Chapter 7 Insurance Claims

The total impact of an insurance claim can be either a most comforting or a most devastating event. As an agent, you have certainly come to realize that when your clients have problems, you have problems. Therefore, anything you can do to eliminate these problems "pre-loss," is a clear "win" for you and your insurer. In order to best serve your client and your own personal exposure to claim uncertainties requires taking your practice to a higher by gaining a better understanding of the Claims Process.

Agent Risk Management

Risk managing can be defined as any conscious action (or decision not to act) that identifies and reduces the frequency, severity, or unpredictability of loss claims. As you know, sometimes there is simply no coverage available for certain exposures or the clear definition of coverage is uncertain or ambiguous. These are times when your role and obligation is to identify the "gap in coverage" to your client so they understand, in no uncertain terms, that an exposure still exists. In other moments, you become their advisor on ways to mitigate potential claims. In either case, you are managing their claims through loss control.

Risk control strives to reduce the frequency or the severity of this loss of resources. Risk control can focus on actual harm, not on the money paid to restore, compensate for, or otherwise finance this harm, which is the concern of risk financing. For example, when a machine is destroyed or a person dies, an organization, a family, or society as a whole suffers a loss of resources. From a risk control perspective, the extent of such a loss of resources is not changed. Similarly, the severity of the loss is not reduced because the owner of the machine or the family of the deceased receives financial compensation for the loss.

A "risk control technique" is risk control only for one or more specified exposures. For example, fire-suppression sprinklers are risk control for fire damage, but not for loss by embezzlement. Similarly, a sprinkler system can be effective risk control for most fires. However, if the system uses water as an extinguishant, the water is a hazard rather than a safety measure for grease fires, which are spread or intensified by water. In short, specifying a risk control technique also requires specifying the exposure being controlled.

Perspective of a Given Entity

The effect of a given risk control technique can be measured only from perspective of a given entity. For example, pedestrians are exposed to bodily injury from being struck by automobiles, and drivers are exposed to the liability from such accidents. The pedestrians' exposure to injury and the drivers' exposure to liability are two different exposures growing out of the same circumstances. Any risk control technique that safeguards pedestrians from being struck by automobiles has different risk control effects for the pedestrians than for the automobile drivers. For the pedestrians, the effect is to safeguard against bodily injury; for the automobile drivers, the effect is to protect against liability. For one entity, an elevated walkway is risk control for a personnel loss; for the other, it is risk control for a liability loss.

Identifying Loss Exposure

To identify exposures, or possibilities of loss, the risk management professional must be able to do three things:

-Apply a logical classification scheme for identifying all possible exposures to loss.

-Employ proper methods for identifying those specific loss exposures that particular persons or organization faces at a particular time.

-Test the significance of these actual loss exposures by the degree to which they may occur and disclose to clients the possible results and remedies.

Loss exposures are typically categorized in terms of the nature of the value exposed to loss. All financial losses that are the concern of risk management can be categorized as property losses, net income loss, liability losses, or personnel losses. The only exception to this would be losses of purely sentimental value.

Elements of Insurance

Purpose of Insurance

The fundamental purpose of insurance is to provide protection against risks of loss that attend the ownership and use of real and personal property and the health and life of an individual. Conceptually, the ownership of any type of property or engaging in any activity involves some risk of loss, and, presumably, for the right price, insurance could be acquired that would protect against such loss.

In reality, most persons cannot afford to insure against losses on an individual basis. Therefore, insurance is feasible only when there is a sizable group of individuals willing to pay a sufficient amount into an insurance pool so that risks can be spread among the participants at a reasonable price.

Insurance as a Legal Contract

Insurance is a legal contractual arrangement creating corresponding rights and duties among the parties to a policy. An insurer has the privilege of specifying the conditions and rules which apply to those who wish to participate in the insurance pool, and a policyholder has a duty to obey such rules and conditions if he or she anticipates coverage for insured losses.

Notwithstanding the contractual nature of a policy, an insurer cannot compel a policyholder to pay premiums, but in such event it can deny claims or cancel the insurance policy.

Parties to an Insurance Policy

The central parties to an insurance policy involve the "issuer," the "owner," the "insured" and the "beneficiaries." The "issuer" is the company that extends insurance coverage over the subject matter by the sale of a contract known as an insurance policy. The issuer is commonly referred to as the "insurer," and less frequently as a "carrier." The "owner" of an insurance policy is the purchaser of the policy. The "insured" is the person who is protected against loss and may or may not be the owner of the policy. A "named insured" is a person or persons whose name is shown on the cover page or the front of a policy.

Even though he or she may not be included specifically on the front of a policy, a spouse who is a resident in the same household as a named insured would automatically assume the same status. An "additional insured" is a person designated under a policy by way of endorsement, because such person has either a legal liability or an insurable interest in respect of the property.

