

# ARE WE PREPARED?

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## Introduction

It seems that just about every other week we turn on the TV and we see images of earthquakes, floods, hurricanes, tsunamis, terror attacks and all manner of catastrophic losses. These events make the media headlines for a couple of days, sometimes even a couple of weeks - then they fade. For the claims department, work is just beginning. Its pretty easy for us to adopt the attitude that it's tragic - but it's someone else's problem on the other side of the globe.

It hasn't really happened to the Insurance industry in Asia in any great measure, but it will at some point and it will most certainly drop into the laps of our claims departments and our loss adjusters and even our lawyers to sort out and I for one don't think that we are prepared. I still don't believe that as an industry, we take claims seriously enough.

Let me look at some of the reasons why I consider it to be important to do a little more planning than maybe we are doing at the moment.

## The Squeeze

Like it or not, we only sell one product - all of us - just one product!

That good old promise to pay.

But our product is being squeezed. Firstly, squeezed by reinsurers, who have a contract, which nowadays, quite frankly, they insist is honoured and in any event, notwithstanding any arguments related to claims cooperation, claims control, or worse "follow the fortunes", reinsurers are protected by 2 basic rules:

Rule 1 - is that the claim must fall within the risks covered by the reinsurance policy... *as a matter of law.*

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Rule 2 - in settling the claim the reinsured must have acted honestly and must have taken all *proper and business like steps* in making the settlement. (Insurance Company of Africa -V- SCOR (1985).

The second squeeze comes from increased pressures put upon claims staff by larger more complex claims, prepared and negotiated by ever more sophisticated claims preparation specialists - often accountants and /or chartered loss adjusters (a sort of gamekeeper turned poacher!)

So, in the face of a tougher claims environment, a failure to handle claims in a business like manner may result in something of a push back from reinsurers.

### **Headline Losses**

Let's look at some claims that have hit the headlines in the past.

#### **The San Francisco Earthquake**

A hundred years ago at 5.12 am on 18 April 1906, the city of San Francisco shook, for a period of 60 seconds, under the influence of a 7.9 magnitude earthquake. The city was devastated and many fires broke out.

Some 3,000 people died and property damage was estimated at US\$400 million - a very big loss by 1906 standards.

At that time there were about 130 fire insurance companies, including 50 foreign companies, writing fire business in San Francisco, with a gross premium income of just US\$2.6 million, against corresponding values at risk of US\$350 million in the most heavily burned district.

Most policies were fire only policies, covering just buildings and all excluded earthquake cover. Policy limits were low, and dual insurance, similar to a form of modern day proportional co-insurance, was common.

There was no such thing as a market wording and it may therefore come as no surprise, that each participating insurer stuck rigidly to his own distinct policy terms and conditions.

Many fire policies *excluded damage by fire resulting from earthquake* whether directly or indirectly caused by the quake. In other cases cover could be voided if collapsed buildings impeded the fire brigade.

The disparity of the forms was however addressed promptly by the market after the quake.

Fifteen insurance companies sat down to work out some form of common method of adjusting the losses. However, not much in terms of consensus was forthcoming from that gathering, but one interesting outcome at least, was the formation of the General Adjusting Bureau or GAB, which still operates today.

In May 1906 the Department of New York Companies, themselves facing combined losses of some US\$42 million, called a meeting of all participating insurers, which took place in New York.

The result of that gathering was something called the "New York Agreement " which determined that fire policies *would respond to fire following earthquake* and that all fire losses would be paid, unless there was proof that a building had been totally destroyed by the earthquake shock.

They therefore decided in the course of that meeting, that where there was obvious fire damage they would ignore Proximate Cause issues.

Where they encountered partial quake damage, followed by direct fire damage, or indeed where a building was deliberately blown up by the civil authority, this was to be handled on a "reasonable compromise" basis.

For that - the reasonable compromise - to be achieved you would have needed some pretty good claims skills and properly qualified and briefed, fair minded but firm loss adjusters.

