CLOSING ADDRESS

by Maurice Greenberg

In the United States, many risk managers of major corporations are experiencing what the motorist went through during the oil crisis -- standing in line for limited supplies at significantly higher prices with the possibility that the pump will be dry when they get to it. A recent article in a U.S. business magazine describes a "world without insurance," with a "monster" threatening to devour the industry that has created it.

The insurance industry has yet to be devoured, but he change that has taken place in the U.S. market within the last 18 months could hardly be more dramatic. At mid-1985, many U.S. insurers were facing situations they could not have conceived of a year or so before -- cancelling policies with little warning to a client, reducing coverage to a fraction of former limits, declaring themselves unable to accept new accounts in classes they had eagerly sought a few months before. Reinsurance treaties, normally finalized by the end of the calendar year, in many cases remained unsigned until March of the following year.

Compared with this picture of drastic transformation, the European scene appears peaceful. The European insurance market has operated in a fairly stable fashion over the past six years. There have not been dramatic swings in price and results that have occurred across the ocean, and while pricing has been fairly competitive, it has now probably bottomed out and we can expect to see some modest rises over the next year.

Serious storm warnings are in effect, however, for European multinationals with U.S. liability exposures. Because of the crisis situation in the American market, many multinationals have lost their U.S. coverage which used to be handled incidentally under their overall Lloyd's policies. Some of these exposures are being picked up by local European insurance and reinsurance companies which will eventually have to face the problems that the U.S. industry faces.

A Problem of No Insurance

The property/casualty industry lost $21 billion in 1984 from underwriting and the investment gain of $17 billion was not sufficient to save its operating results. When you add to this the question of adequate reserves -- some suggest the industry is short by 10 to 15 percent -- one can see that the future will not be bright.

As U.S. casualty losses continue to emerge and spread throughout the system, capacity will continue to shrink. I suspect that 1986 will be worse than 1985.

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

The industry has undergone the longest and deepest cycle in history -- 6 years. Rehabilitation will not occur overnight and for many, it will not occur at all. Many of you may think that this is a short term phenomenon and that as soon as this year's rate increases take hold, we will see the tide of capacity come rushing back.

But capital will only come into the industry when investors are convinced of a safe return, and I think there are more problems ahead than behind us. The industry's first and second quarters bear this out.

The current insurance industry problem is more fundamental than mere cyclicality. The social/legal environment in the United States has evolved to a point of crisis proportions.

The number of punitive damage awards that we live with today is outrageous. Punitive damage used to be limited to gross criminal negligence. This is no longer true. Almost every plaintiff injects punitive damage into a lawsuit and the courts have been, more frequently than not, going along with it. Punitive damages were introduced in the first place to punish a wrongdoer who was grossly, criminally negligent by forcing on him an additional payment as punishment. If this payment is passed on to an insurance company, the wrongdoer has not been pained at all. I think punitive damage awards have reached the point of absurdity.

The contingency fee system, which exists in the U.S. and no place else, is probably one of the gravest contributors to the litigious nature of our civil justice system. It encourages and proliferates lawsuits and all of us are paying for it.

If insurers can't price a product that must be delivered in 10 or 20 years, how can they write it? If insurers can't measure the exposure, how can they price the coverage?

There is some movement toward tort reform. The New York State Legislature has passed a bill which was signed by the Governor to alleviate the medical professional crisis. The bill reduces the contingency percentage of attorney's fees, ranging from 20 percent of the first $250,000 and scaling down to 10 percent over $1,250,000. Awards for pain and suffering are to be structured over the life of the individual. Under the bill, hospitals are required to take on a new responsibility and degree of care in qualifying physicians and establishing peer group review in an attempt to further control medical incidents. If a judge determines that a suit is frivolous, the defendant may recover his legal expenses up to a limit of $10,000. Such measures will help the medical profession in New York. But these changes represent only a beginning for U.S. civil justice reform.

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

Product Liability

It's totally impossible, for example, to measure the influence product liability laws have had on the prices we pay for consumer goods. It's unfair to hold a manufacturing industry accountable for a standard of care that is different from what was believed when the product was first introduced, and especially when the product met all the tests for the standard of care. Now we're finding, twenty years later, that a court decision can say we must hold the manufacturer accountable for what we know about a product today -- rather than what we knew 20 years ago when it was being designed, tested, developed. At this rate, no one will want to manufacture certain types of vaccines or sports equipment or household tools. Doctors are leaving their practices because they can't buy malpractice insurance. The whole system is spinning out of control.

