

Claim settlement

# Major losses: challenges in claims settlement

## 1. INTRODUCTION

Multi-national companies and corporates are exposed to a variety of risks. The transfer of risks to insurers is part of the companies' risk management. This risk transfer is designed by companies by international insurance programs or project insurance contracts. This article shows some practice-related challenges of the settlement of major losses and provides information regarding the procedure in case of a claim.

## 2. FUNCTION AND STRUCTURE OF INTERNATIONAL INSURANCE COVER

In case of a claim, it turns out, whether and how the insurance cover works.

Insurance contracts covering major risks<sup>1</sup> and international insurance programs are complex. Insurance contracts have, in their function and structure, particular characteristics which must be considered in order to ensure an effective claims settlement.

### 2.1 Complexity and variety of insured risks

Insurance contracts covering major risks can affect complex individual risks as in a project insurance contract on the erection of a power plant abroad covering the customer's interests, the contractor's interests and all other persons concerned with the erection. International insurance programs can cover e.g. liability, property and specific risks resulting from the entire activity and structure of the corporation as far as they are insurable and the insured company does not bear the risks by itself.

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<sup>1</sup> For example in plant construction. Here, the term major risk is used in a broad sense rather than a legal sense (as for example by sec. 210 para. 2 German Insurance Contract Act, VVG).

## 2.2 Variety of insured companies and persons

International insurance programs often include all companies belonging to the group (and possibly its employees, e.g. concerning their general liability). They define when a company belongs to a group according to the insurance contract. Additionally, international insurance programs can contain lists of respective national companies which are co-insured. In particular, problems may arise in case of changes within the group. What impact does e.g. the sale of a subsidiary have for the settlement of property damage arising at the production site of the subsidiary?

## 2.3 Variety of involved insurers

Already in order to provide essential capacities, a variety of insurers is involved in contracts covering major risks and international insurance programs.

In general, individual insurance contracts and international insurance programs are “layered”. From a vertical perspective, excess insurances with additional cover follow after primary cover in order to provide a higher total capacity for the insurance cover. Furthermore, from a horizontal perspective several insurers may, at each level of insurance cover, be involved by way of co-insurance or in consortia. From the insurance point of view other parties may be involved in claims settlement, such as for example company owned insurance companies (captives) or also reinsurers due to “claims control” clauses.

## 2.4 Third parties involved

Besides insured companies and participating insurers, third parties, such as e.g. external or “in-house” – insurance brokers, co-operating brokers at the location abroad, experts or lawyers, are regularly involved in claims settlement of major losses.

## 3. INDIVIDUAL ASPECTS OF CLAIMS SETTLEMENT

The following aspects constitute challenges which the complexity of the major losses’ settlement poses to the participants.

### 3.1 Instalments and claims payments

#### 3.1.1 Instalments

From the policy holding companies' point of view it is, in case of a claim, important how quickly a claim is settled and thus the compensating function of the insurance cover is effective. Instalments securing liquidity have an important role. The key issue here is under which preconditions insurers have to make instalments.

For example, the root cause is not always clear at the beginning of the claims settlement process but must be determined. Particularly the amount of loss initially only can be estimated. Insurance contracts should take into account the fact that the loss assessment on the merits and to the extent in complex claims typically includes a process of several steps and a certain period of time. Insurance contracts should appropriately regulate when (i.e. what conditions have to be provided by insureds and by which deadlines) and to what extent (i.e. how much or in what amounts?) instalments have to be paid for settlement and mitigation expenses<sup>2</sup>. Insurance contracts can, for example, regulate that an instalment is to be made for the loss in the amount of the indemnity amount which at least is to be paid according to a loss adjuster's or expert's assessment. Insurance contracts can regulate payments in instalments in the event a loss arises (*example*: the operator of an offshore platform is unable to control the well; environment damages and third party damages increase, loss impairment expenses increase and business interruption periods extend).

#### 3.1.2 Claims payments – requirements by regulatory law and sanction law

Particularly there are special features regarding claims with an international contest. Both when drafting insurance contracts as well as in the regulatory process care is needed with respect to requirements concerning regulatory law and sanction law.

In the event the loss occurs abroad, it may have to be investigated how the payment of insurance benefits can be effected. Providing insurance cover and thus claim payments

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<sup>2</sup> In the German Insurance Contract Law sec. 83 VVG in connection with sec. 82 VVG regulates the policy holder's reimbursement claim in case of measures for averting and minimizing losses. According to sec. 83 para. 1 sentence 2 VVG the insurer „shall advance the amount of necessary expenses.“

must not violate government sanctions. Sanction clauses in insurance contracts aim on ensuring this.

Additionally, insurance benefits may not violate applicable insurance supervision law. Infringements should be avoided, especially in case of losses occurring abroad. In some cases the national insurance supervision law of the state, where the loss occurs, allows the insurance of risks substantiated there only by local insurers (so-called non-admitted-countries). Such losses may possibly be covered by international insurance programs. In individual cases it has to be ensured that claims payments may be paid by the insurance program and do not violate the local insurance supervision law, particularly an infringement could jeopardise the insurance cover.

### 3.2 Loss adjusters

In case of international major losses the involvement of external experts within the framework of claims settlement (Loss adjusters), plays a leading role. Policy holders and insurers involve loss adjusters as experts with claims-related expertise and capacity for claims handling on site. Depending on their specific commissioning in the individual case, loss adjusters ascertain, for example, the amount and the extent of a loss, make reserve recommendation or determine the root cause. In their function, loss adjusters should support the contract parties of the insurance programs in the event of a claim, meaning in the process of claims settlement.