Now, so much for the New York Agreement, but what about the other catastrophe risk carriers - the reinsurers. Most of the reinsurance contracts at that time were with foreign companies, largely in Europe and had been clearly drafted to exclude earthquake completely.

Well, it seems that in those halcyon days of *loyalty and relationships*, the reinsurers, across the board attached a greater weight to their "follow the fortunes clauses" than they did to other conditions in their contracts and they paid!... a decision which undoubtedly saved some companies from otherwise certain insolvency.

I have a degree of difficulty believing that this, rather altruistic approach, would be repeated today. These days contracts are contracts and frankly I don't think that the industry pays enough attention to them at the outset. The increasing number of law suits between reinsurers and cedants suggests to me that I might be correct here and that the insurance industry has changed significantly.

## The 9/11 Terror Attack

Most of us remember where we were on Tuesday, September 11<sup>th</sup>, 2001. It was indeed surreal and made more so when, within 1 hour and 43 minutes, both of these icons of New York simply disappeared from the skyline.

Those in the insurance industry recognised this immediately as a major loss, but what no one could have imagined that that point was just how much this would cost and how long the ripples of the terror attack of 9/11 would stay with us.

The terror attack of 9/11 is the most expensive man-made disaster to date with insured property and business interruption losses approximately equivalent to the entire insured loss caused by Hurricane Andrew in 1992.

If we exclude the insured loss for the towers, property claims amounted to about **US\$6 billion** and business interruption to some **US\$11 billion** (a ratio that is not uncommon today).

If we add in workers compensation, aviation hull and liability, event cancellation etc., the figure for insured losses rises to a massive **US\$32.5 billion**.

There are varying estimates of the number of claims and insured values, but the table shown here (from *Property Claims Services* in the United States) gives one view.

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9/11 property damage

New York	No of Claims	Average Payment	Total Value US\$
Personal	15,000	\$13 333	\$200 000 000
Commercial	15,000	\$1 233 333	\$18,500,000,000
Auto	8,000	\$9 000	\$72,000,000
<b>Total</b>	<b>38,000</b>	<b>\$49 400 0</b>	<b>\$18,772,000,000</b>
Virginia (Pentagon)	No of Claims	Average Payment	Total Value US\$
Personal	1,500	\$1,000	\$200,000
Commercial	200	\$10,000	\$2,000,000
Auto	300	\$10,000	\$3,000,000
<b>Total</b>	<b>2,000</b>	<b>\$3,250</b>	<b>\$6,500,000</b>
<b>Grand Total</b>	<b>40,000</b>	<b>\$469,462</b>	<b>\$18,778,500,000</b>

This captures only property and business interruption claims, together with auto losses in two locations affected by the attack, namely New York and Virginia (where the Pentagon Building is located). As can be seen there was a total of 40,000 insurance claims with a total price tag of **US\$18.8 billion**.

Forty thousand insurance claims take some handling and if you look at the average value of a commercial claim here in New York, which means property and BI combined this was US\$1.2 million.

A single claim of US\$1.2 million dollars requires some pretty good adjusting skills and if you add to this the difficulties and pressures, which can be brought about by a zealous New York Public Adjuster, the task is not one for pussy cats.

And where do you find enough adjusters to handle 40,000 claims which have just dropped on to your desk?

As for the thousands of personal injury claims, workmens compensation and the like, I should mention here that the Federal Government intervened very quickly, with ad hoc legislation. Amongst other things, a Victims Compensation Fund (VCF) was established to avoid costly litigation (this obviously has qualifying rules attached). Matters could have been considerably more complicated, indeed possibly disastrous, for the insurance industry, had this not been done.

## **Hurricanes**

Now moving on to just last year, 2005.

All 21 of the prescribed names allocated to Atlantic hurricanes, were used up. There were so many of these things that they ran out of names during the year and the final five storms were given letters of the Greek alphabet.