Significant Definitions

The concept of insurance is facilitated by an understanding of certain other terms that are customarily used in the industry and that have established legal meanings. A "loss" commonly means being without a tangible or intangible that previously had ownership assigned to it. In insurance parlance the term loss is more restricted and has come to mean "an unplanned, undesired reduction of value on an economic basis."

Losses are not to be confused with expenses. In an insurance sense, expenses relate to something that is predictable, such as depreciation.

Insurable losses are either "direct" or "indirect." If "direct," a loss is the immediate or first result of a peril. An "indirect" loss, the secondary result of an insured peril, is sometimes designated as a "consequential loss." There can be no indirect loss without a direct loss. Insurance policies distinguish between direct and indirect losses when specifying the types and amounts of coverage.

A "chance of loss" refers to a ratio or a fraction where the numerator is the actual or anticipated degree of loss, and the denominator is the total number of loss exposures. By way of illustration, if there are 1,000 vehicles in an insurance pool, and the underwriters expect three of these vehicles to be destroyed during a flood, the expected "chance of loss" is 0.003 or 3/1,000. The "chance of loss" is determined in part by the number of claims filed for a given period, and it is a chance of loss that drives the necessity for insurance.

The causative agent of the loss is referred to as a "peril." Criminal acts, fires, tornadoes, hurricanes, floods, and slip-and-fall accidents are all examples of insurable perils. Losses caused by perils are at the very heart of an insurance policy.

However, coverage under every insurance policy is not predicated upon a specific peril. Except perhaps for suicide, an insurance policy does not specify the peril causing a death. "Hazards" are conditions that enhance the degree of severity or the frequency of a loss.

Another important concept, particularly in property insurance, is "proximate cause," the first peril in a chain of events without which a loss would not have been sustained. If the pilot of a small Cessna, lost in a fog, flew into a petroleum storage tank which exploded, causing several houses in the surrounding area to burn to the ground, the proximate cause of the destruction of the houses would be the plane crash.

Not all situations involving multiple perils are that clear, and when that is the case it may take litigation to determine the proximate cause of the underlying event specified in a claim. One of the basic rules of insurance coverage is that an insured cannot collect unless either the proximate cause or one of the other occurrences in the chain of events is an insured peril.

There are two specific definitions of the term "risk." In the first situation, "risk" is a "variation" in possible outcomes of an event predicated upon chance. The more frequent the number of outcomes, the more enhanced is the risk. The second interpretation of "risk" is "the uncertainty involving a possible loss." Those involved in the insurance business sometimes refer to a risk as an "exposure to loss." The "degree of risk" is an index of the specificity with which the outcome of an event founded on chance can be foreseen. The less accurate the forecast of an outcome, the greater the amount of risk. For an insurance company, a better record of predicting the outcome translates into economic benefits. One of the greatest uncertainties in predicting risk is the uncertain aspect of human behavior.

A "third-party loss" occurs when there is damage to the property or health of a person other than the insured. If the insured was sailing on a lake when the boom on her boat hit her friend on the head, a third-party loss would be involved. If the boom knocked the insured unconscious, a first-party loss would have occurred.

"Premiums" are periodic payments made during the term of an insurance policy by an owner to the issuer for insuring against a loss. Funds attributable to premiums are placed into various investment vehicles by an insurance company. The payment of losses is funded by an insurance company from premiums and income earned on the investment of premiums.

An insurer may be a third party, such as a private company or the government, or a self-insurer. Private insurers are usually involved in selling vehicle and life insurance. The government is an insurer to the extent it provides Medicare and Medicaid coverage, flood insurance, veteran's disability benefits, and FDIC coverage for savings and other types of bank accounts. As the cost of obtaining health insurance continues to increase, many businesses are covering health care plans for employees through self-insurance. In such case, employees contribute to a pool, usually through payroll deductions, and certain medical costs are then paid for by the employer, functioning in the capacity of an insurer.

Suitability of Loss for Insurance Coverage
Not every exposure to loss is suitable for insurance coverage. A number of factors determine whether an exposure to loss is appropriate, including the existence of a suitable class of similar items exposed to the same peril, accidental losses, specific losses that cause extreme economic hardship, and a significant probability of a low incidence of catastrophic losses.

To be relatively successful, a carrier must accurately predict losses before they occur in order to reduce risks. Accuracy in prediction cannot be attained unless a large pool is involved. In order to establish a fair premium, the units in a pool must be substantially similar; otherwise, the pool cannot equitably transfer the expenses relative to the losses. Perils faced by each unit in an insurance pool should be identical. If half the roofs in a condominium complex were covered with wood shingles and the remaining half with composition shingles, the first half would pose a much greater fire hazard, and the risk of loss would be allocated inappropriately among all of the condominium owners.

