



## The New Baremo and Its Impact on the Insurance Industry

### *Reform of Spain's Injury Claims Assessment*

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Act 35/2015 of 22 September 2015, the amendment that led to the reform of Spain's system for assessing damages in personal injury claims (Baremo), was published in Spain's Official State Gazette (Boletín Oficial del Estado) on 23 September 2015. The law came into force on 1 January 2016.

The amendment isn't simply an update of the existing tables or particular rules pertaining to them. It is an extensive and far-reaching reform of the system established in 1995. The new system is much more comprehensive and complex than its predecessor.

Spanish lawmakers decided to reform the Motor Vehicles Public Liability and Insurance Act of 29 October 2004 (Legislative Royal Decree 8/2004). The main change is the addition of Section IV, which is made up of 112 articles, divided into two chapters. The first chapter contains the general provisions and definitions in two parts: the first one with 18 general provisions and the second with 11 definitions. The second has the rules for assessing bodily injuries, with three sections on compensation for death, in addition to permanent and temporary injuries. Furthermore, the law covers all the relevant tables.

According to the preamble to the law, the new Baremo is inspired by the basic principle of full indemnity, which aims to restore the victim to a situation as similar as possible to the one prior to the accident.

Prior to the amendment, Baremo was structured according to basic compensation payments and correction factors, i.e. two main pillars for all compensation payments due to death, permanent and temporary injuries.

The new Baremo is divided into three types of damages: basic personal damages, specific personal damages and material damages (includes loss of earnings). Material damages is one of the most important aspects of the reform because it entails a clear distinction between what can be classified as moral damages and material damages.

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### About This Newsletter

Gen Re's *Casualty Matters International* reviews new liability developments.

While examining the changes to Baremo, it is worth reflecting on certain aspects that are worth emphasising due to their impact on reinsurers.

## General provisions

According to Section IV article 33, the assessment system is based on the fundamental principle of the *full compensation* of damages. However, it does not address what happens when the damages suffered exceed the limits set by the new Baremo. For example, the amount of care required may exceed the number of hours stipulated by the law or if the hourly cost is higher than what appears in the regulation. Also, what will happen if a victim's net salary exceeds the maximum amount of EUR 120,000 in the tables?

Before the amendment took effect, the time that determined the amount of the particular type of compensation was the time of death, or the stabilisation of health or the injuries, whereas with the new Baremo it will be the point of time at which the out-of-court settlement is reached or the court ruling is announced. This might cause delays in the settlement of many claims, as postponing a settlement to the subsequent year could lead to a higher compensation due to updated actualization factors.

In addition, potential modifications to the technical actuarial standards adopted by the Ministry of Economy and Competitiveness to be in line with article 48 have to be taken into account. The economic and financial assumptions provided for in the technical standards may already be somewhat outdated; for example, the reduction of the technical interest of 3.5% could have a significant impact on the Baremo tables and lead to a considerable increase for damages.

Articles 41 and 42 stipulate that compensation can be awarded through life-long annuity schemes instead of a one-time lump sum. A court judge may decide on the settlement in cases involving minors or legally incapacitated persons.

The total amount has to be calculated so that it corresponds to the compensation resulting from the Baremo system based on the technical actuarial standard coefficients (in article 48) for the conversion between income and capital. The

annuity has to be adjusted every year to be in line with the public pensions.

The actualization of the Baremo tables is regulated in article 49. The tables will be updated at the beginning of each year in accordance with the public pensions revaluation rate. The loss of earnings and compensation for help provided by third-parties must be updated to the technical actuarial standards. The future healthcare expenses table has to be updated in accordance with the current tariffs for the provision of healthcare services.

## Rules

This section considers the rules related to each form of compensation — for death, and permanent and temporary injuries, in addition to the three types of damages in each of the cases: basic personal damages, specific personal damages and material losses.

### Compensation for death

Compensation for death is covered by articles 61 to 92 and the corresponding tables. There are five categories of injured parties who are always deemed to suffer what are called *basic personal damages*.

*Specific personal damages* can increase the amount of compensation payments for basic personal damages. Examples include:

- An accident involving handicapped relatives in the same household
- The injured party is the only family member in his/her category
- The injured individual is the sole family member
- The death of the only parent or both parents in an accident
- The death of an only child
- The death of a woman whose pregnancy is terminated as a result of the accident

A provision, which could increase the claim by as much as 25%, has been created for exceptional damages.