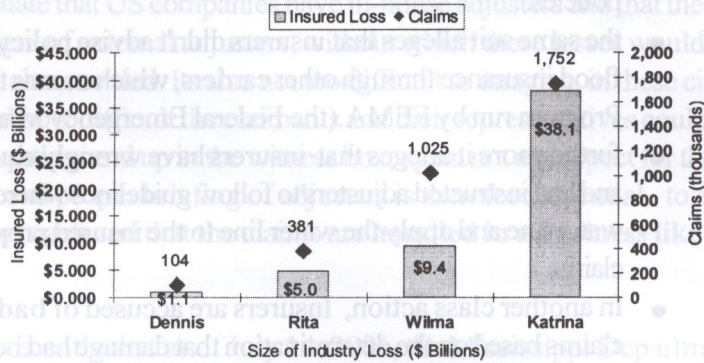
Hurricane Katrina, between August 25<sup>th</sup> and 29<sup>th</sup> 2005, was the deadliest hurricane to hit the United States since 1928, with an estimated 1,300 victims.

Katrina alone produced some 1.75 million claims in the property and business interruption fields, the majority of these being in the State of Louisiana. Add to these the effects of Dennis, Rita and Wilma and we have 3.3 million claims in one year!!

Someone has to record and handle 3.3 million claims.

## Insured loss and claim count for major storms of 2005\*

Hurricanes Katrina, Rita, Wilma & Dennis produced a record 3.3 million claims



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\*Property and business interruption losses only. Excludes offshore energy & marine losses.  
Source: ISO/FPCS as of February 8, 2006 for Dennis, Rita, Katrina and March 27, 2006 for Wilma; Insurance Information Institute.

As you can see here Katrina's property and BI losses alone, are estimated by Property Claims Services at something of the order of US\$38 billion. (This is only an estimate and some assessments put this burden as high as US\$54 billion)

The Katrina losses are divided by value - about 50: 50 between home owners and commercial risks. The majority of these losses are however unfortunately concentrated over a rather litigious, southern part of the United States - mainly in Louisiana and in Mississippi.

This has created a field day for the plaintiffs' lawyers, who are pursuing every angle and are generating class actions by the dozen. As with all disasters, claims that may initially appear straight forward later turn out to be just the opposite.

To highlight a few of the issues which have cropped up, homeowners policies cover wind damage, but very clearly exclude flood damage, whether or not the water was wind driven. This had been accepted for years - well that's what the industry thought, but the lawyers have a different view.

- They say that at one location at least in New Orleans the wind blew a barge into a levee, (which is a sort of sheet piled retaining wall), which caused the levee to fail and so the resulting flood damage was caused by wind, not by flood.
- It is also interesting to note that the Attorney General of the State of Mississippi (Mr. Jim Hood), has filed a suit on behalf of the State, to have all flood exclusions

invalidated in all home owners and property policies issued by 4 insurers in the state. He suggests that these are against public policy!

In another suit it is alleged that :-

- insurers should have known about the topography of New Orleans and indeed the fragility of the levees. Consequently if insurers had intended to exclude damage from such failures of boundaries they should have stated so very clearly in their policies.
- the same suit alleges that insurers didn't advise policyholders of the availability of flood insurance through other carriers, which means the National Flood Insurance Program run by FEMA.(the Federal Emergency Management Agency)
- furthermore it alleges that insurers have wrongly equated storm surge with flood and had instructed adjusters to follow guidelines where they arbitrarily find a nearby water line and apply the water line to the insured property to deny full payment of claims.
- In another class action, Insurers are accused of **bad faith** for wrongly denying claims based on the determination that damage had been caused by flooding when the property had, allegedly, been damaged by hurricane first!
- In yet another matter, US Senate Representative Gene Taylor is attempting to persuade federal government to investigate alleged **fraud by insurers** in denying coverage. Press reports say that Taylor is convinced that insurers have minimized wind damage payments, thus placing the burden on taxpayers to cover Katrina losses through the National Flood Insurance Program.

The National Flood Insurance Program was established in 1968. It sells policies through insurers and allows those insurers to undertake the loss adjustment exercise.