Intentional losses are against public policy. If a policyholder could burn down his or her building and collect for the loss, the expenses would not be spread equitably among the insured pool. Thus, for a loss to be insurable in a practical sense, it must be accidental and beyond the control of a policyholder. It is that same principle that excludes normal wear and tear from the umbrella of property insurance coverage.

Notwithstanding this basic principle, it is interesting to note that many carriers consider a suicide by a policyholder that occurs within two years of acquiring a life insurance policy to be an intentional loss. A suicide that occurs two years and one day after the policy was issued, however, is treated as an accidental loss, and is typically considered the result of some type of mental illness.

In ascertaining the nature and extent of a casualty, a competent claims adjuster appreciates that a loss must be measurable, definite, and of a sufficient degree of severity to cause economic hardship. It must be beyond question that a loss has occurred. Insured losses must be quantifiable. The large-loss principle means that the purchase of insurance is only appropriate when a potential loss is large and uncertain.

Many catastrophic losses are not insurable because the occurrence of a few could possibly bankrupt an insurer. A "catastrophic loss" is one that is, relative to the amount of the property in an insurance pool, extraordinarily large. Generally, catastrophic losses have two characteristics: They cannot be predicted with any degree of accuracy and they are limited in geographical scope. In that sense, a catastrophic loss may also be thought of as a loss that is unpredictable and capable of producing damage that is extraordinarily large relative to the quantity of property in the insurance pool.

From the standpoint of a policyholder, an insurable risk is one that does not require the payment of prohibitive premiums. The financial status of the insured as well as his or her attitude toward and tolerance of risk determine what may be prohibitive to him or her. The potential loss must be of sufficient magnitude to create economic difficulties for a policyholder if not covered by insurance. There are situations which generally are uninsurable, such as losses attributable to changes in price or a competitive market environment. Then there are political risks, such as insurrections, war and devaluation of currency, which are usually not insurable hazards either, although some such perils may be insured by a government instrumentality.

Claims Made Coverage

The ability to predict risks has a direct bearing on the establishment of premiums. Reliance on long-term predictions presents an inherent difficulty in setting reasonable rates. There are two forms of insurance coverage, and each has a distinct impact on the process of pricing insurance.

"Occurrence coverage" policies extend coverage for liability for activities that occur over a policy year, notwithstanding the fact that a suit might be brought at a later date to determine liability on the part of a carrier. The duty of a carrier to provide indemnification for an insured for losses incurred during a policy year could theoretically extend to claims filed a substantial time after the expiration of that term.

Thus, it becomes necessary for a carrier to fashion a premium that covers the eventual or probable results of any present activities. If both the severity and the number of claims is likely to increase over the immediate future, pricing of insurance can become extremely difficult. Because of the burdensome nature of establishing premiums with confidence under occurrence coverage policies, a trend has developed to issue "claims-made" policies.

"Claims-made" policies provide insurance coverage against liability for any claims that are presented to an insurance carrier during a policy year, regardless of when the underlying conduct giving rise to the liability occurred. The premiums for a claims-made policy can be set with more certainty because there is no necessity for a carrier to predict exposure to claims that are more long-term in nature. Because a policyholder under a claims-made insurance agreement is always under the threat of having his or her policy canceled because of unsafe operations, there is an inherent incentive in claims-made insurance to create safe conditions in the insured environment.

Current Events

The Hard Markets

The general downturn in business is forcing companies to look for ways to reduce costs in all areas, especially claims. Risk avoidance, loss control, fraud avoidance, electronic productivity, automating workflow, legacy system improvements are all encouraged to make the handling of claims more efficient.

Challenging the Claim

In response to certain state legislation aimed at reducing premiums, insurers are challenging accident claims far more aggressively than in the past. They have been less willing to settle claims.

Class Action Problems

A disturbing trend is the severity of individual claims and wholesale growth in class-action lawsuits. In essence, people today are not waiting for something to happen to sue, they're out looking for vulnerabilities.

Natural Disasters/Global Warming

In recent years there have been at least fifteen "billion-dollar" climate-related natural disasters that have put some reinsurers out of business and the outlook is not good.

Fraud

Insurers claim to be losing between $85 and $120 billion a year to fraud. The problem will get worse as long as insurers continue to handle claims by phone or mail instead of investigating and negotiating claims in person.

Fraud Detection

The industry knows that insurance fraud is growing at an alarming rate. New software advances using predictive, similarity search, and visual link resources are proving to be effective investigative tools.

Internet Fraud
As carriers expand their online presence and begin integrating claims services electronically, the forging of documents and falsifying accident reports will most likely be commonplace. Currently, misleading web ads are rampant and the source of many claim problems.

