years.
28. Housing and Business Rates (NNDR): To realise savings from the Housing and Business Rate matches some additional investigation resource will be required. It is envisaged that the additional investigation resource can be mostly delivered through the recruitment of Fraud Investigator Apprentices, on two-year fixed term contract, but these will need to be supported by experienced Fraud Investigation Officers drawn from the existing pool of investigators and partnership funding. Alternative referral investigation costs are available under the LCFH contract, by fraud type and per referral, and details of these costs are provided separately as background information . However, these costs are significantly higher when compared to utilising an enhanced in-house Shared Fraud Partnership resource.
29. Other costs: Other, as yet to be quantified, costs include: the monthly provision of the requested data-sets (these should be minimal once correct extract script are agreed); and the cost of collection as some cases might require legal action to secure sanction outcomes.

**Governance Arrangements:**

30. The London Borough of Ealing hosts the contract management team, which is funded through a contract mechanism that top-slices revenues from the contractor's charges. The competitive dialogue procurement procedure conducted by the London Borough of Ealing complied with the Public Contracts Regulations 2015 (as amended) (PCR 2015) and Ealing's Contract Procedure Rules were followed.
31. Regulation 38 of the PCR 2015 permits contracting authorities such as the London Borough of Ealing to jointly procure services and on behalf of other named contracting authorities. Kingston Council was one of those named parties. The contract was let as a single contract, as opposed to a framework agreement (which would have been limited in its length), and the council can join the Agreement with the provider through a Deed of Adherence.
32. The contract is for a period of 7 years effective with no options to extend. The hub has been set up and operated in a manner that is compliant with the General Data Protection Regulation 2018 and the Data Protection Act 2018. There is no allowance within the current subscription model for new fraud type development funding. Any development will be subject to further agreement with the contractor and may be subject to additional charges.

33. The hub will be operated by CIPFA, who won the contract successfully through competitive tender, under the direction of an:
- Oversight Board - made up of 4 Finance Directors from selected participating authorities;
  - Independence Panel - made up of 8 representatives from participating councils' fraud and investigation teams; and
  - Stakeholder Board - with 1 representative from all participating authorities.
34. The Oversight Board, which currently consists of Finance Directors from the four pilot authorities, has been established with the purpose of reporting on the effectiveness of the hub and providing a joined-up approach between the lead authority, London Borough of Ealing, and other local authority stakeholders, and the wider stakeholder pool affected by the implementation of the hub.
35. Joining the LCFH is through a Deed of Adherence, which is also signed by CIPFA and the lead Authority. Once the Deed of Adherence has been entered into the Council becomes a party to the Agreement.
36. Termination rights can be exercised if the level of performance of the contractor, during the contract period, is below service delivery expectation in respect of any Key Performance Indicators (KPIs). The KPIs are currently being refined, to be agreed by a special working group within the Society of London Treasurers (SLT), and in addition, a process for councils to receive subscription credits should the hub match outputs fail to meet the expected volumes.
37. The planned approach has been for an incremental roll-out of the solution across all the London boroughs. This provides an opportunity to iron out any implementation issues before most boroughs join the hub. It will also serve to manage the capacity of the provider for on-boarding all the London Boroughs as effectively as possible.
38. Data quality is a key factor in the success of the hub, and it is recognised that, as with all data matching exercises, this will be a potential limitation to the success of the project. However, the feedback provided will enable councils to improve their own data quality, and so in turn will lead to more accurate identification of potentially fraudulent activity as well as ancillary improvements to other services.
39. It will be critical that the hub can provide an effective and prioritised list of potential leads. If it cannot then considerable resources will be spent following up cases that do not contain any fraud, and whilst an element of this is inevitable with any data matching tool, their success depends on getting this prioritisation right. LB Ealing, as the lead authority, considers this risk to be low level as the product has been tested by the pilot authorities and demonstrated to meet the necessary performance standards as well as meeting data security requirements.