### Other Katrina issues

Its not only property losses that are being litigated either.

South East Louisiana is home to a large number of oil refineries and storage facilities.

Murphy Oil is being sued in a reported 19 separate class actions for damage caused to 2,500 homes when one of its oil tanks burst.

Shell and other companies are being sued for the escape of some 9 million gallons of oil, which spilled into the floodwater and allegedly damaged surrounding property, oyster beds and fish breeding grounds.

Law suits against other oil companies claim that the damage that these industries had already caused to coastal marshes by drilling, had served to exacerbate the impact of the storm on New Orleans and in addition, that Katrina's intensity was increased by the oil companies'

contribution to global warming.

Legal innovation continues unabated! There are literally hundreds, if not thousands of these cases.

Katrina was really the occurrence of the un-imaginable and insurers, their in-house adjusters and external adjusters have a mammoth task.

It is indeed somewhat fortunate that US companies have in-house adjusters and that the country supports a large contingent of external adjusters, without which these losses would probably never be examined, let alone settled. Its also not too difficult to imagine, in these circumstances, how aggressive and how difficult the claimants and their representatives could be. A number of adjusters will doubtless end up in the witness box, again not a prospect for the faint hearted! The organisation and proper briefing of adjusters is therefore essential.. to ensure that there is a consistent approach and that the claims are **handled in a business like manner!!**

Incidentally, I was reading recently that as of July 14, 2006, the Mississippi Department of insurance announced that 2,677 requests for mediation had been filed with the Mississippi Hurricane Katrina Mediation Program. Clearly any planning exercise could now do with factoring in a bunch of mediators too!

### **The Asian Tsunami**

Moving a bit closer to home, the Asian Tsunami followed a magnitude 9 earthquake on the Richter scale.

The Nicobar Archipelago shifted 10 metres to the south west and the waves travelled at a speed of some 800 KM per hour

The run up of water, once the waves hit the beaches, was as much as 10 metres (this, by the way is minor compared with some Japanese Tsunamis where wave heights of 30 metres have been recorded... three times bigger).

As everyone knows the Asian Tsunami was devastating. It affected 14 countries and killed about 220,000 people and injured many more.

Overall economic losses are estimated at US\$10 billion, with insured losses of only some US\$1.3 billion.

This incident raised some insurance claims problems particularly in Thailand. For example, was the proximate cause a flood... or was it an earthquake?

Lastly, I have mentioned adjusters. These guys face a tough time because it's feast or famine. Here I am pleased to say that the industry got together and resolved contractual issues imme-



diately. This cleared the decks for insurers to pay claims where either earthquake cover and/or flood cover had been purchased.

Although probably minor compared with the disasters mentioned earlier, the event did raise some questions over the interpretation of business interruption covers. Here a little intervention and a guideline, very sensibly issued by the Department of Insurance of the Government of Thailand, ensured that there was a consistent approach to such claims and these have largely all been settled.

The adjusting contingent in Thailand was stretched by the event, but was able to cope with the claims, And you will all be pleased to know that on balance the claims, in the humble opinion of this loss adjuster turned reinsurer, were handled in a business like manner.

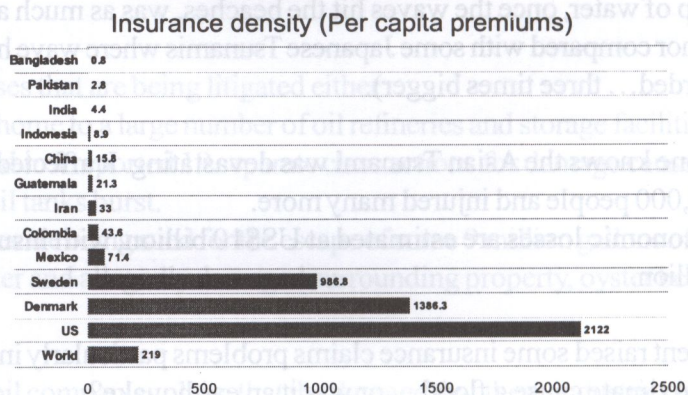
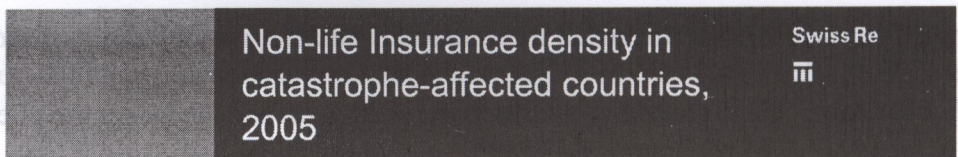
### Insurance penetration