"All Claims" Database
Slowly, but surely, the insurance industry is moving toward a national "all-claims" database system to be used by insurers and law enforcement agencies to help identify questionable claims and other insurance fraud.

September 11
The effects of 9/11 on America and property insurers are profound. Business interruption claims, for example, are being filed whether or not there was any direct physical loss of property. Coverage analysis of the many claims still being submitted will necessarily be dependent on the particular facts of each individual claim.

Network Problems
The recent experience of insurers with network repairs has been frustrating and expensive. Several state legislators have adopted anti-steering reform bills, and insurance executives are looking at shifting their business to independent call centers that operate in fields detached from suppliers, such as technology or software. Carriers and agents are better assured that their customers are professionally served and that work is done correctly, completely and cost-effectively.

E-Business Claims
Most traditional forms including Property, Business, Income, and CGL policies require that physical or tangible damage occur to be eligible. Look for new CGL language with exclusionary language related to computer losses as well as new, innovative policies/endorsements offering first party and third party coverage for technology related offenses, perils, and security.

American Disabilities Act
Insurance companies and their agents will see increased activity in the area of civil rights claims, particularly those dealing with the American Disabilities Act (ADA).

AIDs/HIV
Cases are surfacing that challenge the AIDs/HIV policy exclusions and limitations and emphasize that the limitation must be highlighted or set apart in some way.

Defining Occupation
In essence, insurers are attempting to narrow down the definition of client's occupations as a way to deny benefits with varying degrees of success. Look for more of these "narrow definition" conflicts which may involve agents.

Psychologically Induced Illness
Insurers are attempting to deny claims because they felt that some of their client's injuries were at least partially psychologically induced. The courts, however, seem likely to rule in favor of the client if his disability is "total" as defined by the policy, regardless of whether the illness was psychologically stimulated or entirely physical.

Experimental Treatment
There will undoubtedly be many cases defining what constitutes experimental treatment under health policies in the years ahead. Recent cases have "tested" policy meaning regarding alleged experimental breast cancer treatment, AIDs-related liver transplants, bone marrow transplants, etc. Insurance companies have lost their cases where an exclusion about experimental treatment was NOT highlighted in a conspicuous manner or where policy language was considered

ambiguous.

Language Barriers
There are new cases developing in the area of language misunderstandings where clients have pursued claims on the basis they did not fully comprehend the matters at hand. The courts have determined that the insurance company could only deny coverage where an intent to deceive was found.

Defining Accidental
Policy language often limits coverage for "accidentally sustained" injuries, so when cases are built around attempted suicides have left clients permanently or severely injured insurance companies have generally refused to pay. The courts seem to focus on if "accidental" was highlighted in the policy, and if the insurance company is required to treat the self-inflicted injuries or the mental disorders that usually motivate such actions.

Tenants as Implied Beneficiaries
The courts are leaning more and more to the proposition that tenants are implied beneficiaries under a landlord's policy with occasionally bizarre results. Research Bannock vs Sahlberry (1994), American National Fire Insurance vs A. Secondino (1995), Cigna Fire vs Leonard (1994) for details.

EIL vs CGL
Within the last 20 years the insurance industry introduced environmental impairment liability insurance (EIL) in an effort to provide pollution coverage for events the industry deemed not to be covered by the more well-known comprehensive general liability policy (CGL). A very important distinction between these coverages is that EIL policies are claims-made policies, while CGL policies are occurrence-based. What is covered un EIL and CGL policies and where these policies overlap has been the subject of much debate and litigation.

Contamination
Despite the fact that policies have been written as "All Risk," insurers continue to deny contamination claims based on policy exclusions.

"Sick Building" Syndrome
People have an unusual ability to acquire the problems and illnesses of others. Most "sick building" illnesses are found to be psychologically based rather than rooted in fact. Courts have sided with the insurer in many of these cases.

Asbestos
The removal of asbestos continues to be a major source of conflict between clients and insurance companies. Client's all risk policies do not typically cover the removal of asbestos since it is not considered an unexpected event.

Lead
New standards introduced in September 1996 require property owners who are selling or renting real estate built prior to 1977 to disclose any known lead-based paint or lead hazards. Experts believe that the next wave of lawsuits will result from these disclosures and potential client illnesses, real or not.

Business Interruption
On the heels of major hurricanes and earthquake, claims are surfacing concerning business interruption where clients have been forced to close stores and businesses incurring major damages. A major issue that occurs in these cases is the determination of income. Most policies include a clause similar to this: "In calculating your lost income we will consider your situation before the loss and what your situation would probably have been if the loss had not occurred."

Miscellaneous Actions
In addition to the events mentioned above, experts anticipate actions in the areas of Y2K compliance, Fen-Phen and Redux diet drugs, latex gloves, construction product defects, intellectual property, tobacco and carbon monoxide.