When assessing *material damages* for death, a distinction is made between basic material losses

(an expenditure for which there is no need to provide justification) that are fixed at EUR 400 per injured party, and specific expenses, which include costs for transportation, repatriation and funerals. The provisions that deal with material damages also include clauses on compensation for loss of earnings and regulate who is entitled to receive compensation: children under the age of 30, spouses and former spouses with pension rights. These victims must also earn an income from gainful employment or social services. The new part is that the unpaid work of the victims, who are exclusively, entirely or partly, responsible for maintaining the household, is also taken into account.

To calculate such material damages, a special actuarial model has been adopted. The net income of the injured party is multiplied by a factor, which consists of the following variables: 10% for the injured party alone, 60% for the spouse, 30% for the children and 20% for others, statutory pension, the duration of financial dependency, the risk of death and the discount interest rate that takes inflation into account.

### Compensation for permanent injuries

Compensation for permanent injuries are stipulated by articles 93 to 133 and the corresponding tables that have defined three distinct categories, as is the case with compensation for death, and that include compensation for basic and specific bodily injuries in addition to material losses, which in turn include general losses and loss of earnings.

The parties entitled to receive compensation include the injured, in the case of permanent injuries, and his or her family, in the case of a severe disability.

*Basic bodily compensation* is listed in a medical Baremo that contains an overview of the different injuries. The list includes psychological and physical damage, in addition to organ and sensory damage. The medical Baremo also includes the classification, description and assessment of the individual injuries. The degree of disability is measured in points, with 100 representing the highest possible rating. Furthermore, it includes a special section for aesthetic damage, which is rated in points up going up to 50.

The following formula is applied for concurrent permanent injuries:  $[(100 - M) \times m] / 100 + M$ . An increase of up to 10% can be applied for the aggravation through the concurrence of the consequential damages.

For injuries that aggravate a pre-existing condition of the victim the following formula is applied:  $(M - m) / [1 - (m/100)]$ .

*Specific bodily damages* are defined as additional moral damages, which result in mental and physical injuries, organ and sensory damage, and aesthetic impairment. Additionally, it includes moral damages for the impairment of quality of life due to permanent disability, especially for the family members of severely disabled victims, and the loss of a foetus as a result of the accident. Finally, it includes exceptional damages, which increase the compensation payment for basic personal damages by up to 25% and should comply with the legal principle of proportionality.

As mentioned earlier, how *material damage* is determined is one of the most important aspects of the reform. One important change concerns the anticipated expenses for future healthcare, which the insurer has to pay directly to the public health service. As yet, the regulations do not account for the possibility that the social security institution can file a claim against the liable party's insurer for damages incurred by these institutions.

The injured party will be directly compensated for the expenses for prostheses and orthoses, care at home or for outpatient care, technical devices or products that enable personal independence, changes required for his home and the resulting costs for mobility (for examples, modification of the car and other necessities).

Compensation for the cost of assistance provided by a family member or a care service is stipulated in article 120 et seq. The number of hours for each injury is specified in table 2C2. The amount of compensation is determined by multiplying it with the value of the injury found where the row with the daily number of hours intersects with the column for the relevant injury in Table 2C3. The amount is the result of multiplying the cost of the care services (1.3 times the legal minimum wage) with the value for the relevant injured party

that is based on the following factors: the right of the injured party to get help and care from a third-party, the duration, age, risk of death and the discount interest rate.

In various scenarios, especially very severe cases, both the amount of compensation and the number of hours could be insufficient for the full reparation of the damage. How courts will decide remains a question.

Compensation for loss of earnings is calculated on the basis of the victim's net income. The model is similar to the one described above: the victim's net income serves as a basis or, statistical figures in the case of minors and victims who are responsible for the household. This value is multiplied by a coefficient that is the result of the following factors: the entitlement of the victim to public allowances for home care, duration, age, risk of death and the discount interest rate.

### Compensation for temporary injuries

The rules for assessing temporary injuries are based on the differences among the three basic types of damages: basic damages, specific damages due to a temporary loss of quality of life or the results of a surgery, and material losses, with the possibility for insurers to pay the healthcare centres directly for the costs of services rendered by signing agreements, as well as various recoverable expenses and loss of earnings.

According to article 135, compensation for whiplash will only be provided for permanent injuries that can be verified by the following: supporting medical tests, a conclusive medical report concerning temporal inability to work, and the establishment of a link between the occurrence of injury and consequence of loss. The aim of this rule is to hinder fraud, which insurers experience as a result of purported damages.

This scenario could also lead to an increase in the number of disputes that land in court – at least in the initial years following the implementation of the amendment.

### Other changes

An additional amendment is the abrogation of liability for persons under the age of 14 and those who are legally incapacitated. This

will automatically lead to an increase in the compensation in such cases because a potential contributory negligence is excluded for these victims.