Here in Asia, we are, for the time being largely immune from these mega claims.

The reason why is very simple.

We recently passed the 30<sup>th</sup> anniversary of the Tang Shan Earthquake in the PRC, which completely razed that city.

We have had recent earthquakes in Indonesia and we do of course have regular visits from typhoons, but as this chart shows, insurance density in Asia is considerably lower than that in the USA.



Source: Swiss Re, sigma No 5/2006

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The average spend per capita in the USA is US\$ 2,100 per year. That in the PRC is US\$15.80. Indonesia comes in at about US\$9 and I am aware that Thailand is about US\$40.

However, once the insurance purchasing power and insurance awareness of Asian nations increases, we will undoubtedly see more large scale property and casualty claims brought about by disasters, both man made and natural.

## Asian Exposure

Here in Asia we have increasing wealth and the prospect of wealth, bringing with it demographic changes. People are moving into the cities or into industrial areas, particularly on the typhoon exposed coast of the PRC

Asia still has terribly low safety standards. More so in the heavily industrialized zones.

Industrial accidents, explosions for example, with potentially catastrophic results can't be ruled out.

I mentioned typhoons, earthquakes and tsunamis earlier. We also have many floods, which now carry the prospect of claims for toxic mold clean up - already big business in the USA!

We have an apparent spawning ground for infectious diseases very close to our big cities and we have the gloomy prospect of industrial accidents causing contamination or pollution.

We also of course have modern, high rise, densely populated cities, susceptible to terror attacks.

The insurance industry in Asia must therefore be prepared for large scale events

So how do we prepare? Well this firstly demands a certainty that reinsurers will follow - and how do you achieve that? You make sure that your reinsurance contracts are clear, are unambiguous and are preferably signed.

Beware also - Co-insurance - a favourite practice of a number of markets here, can also lead to some unintended gaps.

In Asia we tend to use English for many of our contracts. English, if used properly, is a very precise language and sometimes if we get it wrong, it can then very precisely mean something quite different! In my view a large sector of the insurance industry would also do well to spend some time and effort in reviewing the majority of its policy wordings.

Lastly, I have mentioned adjusters. These guys face a tough time because it's feast or famine. The famines have prevailed for some time in certain parts of the world and indeed in Asia and

the number of good qualified adjusters has declined. Meanwhile there has been growth in the number of claims preparation specialists, some of whom are very well qualified indeed.

### Summary

So, are we prepared? No we are not, in my opinion. We still do not take claims seriously enough.

So what do we do? Well, for immediate peace of mind I suggest that reinsurance managers really ought to be making certain that reinsurance contracts are properly in place and that they do provide contract certainty.

The NEW YORK AGREEMENT will never happen again, so do talk to reinsurers and don't be afraid of wording changes. Make sure it makes sense to both parties!.

In the medium term claims departments should be beefed up. Invest in good quality bright people and train them. (How many of your organisations have a claims representative on their top management committees?) Claims is the only product you sell!

A closer and industry-wide cooperation with the loss adjusting profession would serve us well in our preparation for the future. (The ABI and the Chartered Institute of Loss Adjusters cooperated after the London bombings). Liaison with Government Insurance Departments over "what if" scenarios is also a good idea in disaster planning - rather than scrambling around for support once the worst has happened. Look at 9/11.