Man-made risks present unique challenges

Claims relating to man-made losses, rather than those associated with natural catastrophes, are likely to present the most pressing challenges to the re/insurance sector going forward.

That is the view of Clive O’Connell, partner at law firm Goldberg Segalla Global, who says that the majority of claims disputes he sees revolve around man-made catastrophes, as opposed to natural disasters.

“The core purpose of insurers and reinsurers is to pay claims, not to challenge them,” he says. “The prompt and full payment of claims is their raison d’etre. Insurers pay losses expediently in the face of consumer and political pressure.

“And reinsurers don’t seek to ‘nickel and dime’ clients because their role is to support the insurance sector and ensure that there are renewals. As such there are very few issues around the payment of claims in the natural catastrophe space. Such losses are expected and planned for.”

Where there are disputes, he says, is around man-made catastrophes. This is because these are often unforeseeable. As such, when they do arise, there may be challenges around the wording of contracts and the location of the dispute. Claims around Asbestos, Agent Orange, Lloyd’s, Enron, BP and LIBOR all illustrate this point – they have all created unique challenges around the wording of contracts.

“Further complicating matters is the fact that man-made problems tend to have longer tails,” O’Connell says. “Problems can emerge five, ten, even 50 years down the line. Also, there isn’t always the guarantee that a renewal will help you to recoup losses. Take Arthur Anderson, for example. Claims might have been made but the firm was simply not there.”

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One growing man-made concern is cyber risk. Daniel Gerber, partner at Goldberg Segalla, explains that re/insurers too often take a tick box approach to such risks. He advocates a more proactive strategy that involves close talks with brokers, lawyers and policyholders about the threats posed.

In response to rising levels of cyber risk, Goldberg Segalla has developed a cyber and social media practice group that is working closely with insurers and reinsurers to identify and head-off the threat. As Gerber warns, cyber risk may yet emerge as the next man-made risk that will challenge the industry, the wording of contracts and the ability to pursue claims. Approaching this new risk pro-actively will be critical.

Pricing must be more granular

Reinsurers need to start charging cedants per peril and per territory as opposed to offering policies that cover multiple perils. This is how the ILS market works and reinsurers should learn from this.

This is the opinion of Patrick Hartigan, head of treaty reinsurance at Beazley. He says that while multi-peril policies are a good deal for cedants, they are not always fair to reinsurers. Going into 2013, Beazley will be looking to apply charges in that way. “It needs to be more granular about what is provided,” he says.

Sections of the ILS market, where there is a single peril, a single territory and a single limit, are good examples of how its kind of theory can work. There is much more concentration in this market, and that has much more appeal to the seller, says Hartigan.

Losses emanating from 2010 and 2011 have shown how reinsurers can be caught off guard by perils that are not always modelled or understood very well. He cites flood risk as a particular example. “It is not a well understood peril,” he says.

This is one of the reasons Hartigan believes that it is important for reinsurers to break down the coverage to ensure that cedants are paying a price that matches the risks that the reinsurer is taking.