

Money machine: subrogation strategy is evolving in the US

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Insurance companies have learned subrogation can be a carrier's leading revenue stream during periods of weak financial markets

Subrogation is the right of the insurer to assume the rights of its insured when the insurer has indemnified the insured. The carrier steps into the shoes of its insured to seek recovery from the responsible party. The philosophy is the responsible party does not take advantage of the insurance taken by the injured to cope with unforeseen damage-causing events.

For many years subrogation was the stepchild of the insurance market, but this image is changing. Today, in an environment of flat investment returns, subrogation is being used as a way for insurers to add to the bottom line.

Historically, subrogation was viewed as the final function of the claims handlers, as such carriers could not perform sophisticated statistical analyses of subrogation recovery for its impact on costs. More recently, the US insurance industry has become much more sophisticated in analysing and exploiting subrogation recoveries. During weak financial markets companies have learned subrogation can be a carrier's leading revenue stream.

As a result, many US-based insurance companies have created large and sophisticated subrogation units specialising in recovery. Additionally, the US industry has trade groups, such as the National Association of Subrogation Professionals (NASP), which work together to recognise subrogation recoveries as a distinct industry. Through the sharing of information and resources, much more statistical information, as well as levels of certification, are available to subrogation professionals and their clients.

In addition to being a significant revenue stream, strong subrogation programmes also can have a profound positive effect on underwriting and experience ratings. Subrogation recoveries are credited as a debit to actual loss totals in primary losses, so subrogation recoveries offset experience modifiers and, ultimately, can enable carriers to offer more competitive premiums.

Benchmark studies

The insurance industry has engaged in benchmark studies to help it obtain stronger statistical analyses for its subrogation programmes. Initial studies were created in the 1990s but additional and more sophisticated benchmarks have occurred in the past 15 years. For example, the NASP has made available to the industry studies for motor, property and workers' compensation. There are active studies dated 2012 for motor benchmarking and 2013 for property benchmarking.

These studies have revealed significant percentages (approximately 15%) are closed with a missed subrogation opportunity. This could lead to annual costs of more than \$15bn. The original study by Ward – Total Dollars of Net Subrogation Recoveries as a Percent of Total Indemnity Paid Losses for Personal Auto Collisions – indicated a high-performing carrier would collect about 24%, while the average was about 11.5%. More recent studies, as prepared by the NASP, show the standard recovery for paid collisions is up to 27%, while non-standard carriers have a recovery rate of 14.5%. These numbers are a significant increase since the original benchmarks in the 1990s.

There are different metrics that are analysed by the benchmark studies. By having specifically trained subrogation professionals, companies can analyse the legally recoverable dollars as compared to the amount paid out on the claim.

Often, the contracts of insurance allow for more payment than would be available under negligence and damage theories in US courts. As a result of the benchmarks, companies know how much each subrogation adjuster should recover in gross dollars. They also recognise what is an appropriate cycle time from the time subrogation is identified until recovery. Furthermore, benchmarking enables companies to analyse the cost. They are then able to decide whether it makes more sense to keep the recovery process internal or to turn the matter over to service providers such as attorneys or recovery services, which work on a contingency basis.

By analysing the percentage of files closed with no recovery, the carriers can either become more creative or more aggressive, reducing the percentage of files closed without recovery. Areas of focus for subrogation include motor, property, workers' compensation and healthcare. Each of these areas has a special focus and strategy often dependent on the laws of the different states. For example, in motor recovery some states permit recovery of medical expenses, while other states permit recovery only of property damage. Further, some states are enacting anti-subrogation legislation, which will severely limit the ability for insurance companies to recover.

The industry has learned and is continuing to learn how to effectively mine high-volume, low-loss subrogation efforts, as well as major catastrophic losses. The creativity of the efforts includes unearthing legal theories related to storm losses, which on first blush might seem to be excluded as an "act of God".

Successful subrogation

To pursue subrogation successfully, insurers and their attorneys have to be well versed in the coverage afforded to the responsible party. If there is no insurance available to the defendant, carriers will use different strategies in seeking judgments against uninsured parties or entities. The statistics garnered through the benchmark studies help to drive these strategies, so subrogation efforts are an efficient and cost-effective process for all parties involved.

Right now it appears the US market leads the aforementioned developments. Europe is not there yet, but the situation is changing. In the Netherlands, for example, for many years as a result of the “clubby culture” within the Dutch insurance industry, there were agreements between the members of the Dutch Association of Insurers (DAI) to not exercise subrogation rights towards each other at all or only partly in a category of cases.

One could think of subrogation claims related to certain fire insurance policies. Since 95% of the insurers operating in the Netherlands are members of the DAI, the impact of the agreement was far-reaching. With the globalisation of the insurance market and competition driven by new players entering the market, that culture is changing. That is illustrated by the changes implemented in the aforementioned agreement on January 1, 2014. Subrogation claims are now possible in a wider range of cases.

Subrogated recoveries have been a feature of UK and Australian law for many years, and in Australia there are few statutory limitations on rights of subrogation. Many insurers have downsized their internal legal and claims teams, so there is little focus on potential recoveries. Similarly in the UK, the existence of the "loser pays" rule, coupled with the difficulty of recovering costs in small claims, discourage subrogation claims unless the potential defendant is insured, the claim is big enough to be worth bringing relative to the costs incurred and the risk of losing is low. This culture, too, indicates third-party funding (TPF) on a "normalised" commercial basis, which in the UK has to be coupled with insurance against the cost of losing, may be vital to the full development of the pursuit of subrogated claims.

TPF is a non-recourse funding facility offered by specialised providers, where the funder takes over the litigation risk and covers all costs related to the exercise of the subrogation rights. Since TPF is becoming increasingly widely available in Europe and the UK, it is to be expected the subrogation claims market in the US will continue to develop and the UK and Europe will soon catch up with those developments.

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