Changing the Legislative Climate

We are not going to change the legislative climate in the U.S. overnight, but we realize it has to change. Change can only happen with a unified plan between the business community and the insurance industry. Insurers can't fight that battle alone. We don't have the credibility alone. I think that jointly we can do far more than has been done to date. There has to be a major effort to change the climate of the legal system as it applies in the tort system in the U.S. Failing that, there are going to be fewer and fewer carriers willing to underwrite anything in this market.

This creates a new reality for European risk managers, who have been insulated from much of the pressures of the U.S. insurance markets. They need to prepare themselves now for sharp changes at renewal time. Liability covers, which have been written by local European insurers in recent years, will be far more difficult to place and a return to U.S. markets will be necessary.

Budgeting for insurance programs will become more challenging, as a disproportionate amount of premium must be allocated to U.S. exposures. European risk managers must realize that pricing for their U.S. exposures will be entirely different from the rest of the world, and that it is, in fact, almost impossible to determine sufficient coverage in the United States.

Some smaller exporters may decide to withdraw their products from U.S. markets if product liability becomes prohibitive or unobtainable. In pollution liability, policy forms are still much broader in Europe than in the United States, where coverage is severely restricted or even unavailable.

For the short term, a claims made form is one answer. It is a restrictive form, without all of the broad features and extensions of coverage we have been used to. The claims made concept is not new. We saw it utilized for tail business in the early seventies in the United States, particularly in professional liability.

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

Products liability coverage on a claims made basis has also been included in some European forms. In France, for example, some policy forms restrict cover to damage or injury which occur between the date of inception of the policy and its termination, with a limited extension of reporting up to one year after the policy expiration.

The whole products liability issue will continue to be a major national problem, the consequences of which cannot really be over-estimated. We all have to deal with it.

Shrinking Capacity

Both the direct and reinsurance markets are in an extremely fragile position. Industry losses for the past two and a half years have resulted in a major challenge of meaningful capacity. First, the retrocession market which has probably been the most irresponsible area of the business has disappeared, leaving reinsurers writing business virtually for their own retained accounts. The retrocession markets have borne the brunt of the competitive cycle as they are the final link at the end of a chain of progressively diluted premiums and escalating losses. The collapse of the retrocessional market is not the only reason for the present capacity squeeze. Lloyd's which historically derives the majority of its premium income in U.S. dollars, while seeing its capital basis increase in pound sterling terms, has seen its capacity reduced by some 30 to 40 percent purely on the strength of the dollar. This situation is similar through most of the world. The strength of the dollar also has an alarming effect on the reserves already posted by international reinsurers for U.S. claims in their local currencies.

The so called "Third World Market," the Bermuda market, which added so much capacity in the late seventies has folded and left trails of red ink for many of the industrial parents.

Other Concerns

Another area which must be addressed is terrorism. Not only is terrorism on the rise but 1984 marked the first year in which terrorist acts against corporations exceeded those against governmental agencies. Security against terrorism must be an integral part of your company's insurance program. From a protection point of view, more insurance covers are being developed in the areas of kidnap and ransom and product and property extortion, including damage by terrorist acts under standard forms. Companies must develop formal programs to reduce the potential and minimize damage and disruption after an event has occurred. AIG has set up a separate facility to address this whole area and will be working with organizations in their planning stages.

Risk managers must be concerned with their insurance carriers' security and continuity. Many of you are going to have to participate more broadly in your own risk. Deductibles are going to go up, much higher than they have been. Coverage is going to be restricted more than it has been. We have to

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

work out this problem together, and we will do all we can as a company to meet the needs of our clients. We must develop long term relationships in order to achieve stability of market and coverage.

<u>Summary</u>

The near future will be a major transition period for both buyers and sellers of the insurance product.

- There will be significantly less capacity in U.S. casualty, specifically products liability.

- Coverage application and form design will be restricted and in some instances the way we do business will change to claims made instead of occurrence.

- Pressures on the insurance industry to finance social problems will continue through the decade.

- Strict liability reward rather than indemnity will continue to burden the underwriting community.

- Manifestation of injury from existing and past technology will emerge, stretching even further the capacity of the underwriting community.

- The efficacy concept will impact manufacturers and their ability to cope with potential resulting liabilities.

- We must work together to bring about tort reform and change the fundamental causes of the ills which plague buyer and seller.

* * *

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE

Donación de AGERS al Centro de Documentación de FUNDACIÓN MAPFRE