Article 14 stipulates a mediation procedure for disputes. Whether this will be a success remains to be seen, considering Spanish tradition and culture, and experience with the Spanish Arbitration Act.

A provision requires the injured to file a preliminary claim with the insurer. Furthermore, the law provides for the possibility that the injured party can call upon the Institute of Legal Medicine at the insurer's cost.

The third new provision affects damages that arise in connection to medical services and stipulates that the assessment system governed by this law serves as reference for future regulation of the compensation table for damages resulting from medical services. This will undoubtedly give additional impetus for this system's ripple effect as it extends not only to the field of healthcare but to civil liability as a whole.

The law only applies to accidents that occur after the law has taken effect.

However, some in the industry fear that some claims for accidents that occurred before this law took effect could be assessed on the basis of the new Baremo, if the type of compensation was not covered by the previous system. Moreover, given the anticipated ripple effect mentioned above, it seems quite easy to suppose that it might be used as a reference point for assessing bodily injuries for all types of civil liability – not just for medical services – and for all accidents that are pending on this date, as well as for accidents in which procedural circumstances allow it.

### Implications

All the changes will not only affect insurance rates, but also reinsurance rates, which are yet to be taken into account in the impact analyses commissioned by the insurance sector.

The new Baremo will also affect claims management and the training of the underwriters, not to mention the costs associated with implementation. It is worth noting that applying

the new Baremo is significantly more complicated than the previous system, so special applications will be required to facilitate the process.

Recent reforms to the Spanish Penal Code and Criminal Code Procedure, which eliminated trials for minor offences due to their decriminalisation, will also affect claims handling, especially processing time. Until now, many insurers used trials for minor offences as an opportunity to settle claims with injured parties. In addition, these trials provided the insurer the information required to assess liability for the accident and the relevant damages, as they provided access to police reports, the victims' medical files (pertaining to the accident) and the forensic medical report. Court rulings were often made once the forensic medical report had been entered into the court records. The reform will make it harder for insurers to obtain information on the injured party, so claims handling will become more difficult. Months or even years may go by between receiving the injured party's health report and the civil trial, which is required by the reform.

Baremo's impact will be particularly significant for reinsurers with excess of loss contracts given the remarkable increase in the compensation for death and more so in cases of severe injuries. Frequency and severity could also increase for some lines of business.

For now it's difficult to forecast the precise implications of the reform in figures, as there is currently no statistical data. According to case studies, claims involving severe bodily injuries might increase from EUR 1.4 million to EUR 2.5 million and even EUR 4 or EUR 5 million, depending on the individual case. And even these case studies do not take into account net incomes exceeding EUR 120,000. Compensation for death might rise from an average of approximately EUR 130,000 or EUR 150,000 to EUR 240,000.

According to the amendment's changes, age is clearly a decisive factor in determining the amount of compensation. Damages for death will increase, and compensation for permanent injuries will be higher the younger the victim.

Another decisive factor is the income level. As the maximum amount in the tables is EUR 120,000, damages for claims in which the victim's income exceeds this figure will be decided by the courts.

The severity of the injuries is an additional factor that considerably affects the amount of compensation because severity increases the damages exponentially. This is in part due to the fact that a severe injury normally increases the need for third-party assistance and leads to higher medical costs in the future.

However, we will not be able to speak of the exact impact of the changes for a few years. The claims for accidents in 2016, in particular those involving severe injuries with longer rehabilitation periods, will require more time to handle. This will be based on the point in time when the particular type of compensation is determined and on the changes in the regulations and legal proceedings.

All in all, we can confirm that the new Baremo and all the developments mentioned above will lead to a significant increase in compensation payments for more serious accidents, particularly for those cases resulting in death and severely injured parties. On the whole, this will lead to great initial uncertainty due to the greater complexity of the system, the new grounds for compensation and the new injured parties, and it will increase the number of court proceedings taking place at least for the first few years or so. The system's ripple effect on other sectors is also important to consider, and it could represent a business opportunity stemming from the need to increase the insured sums. And finally, we must once again mention the need for continuous monitoring of the application of the system and the importance of being very vigilant of possible future modifications to the economic and financial assumptions of the technical bases, which could have an extremely significant effect on accidents that have already occurred, particularly those which occurring between 1 January 2016 and the amendment in question.

In conclusion, it is safe to say that Baremo isn't taking us into the complete unknown. There will be answers to the open questions and uncertainty will turn back into familiar stability in three, four or five years, despite the fact that some have considered the last 20 years of Baremo a period of crisis.

#### About the Author

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