#### 3.2.1 When loss adjusters are involved?

Insurance contracts regulate when the insured company affected by the loss or the policy holder involves a loss adjuster. For example, the insurance contract may provide for the involvement when a loss in particular countries occurs or when the expected compensatory payment exceeds the local self-insured retention by a specific amount.

#### 3.2.2 What is the scope of responsibility and what effect has the determination?

Practical experiences show that the idea concerning the role of loss adjusters considerably varies in different markets. Partly loss adjusters make, due to local customs, a statement concerning coverage issues. Most policy holders and insurers would agree that coverage issue between contract partners needs to be clarified directly. In this context in practice problems may occur because the loss adjuster makes his determination on the amount of loss based on the provisions of the (local) insurance contract or insur-

ance programs (in case a business interruption loss is to be determined its calculation is governed by the insurance-related provisions. These have to be applied by the loss adjuster). Finally, also with respect to a potential coverage dispute, uncertainties (“an actual precedent”) by statements of loss adjusters concerning coverage issues are to be avoided. Therefore insurance contracts should clarify which tasks will be performed by the loss adjuster and which will not (coverage issue).

In addition parties should regulate what the purpose of the loss adjuster’s findings is and which legal effects they have between the parties (how far do the findings bind the parties? Do the findings replace a properly expert procedure as, for example, usual in the property and business interruption insurance?). In this context it has to be regulated by whose order and in whose interest the loss adjuster operates.

### 3.2.3 Who bears the costs?

In practice policy holders and participating insurers may have different ideas on who should bear the costs of the involvement of a loss adjuster. From the insured company’s point of view, the key issue in this context is to what extent insurance cover includes the costs. Are costs for loss adjusters also covered by limits or are these settled “on top”? Clear regulations should create a consistent level of expectations and for example should also include the case that only after completing the ascertainment of the claim it turns out that there is no covered loss.

## 4. OBLIGATIONS IN CASE OF A CLAIM

In case of claim the policy holder has to observe several (statutory and contractual) obligations in order not to endanger its insurance cover. Not only the policy holder (e.g. the holding company) but also the co-insured allied company, where the damage occurred, is regularly affected by these obligations.

From the policy holder’s point of view it is important that a functioning internal risk or claims management ensures that obligations are fulfilled.

In particular, the occurrence of an insured event shall be reported within the period stipulated. Moreover, there are obligations to inform and to cooperate. Principally the policy holder has to report the occurrence of the insured event to every insurer involved in the insurance contract or program who may be affected by the damage (this

can also be co-insurers and excess insurers). Specific insurance stipulations may govern to whom and in what form the policy holder has to fulfill the duty to inform effectively.<sup>3</sup>

## 5. COMMUNICATION AND CLAIMS HANDLING

From the policy holder's point of view an immediate and correct way of handling is, in case of a claim, crucial for a successful claims management.

### 5.1 Coordination and monitoring of the settlement process – negotiations regarding coverage issues

#### 5.1.1 Initial assessment – particularly concerning the applicable law

Especially international losses require a reliable initial assessment. Which law is applicable and what are the effects of the applicable jurisdiction on the claims management and the insurance claim? For example liability claims may comply with different jurisdictions and the company insured can hardly influence where and on what legal basis injured third parties pursue liability claims.

On the coverage side the practice shows that participants often have different ideas about how coverage should work. The companies insured and the participating insurers often have their registered office in different countries. They “stem” from different jurisdictions and markets with own customs. A divergent understanding of relevant terms – also and especially legal terminology – can exist. The question, which law is applicable to the insurance contract and thereby to the insurance claim, has to be clarified promptly in order to avoid ambiguities in the settlement process.

#### 5.1.2 Coordination of claims settlement

The company insured will involve external advisors in order to ensure a reliable claims settlement. This applies in particular for the legal assessment regarding the local law and the settlement of a loss on site.

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<sup>3</sup> Insurance contracts may for example regulate by broker clauses that it is sufficient for the policy holder to make the respective notification to the designated insurance broker who will then inform the involved insurers. Further regulations concerning insurers involved contain, for example, leadership clauses (cf. hereto *Herdter in Versicherungspraxis* October 2012).

The early involvement of external advisors, particularly lawyers who perceive the securing of insurance claims and who conduct and monitor the settlement processes together with the policy holder and who conduct coverage negotiations.

## 5.2 Loss mitigation measures

In case of a claim, measures to mitigate the loss need to be taken immediately and have to be coordinated. Individual insurance contracts and international programs should – also by local policies – ensure that efficient measures are possible. The cause of loss is not always known at the beginning of the settlement process, but must first be determined. However, the consequences of the loss have a direct and immediate effect. Any issues regarding the cover on the merits may, by appropriate regulations, partly and provisionally be excluded by the contracting parties in order not to endanger a functioning coverage.

## 5.3 Contractually agreed responsibilities and procedures

Of considerable practical importance are clear contractual regulations governing responsibilities, communication lines and courses in case of a claim: Whom the policy holder has to enable to conduct an initial survey and with whom, if appropriate, it should be arranged if the policy holder may change the location and which initial loss mitigation measures should be taken by the policy holder?

In order to prevent delays and disagreements within the claims handling process, insurance contracts commonly determine communication lines and regulate who is involved at which steps and was in the settlement process. A working contract management ensures that the information on communication lines is up to date – for example, if the leading insurer selects a new company insurance expert as contact person. In connection with the communication within the claims handling process, translations and applicable languages are of particular importance.

## 6. CONCLUSION

Insurance contracts have to prove their value in practice of claims settlement: Is the claims settlement working? How quick will the policy holder receive instalments and a final settlement decision? Clear structures and appropriate contractual regulations allow effective insurance coverage. The active and early coordination of the claims handling ensures an effective claims settlement.

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