

NEWSSTAND

The Chile Earthquake: Emerging Compliance and Claims Issues Arising from the Most Expensive Insured Event in Latin American History

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Even if insured losses fall somewhere in the middle of the current \$2-\$12 billion range of estimates, the Chile earthquake will easily outpace Hurricane Wilma as the most expensive insured event in Latin America's history. These figures are more likely to rise than fall as a clearer picture of business interruption losses emerges. Of further concern to the international (re)insurance market, such losses will not be limited to the local market.

To the contrary, most of the earthquake cover in Chile was reinsured with international reinsurers based in the United States, Europe and Bermuda. Numerous individual reinsurers from these areas have already released significant loss estimates that in total easily exceed US \$3 billion. In addition, many of these individual loss estimates were based off of earlier total damage estimates, which have continued to rise in the ensuing weeks.

Although it is still very early in the claims adjustment and handling process, some compliance and coverage issues have begun to emerge from Chile as investigation of losses progresses. In addition, Chile's insurance regulator, the Superintendencia de Valores y Seguros (SVS), has issued two decrees since the earthquake that modify the usual claims process.

Claims Adjustment Regulations

Chilean law requires that losses be investigated and estimated by personnel of the insurance company providing coverage or by local licensed and registered independent "liquidators." Performance by non-authorized (including foreign) adjusters of any of the duties reserved for such licensed professionals can lead to fines, difficulties supporting loss estimates and coverage determinations and further regulatory penalties in extreme cases. Although rules for noticing claims and adjusting losses are quite strict under both local regulation and most local policies, the SVS and the local insurers' association have both recognized the difficulties posed by the earthquake's devastation. Therefore, the insurers' association agreed to relax requirements for timing (now generally 90 days) and means of notice (essentially any means now permissible) for insureds affected by the earthquake, a move acknowledged in a decree from the SVS (notably, the insured must demonstrate that its ability to make notice was impacted by the earthquake in order for it to avail itself of the relaxed claims notice process). The SVS also relaxed adjustment regulations for homeowners policies, instituting an abbreviated investigation and claim determination process designed to allow homeowners prompt notice of the coverage determination and valuation of their loss.

Does the Insured Even Have Earthquake Coverage?

In the scramble to adjust the flood of claims arising from the earthquake and subsequent tsunami, it is important not to lose sight of one basic question: did the insured purchase earthquake coverage? As in most jurisdictions internationally, earthquake coverage is not a standard part of most homeowners and commercial property policies in Chile. Instead, where it exists, earthquake coverage is generally provided by endorsement. It is generally understood that most large corporations with operations in Chile did carry earthquake coverage. Likewise, homeowners with a mortgage were generally required to purchase such coverage as a prerequisite to obtaining a loan. However, medium-sized companies (PYMES) and homeowners without mortgages may well not have purchased earthquake coverage, either purchasing standard property policies or eschewing insurance coverage altogether. A basic, initial review of the insured's coverage before further investigation is therefore advisable.

Insurer's Duties to the Insured and the Reinsurer

Given the strict local regulation of time periods for coverage determinations and other aspects of the claims adjustment process, it is likely that local insurance companies will encounter instances where conflicts arise between their duties to their insureds and their duties to their reinsurers (which may have various rights under claims control, cooperation or similar provisions contained in the parties' reinsurance agreements). For example, an insurance company may have only ten days to accept or reject a liquidator's report on coverage and magnitude of loss, but may be obligated to allow the reinsurer a longer period to consider and direct acceptance or denial of the claim. Should the insurer comply with its obligation to its insured and grant coverage within ten days, it may later find itself in a dispute with its reinsurers. Should the insurer delay its coverage determination while awaiting word from its reinsurers, it may waive its right to deny coverage and/or find itself in a dispute with its insured. Nonetheless, the Chilean regulator and courts have shown little difficulty in the past holding insurance companies responsible for complying with both sets of duties or for violating either.

Business Interruption Losses

There is significant concern in Chile that, as seen with the Northridge earthquake in 1994, business interruption losses may continue to grow, eventually dwarfing actual property damage losses in many instances. Business interruption losses pose additional difficulties for adjusters (and forensic accountants) given the need to rely upon the insured's financial records. Furthermore, determination of the extent to which business interruption is attributable to damage to the insured's property as opposed to damage to public infrastructure (which was significant in Chile) may impact coverage determinations and insured loss calculations.

Failure to Build to Code

In a number of publicized instances, damage to private buildings and public infrastructure exceeded expectations given the magnitude of the Chile earthquake and the strictures of local building codes. Such instances indicate that some structures may not in fact have been built up to code. Any such failure would pose significant coverage issues as it would potentially implicate relevant exclusions as well as form the basis for potential rescission of the policy where the application contained representations as to construction compliance.

Earthquake vs. Tsunami Damage

Particularly on the coast and islands, many properties suffered damage from both the earthquake tremor itself and from the subsequent tsunami. In such circumstances, depending upon policy language, there may be some question whether tsunami damage is covered at all (posing issues similar to the wind/water disputes seen with Hurricane Katrina), and, if so, whether the tsunami and the tremor represent separate claims (potentially with separate deductibles and limits). The various subsequent tremors experienced in Chile may pose similar single claim vs. multiple claim issues.

Conclusion

The issues discussed above represent just a few of the complications that may arise in investigating, adjusting and handling claims resulting from the Chile earthquake. It is therefore important for reinsurance companies with exposure in Chile to closely monitor local claims handling in conjunction with qualified local and international counsel.