

General Insurance Parallel Session: Latent Exposures

March 19, 2002

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A New Challenge for Actuaries**

Agenda

- Asbestos
 - Current Status of Asbestos Litigation
 - Reasons for the Increases in Claim Filings and Settlement Awards
 - Milliman USA Estimates of Ultimate Asbestos Liabilities
 - Reserving / Quantification Issues
 - Tillinghast Estimates of Ultimate Asbestos Liabilities
 - Where Do We Go From Here?
 - Recent Changes
 - Possible Federal Legislation
 - Worldwide Exposure
- Emerging Latent Exposures
 - Identified Exposures (e.g., Pollution)
 - Developing Exposures
- Effects of Latent Exposures on Company Valuation

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Asbestos Claims Continue to Mount

Specter of Costly Asbestos Litigation Haunts Companies

*How Plaintiffs' Lawyers
Have Turned Asbestos
Into a Court Perennial*

*Asbestos Suits
Target Makers
Of Wine, Cars,
Soups, Soaps*

Firms Hit by Asbestos Litigation Take Bankruptcy Route

Asbestos claims standards raised

*W.R. Grace Seeks Bankruptcy Protection
In the Face of Asbestos-Related Litigation*

Background

- Miracle mineral
- Over 3000 applications
- OSHA guidelines since 1971
- Asbestos containing products still legal in the U.S.
- Diseases marked by long latency period (average 15 to 40 years)

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Legal Landscape

- Started with Borel vs. Fibreboard in 1972
- Super Strict liability standard rather than negligence based liability
- U.S. Supreme Court in two decisions closes off avenue for meaningful class action settlements
- In Daubert v Merrill Dow the U.S. Supreme Court sent a message to federal judges to act as gatekeepers against the use of “junk science”
- In Metro North v Buckley the U.S. Supreme Court rendered awards for emotional harm and medical monitoring inappropriate
- The Cosey v E.D.Bullard Co case in Mississippi was the last straw that broke the camel’s back

Tort Process

- Types of lawsuits against asbestos defendants
- Typically plaintiffs name 30 to 40 defendants
- Statute of limitations
- Until recently, defendants preferred to enter into bulk settlements rather than taking cases to trial

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The Specter of Asbestos

- Increase in claims reported by Manville and other defendants in 2000 and 2001
- Majority of the plaintiffs filing claims are not impaired
- Defendant pool has expanded from 300 in the mid-1980's to 2,400 today
- Over fifty asbestos-related bankruptcies to date
- Nineteen asbestos-related bankruptcies since 2000 alone
- Average settlement demands for individual defendants have increased
- Legislative attempts have been unsuccessful so far
- The court system has ceased to be effective in the fair determination of liability
- The U.S. Supreme court has closed off the avenue for meaningful class action settlements
- As companies file for bankruptcy, costs are being shifted to solvent parties and new defendants
- Experts increase asbestos liability projections for defendants and insurance companies

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Reasons for Increase in Filings

- Bankruptcies require identification of all claimants prior to the bar date, resulting in a surge of claims for all defendants
- Plaintiff's attorneys mining for claimants through advertising and free asbestos screenings
- Claims awareness has increased
- The exposed population is now believed to be in excess of 100 million, considerably higher than the 28 million estimated by Selikoff
- Broadening of industries

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Reasons for Increases in Claim Size

- As companies become bankrupt, solvent companies share of awards increases because of joint and several liability
- Grouping of unimpaired plaintiffs with impaired plaintiffs
- Defendants cave in to higher demands because of fear of plaintiff attorney tactics
- Forum shopping

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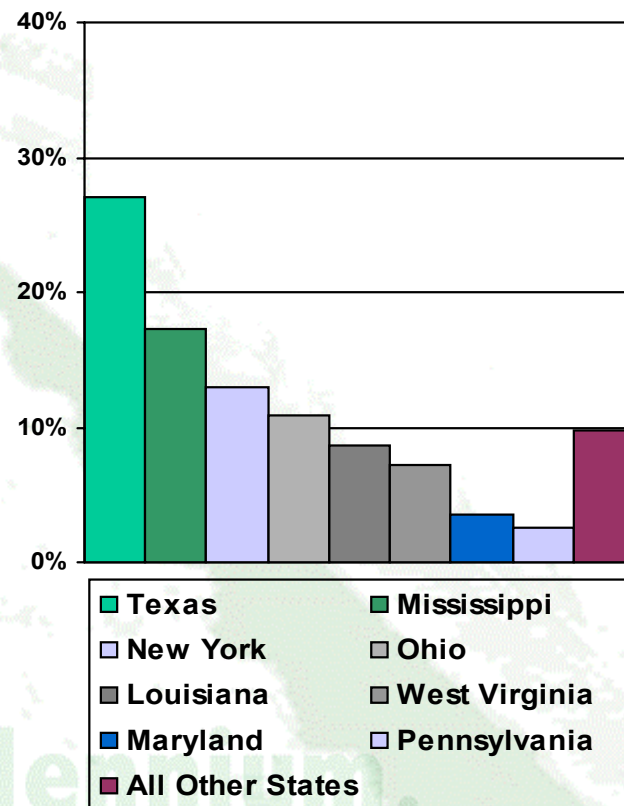
Forum Shopping Increases Severity