### **Future Developments and Potential Benefits:**

40. Most new fraud initiatives will have the greatest impact within the first-year of operation as match results will identify historic as well as current potential fraud cases. The hub model includes the development of additional fraud match types so as fraud identification from one fraud type is exhausted it can be removed and replaced by a new fraud match type. Changes to fraud match types will be subject to approval by the Oversight Board and may have an impact upon the annual subscription rate.
41. The success and accuracy of the hub output is linked to the quality and accuracy of the source data-sets. Working through the hub matches will provide Councils with an opportunity to cleanse and improve the quality and accuracy of their data-sets which may assist with future decisions around service delivery in addition to better focused fraud match outputs.
42. The need to be able to verify residents' and clients' on-line identity is becoming more important as access to Council services is increasingly via an on-line portal. The LCFH has the potential to the need to provide a verification tool and an application checker for several council services which should enable Councils' to achieve resource savings through removal of some initial application checking control processes such as housing, right to buy, as the smart data analytics will provide these functions.

### **Current Fraud Resource:**

43. Kingston Council has a good record for fraud detection and fraud prevention. It has been part of a shared fraud investigation service, the SWLFP, for over three years who during this time, across the partnership, have investigated 4,192 cases and achieved 1,123 (26.8%) sanctions. This is a slightly above 1 in 4 return on cases investigated and represents a substantial positive return on resources applied.

## **CONCLUSIONS**

44. The results from the VFM forecast (refer Table 2) provides indications of positive returns on investment at both the best and worst case hub output forecasts. These calculations are based upon the assumptions provided by CIPFA and LB Ealing as to the likely volume of positive smart referrals and forecast savings, and that all savings will be realised. In reality it would be unrealistic to expect that 100% of savings will be recovered. Using the figure shown in Table 2 above, Kingston would be required to achieve a 51% recovery rate on year-1 savings estimates from the worst case hub output scenario to achieve breakeven.
45. The LCFH, unlike NFI, will not have the statutory basis that requires all authorities to provide data, but the strength of any fraud hub is directly linked to the number of participants and becomes diluted where differing fraud hubs enter into competition with each other. Similar initiatives exist within the private sector for areas such as insurance and banking, but these took considerable time to achieve the necessary buy-in from the various financial institutions.

46. Whilst there are significant advantages of being part of a London fraud hub, the exclusivity clause and the length of contract (seven years) without the option for a break clause could potentially inhibit further technical developments in combating fraud as some small niche external providers usually develop their fraud detection products with individual Councils. The hub's development of new analytics across differing fraud types will be linked to common fraud risks which whilst similar across London, may not proceed at a pace desired by any individual Council.
47. In the absence of a break clause, the Council will be reliant upon the robust nature of the KPIs designed to ensure the contractor performs satisfactorily, delivering the forecast volumes of smart fraud matches. However, these KPIs are still being finalised and any decision for joining the LCFH will be subject to the Director of Corporate and Commercial satisfaction that these measures are suitable to protect the Council's interests.

## **IMPACTS AND IMPLICATIONS**

### **Financial:**

48. The cost of membership of the LCFH will be £70k per annum (for a period of seven-years) plus one-off on-boarding payment of £75k. The additional first full year investigation costs to process the increase in smart fraud referrals is likely to be in the region of £54k, if additional resources are applied to the shared fraud partnership, rising to £194k if investigations are to be undertaken by CIPFA (based upon a mid-point, worst to best, smart referral output for Housing and a 75% success rate for Business Rate matches). The engagement of additional investigative resource would be rolled out proportionately in relation to the number of smart referrals generated by the fraud hub.
49. The investigation and subscription costs can be offset against future savings that will accrue from the additional fraud recovery savings envisaged through the identification of smart fraud referrals. Costs associated with the detection, investigation and recovery of housing tenancies can be charged to the Housing Revenue Account (HRA) and costs associated with the detection, investigation and recovery of wrongly applied single person discounts and falsely claimed NNDR can be charged to the Collection Fund.

### **Legal:**

50. Were the Council to proceed with hub membership legal advice on the contract and the Deed of Adherence would be sought.

### **Background papers – held by the Authors of this report:**

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## **GLOSSARY**

CIPFA	Chartered Institute of Public Finance and Accountancy
DCLG	Department Communities and Local Government (now MHCLG)
HRA	Housing Revenue Account
KPIs	Key Performance Indicators
LCFH	London Counter Fraud Hub
MHCLG	Ministry of Housing, Communities and Local Government
NCA	National Crime Agency
NFI	National Fraud Initiative
NNDR	National Non Domestic Rate
PCR	Procurement Contract Regulations
ROI	Return on Investment
SBR	Small Business Relief
SPD	Single Person Discount
SLT	Society of London Treasurers
SWLFP	South West London Fraud Partnership
VFM	Value for Money