

The cost of handling (Longtail) insurance & reinsurance claims in Latin America

By Russell Green

In the past, the State-run and State-owned monopolies that existed in several major markets of Latin America used to sweep up many of the poorer quality risks and claims presented to the front-line local insurers, thereby acting as a solid buffer between the former and the International reinsurance market. Caja Reaseguradora of Chile, Reaseguradora Peruana of Peru, INDER of Argentina, Banco de Seguros of Uruguay and IRB of Brazil, all used to perform this function. Only the latter two continue to exist as state reinsurance monopolies and it would appear that IRB itself will finally be privatised this year, with all the uncertainties which that will bring for the company.

The effect of this dual protective and buffer role was to allow local insurers to have a relatively passive attitude to their handling of, in particular, large claims. Generally speaking, pressure was not heavily applied in this area by the international reinsurers, (except in the cases of large facultative risks) as they were already one step removed from the losses – as retrocessionaires of the local monopoly reinsurer. Claim management of larger, contentious, claims was dominated by the local reinsurer, working in conjunction with lawyers appointed by the original insurer.

As the State reinsurance monopolies have become replaced by International commercial reinsurance markets, large claims settlement requests from local insurers have come under greater scrutiny. However, insurers have not really accustomed themselves to the more stringent conditions – such as strict compliance with claims co-operation clauses and prompt claims reporting requirements – which international reinsurers insist upon before giving their agreement to settle claims. This is particularly the case in the situation of the many insurance entities which have closed down their active operations, allowing the remaining claims portfolios to run off (passively) to extinction.

The risks inherent in this form of treatment of claims are manifest for both insurers and their reinsurers (whether current International ones or old State-owned ones).

Inflation and interest are obvious consequences of delays in finalising claims settlements. Since most excess of loss reinsurances in Latin America have not been placed on an index-linked basis this inevitably means greater exposure over time for reinsurers, even in the cases where limits are expressed in US dollars.

The vagaries inherent in the judicial process through which most large long-tail claims are resolved, from Court of 1st Instance to Court of 2nd Instance and then Provincial or National Supreme Court, mean that final determination of liability and quantum can be a long, drawn-out and uncertain process. This process is only exacerbated by statutory judicial requirements in many Latin American countries, such as Argentina, where a key requirement is the production of reports from medical experts, physiological and psychological specialists and material damage assessors, according to the type of claim being considered.

The contribution of legal costs towards the increase in size of major long-tail claims can also be significant. The normal practice in Latin America is for the management of contentious claims to be handled by appointed lawyers. In any legal action in Argentina involving Motor or Employers' Liability business, insurers are automatically brought into proceedings as defendants and therefore lawyers are instructed immediately to protect their interests. The form of operation of the lawyers is to make use of all available possibilities to fight a case on behalf of their clients. Given the structure of the Appeals process, legal costs can escalate considerably as this is followed through.

An additional costs factor can come into play when cases involve jurisdictions outside the capital cities through the need to employ 'on the spot' local correspondent lawyers to protect the interests of the insurers (and reinsurers), thus 'doubling-up' on the legal representation.

The possibility also exists of late appearance of liability claims, particularly from 'medical' causes. These also are increasing as knowledge of (and attitudes) to latent diseases and other similar developments increases. The length of limitation periods can exacerbate the claims 'tail'. In some countries professional indemnity claims, such as medical malpractice, have a ten-year actionable period.

It should also be noted that the general social trend in all markets over the last twenty years has been away from the insurer and towards the insured, whatever the strict legal position. A good example of this is the degree to which Latin American judges have ignored technical niceties such as (shorter) limitation periods, whenever these have not benefited plaintiffs, particularly in personal injury type cases.

All of the above signify the same thing – increased costs – higher claims, higher legal fees, greater administration expenses, more expensive reinsurance. What is the solution? The basic tenet is ‘pay less now rather than more later’. Claims must be fully investigated and properly adjusted. ‘Ex-gratia’ settlements should still remain the exception rather than the rule. However, it cannot be denied that claim size development over time is much more often upward rather than downward. Early settlement of a claim should be considered at all stages of its development – from the time of its first presentation through to each occasion an opportunity of closure appears. A close control should be maintained by the insurer over the actions of the lawyers and other experts by staff with the specific responsibility and remit to close claims off sooner rather than later. It has not been generally the case that it is in the interests of lawyers for disputes to be resolved early through negotiation or compromise. However, there are many occasions when it is certainly in the interests of the insurer and his reinsurers.

To the general reasons for the increasing size of claims can be added a less pro-active approach on the part of some insurers and reinsurers. Insurers sometimes retain for their net account only a small proportion of a claim. Reinsurers sometimes suffer from a lack of true awareness of the likely final value of claims.

In the latter case, this can be due to an over-reliance by reinsurers on the reporting procedures of brokers to keep them fully advised of the development of claims to the reinsurance account. Unfortunately this reliance is not always justified when reinsurers do not renew their participations in an insurer’s protections as brokers inevitably accord a lower priority to maintaining past reinsurers fully informed of latest reserve changes.

The slowdown in the supply of accurate claims information tends to be exacerbated when two or even more sets of intermediaries are involved in the reinsurance chain ie. local broker, international broker and possibly part order foreign placement broker.

The less dynamic approach referred to above is another which serves to reduce the opportunities to reduce the final cost of large claims. The most effective way of ensuring a tight control is kept on the development of claims costs is to insist on a demonstrable pro-active approach to the management and eventual closure of the claims, with regular reporting to insurers and reinsurers. Lack of local representation, particularly where an insurer is in run-off or the reinsurer no longer has an active involvement in the former’s portfolio, can result in nasty surprises for the ultimate risk carrier in the long term if he doesn’t take active steps to protect his position.

To summarise, then, there are many reasons for increasing costs of liability claims in Latin America - inflation, interest, increased legal costs, medical advances and changing social and political attitudes. These can best be combatted by tighter control and early settlement of claims.

The benefits are manifold, ranging from reduced overall claims costs, reduced administration costs and earlier freeing up of reserves to lower reinsurance premiums and (often) better relations with insureds.

In the end these all lead to greater profitability for insurers (and reinsurers) and thereby translate to lower premiums for insurance consumers.