

Complex losses in Russia: adjustment practice and special features



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Being a part of the international market, Russia is gradually implementing global insurance practices. A large number of companies in Russia have decided on a combined insurance protection including property damage, business interruption and third party liability coverage. However, the majority of them are not ready to respond correctly in case of a complex loss occurrence due to the absence of relevant experience.

Large complex losses are always a certain challenge which tests insurance coverage and relations between the insured and insurer. Moreover, interests of various parties, such as reinsurers and beneficiaries, are usually involved in this case. Involvement of an independent loss adjuster ensures proper investigation followed by reasonable and trustworthy settlement of a loss.

When adjusting a loss LABB follows policy provisions and the international best practices. At the same time, there are local legal, financial and technical regulations which should in no case be disregarded.

This article provides a general overview of special features that should be kept in mind in the course of a loss settlement.

A complex loss usually comprises a property damage (PD) loss together with a

relevant business interruption (BI) loss. The proportion between PD- and BI-related losses can vary significantly depending on a particular case. The early and, of course, accurate estimation of this ratio just after the loss occurrence is crucial for choosing an optimal strategy for reinstatement of the property and case investigation.

Example: fire in a hypermarket, the total amount of loss (PD+BI+TPL) was around EUR 12M. A building, equipment and stock were damaged that caused a business interruption loss. Several designs of building restoration were under consideration, which differed in costs and the works time span. The ratio between the estimated building restoration costs and the BI-related loss was about 50/50. The intensive discussion with the insured and immediate analysis of figures allowed choosing the optimal way with a best balance of the costs and the period of restoration.

Another key point of the complex losses is represented by the immediate measures that can be undertaken to mitigate the loss. It is important to establish a permanent contact and information exchange between the insured, the adjuster and the insurer. Unfortunately, some companies are reluctant to discuss

the mitigation measures and the recovery process until it is over. This makes the settlement longer and leads to potential disagreements between the parties. The adjuster helps all parties involved to keep contact during the whole period of adjustment.

Certain mitigation measures, being a common practice for people facing losses in their everyday life, can be absolutely unusual for the insured. The following is only a small part of the measures that could significantly reduce the loss if taken professionally and in time. Unfortunately, they are often disregarded or underestimated by the insured.

- ▶▶ Electrical equipment contaminated with soot could often be cleaned with guaranteed further performance.
- ▶▶ Temporary protection of damaged or intact property allows avoiding additional damage.
- ▶▶ Air dehumidification prevents corrosion.
- ▶▶ Buildings should be heated in certain cases to avoid water freezing.
- ▶▶ Sometimes equipment can be repaired using non-original parts.

Availability of the most current information





on damages and recovery plans allows the adjuster or the insurer to utilize their whole potential and experience and to recommend the insured the most practical way of loss mitigation.

Some mitigation measures for complex losses can have complex nature. For example, fire totally destroyed a production building of a food processing plant. The estimated period for the production building restoration was 2 years, and during this period the company had no revenue. The total amount of losses (PD+BI) were around EUR 70M. The insured arranged sales of products which were produced by related companies in order to keep the market share and to receive VAT rebate against the reinstatement expenses.

Taking into consideration that the general VAT rate in Russia is 18 %, its indemnification becomes very important. In the majority of claims an insured has the possibility to rebate VAT that means the compensation of a part of the reinstatement expenses and the reduction of losses. At the same time, in case an insured sum is established including VAT, an insured may reasonably insist on including VAT into the indemnity. Therefore, it is reasonable to clarify this issue at the stage of policy conclusion and to make relevant provisions in the policy wording.

Another peculiarity of losses on the Russian market, especially in the industry and retail sectors, is that significant amount of recovery works may be done without involvement of any contractor, only by efforts of the own personnel of the company. The scope of these works can vary from preparatory or cleaning works performed by unskilled workers to installation of equipment performed by

the in-house maintenance department. Some insurers are still not ready to consider and compensate such in-house works notwithstanding that in most cases this option helps to reduce the amount of loss because the expenses incurred by the insured are usually lower than the commercial rates of outsourced contractors.

The abovementioned issue has a prime importance in the presence of BI coverage. Frequently, an insured cannot dismiss the staff immediately after the loss, even in case the production facilities are not operating. In such situations the salary of the staff, being the fixed costs, will form a part of the BI loss. The involvement of the staff in the reinstatement works can be an optimal solution in some cases.

Dealing with the property damage losses, especially the significant ones, the possible amendments of design or characteristics should always be considered. Such amendments are highly probable when more than 20–30 years old building or equipment is recovered, due to essential changes in technology. At the same time, equipment manufacturers in some sectors (such as food industry, production of electronics and automobile components) change their production range every 5–10 years. In case the damaged property is restored under an amended design, the following issues should be investigated:

» Whether the functions of the new property significantly differ from the initial ones. In some cases changing the model range means only slight differences in the exterior and controls while in other cases this can mean a significant increase in the production characteristics.

» Whether it is technically possible to

restore the property according to its initial design. For example, in case of damage to the power plant control system produced in the 1960s it is practically impossible to restore it to its initial state because the majority of its components is not produced any more.

» Whether the restoration with the initial design is reasonable. For example, many existing production buildings in Russia were built of concrete in 1950–1980s. Being damaged they are usually restored using lightweight steel structures, because it is cheaper, in most cases, than restoration with the initial design.

Complex losses with the BI component usually call for a complex investigation, not only into the root cause of the incident but also into the general impact on the production. For example, a short circuit in a fan motor can cause the shutdown of the whole plant. Therefore, all connections between the initial incident and further consequential losses should be scrutinized.

A third party liability loss (TPL) component can also be a part of complex losses. At this point it is important to remember that in Russia insurance covers only the general liability resulted from the civil legislation. All additional obligations originated from a contract between an insured and an affected party are usually beyond the policy coverage. This can be an unpleasant surprise for the insured having significant contractual obligations.



Domino collapse of racks in a warehouse. The total amount of loss (PD+TPL) was around EUR 20 million.

Complex losses become not so complex when given into the hands of a professional loss adjuster. In any case, it is worth to remember that the positive intention and concerted efforts of all the parties are key factors for the successful adjustment of a loss no matter how complex it is.