- Courts have allowed joinder or grouping of claims to deal with huge caseload
- Plaintiffs use joinder rules to “forum shop”, or migrate to courts with favorable rules

Award sizes in various states (Indexed to Ohio)

Mississippi	19
Texas	3
Ohio, Pennsylvania, and Indiana	1

Total of 136,000 Pending Claims as of
6/30/2000
Sample Asbestos Defendant



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Coming to Terms

- Increased level of claim filings in 2000 and 2001 (Reported to date > ultimates estimated by experts in 1993)
- YOFE still in 50s – 60s for claims being reported
- More industries and more people exposed
- Average age of claimant population is not increasing
- % of non-malignant claims increased, but there is also an increase in the number of malignant claims

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Coming to Terms

Number of Claims Received by One Defendant

Year	Mesothelioma	Lung Cancer	Other Cancers	Non-Malignant	Total
Number of Claims Filed					
1999	1,309	1,774	357	24,976	28,416
2000	1,597	2,642	634	50,203	55,076
Percentage Distribution					
1999	4.6%	6.2%	1.3%	87.9%	100.0%
2000	2.9%	4.8%	1.2%	91.2%	100.0%

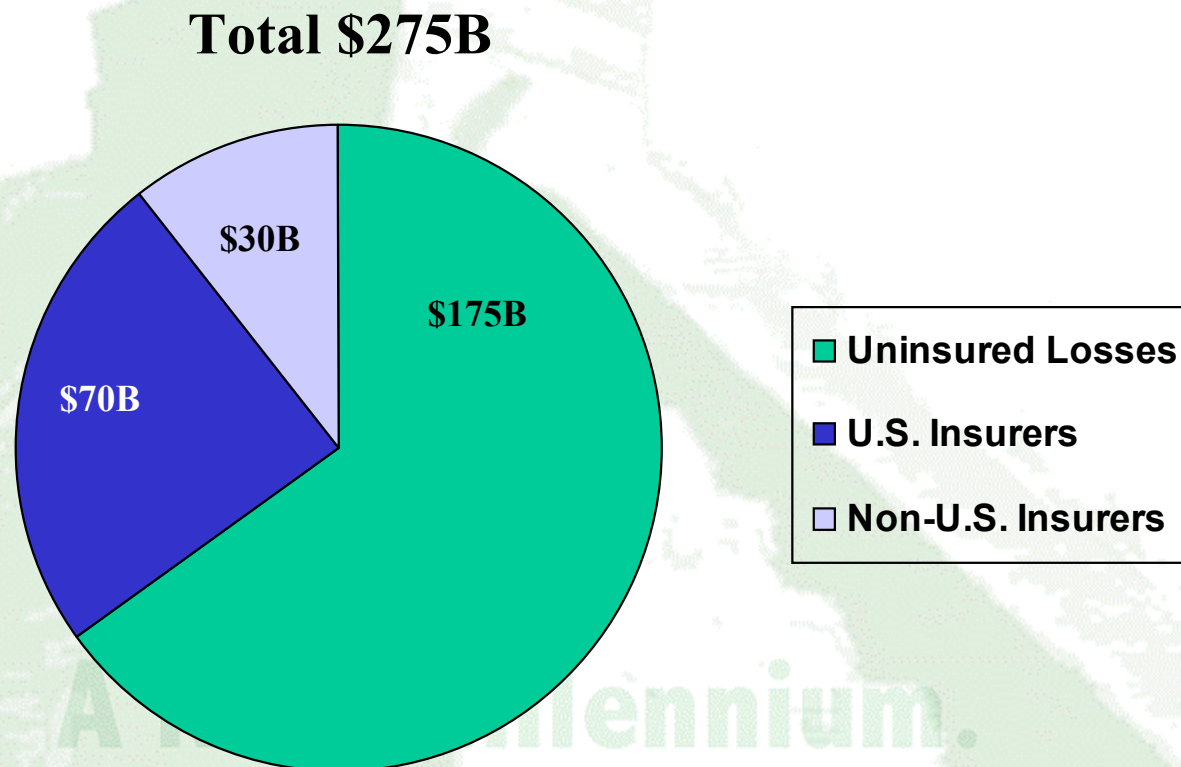
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Sources of Increase for Insurers

- More losses reported for known defendants
- Increase in size of defendant pool, providing more potential limits
- Defendants involved in installation activity claiming coverage under Premises/Operations

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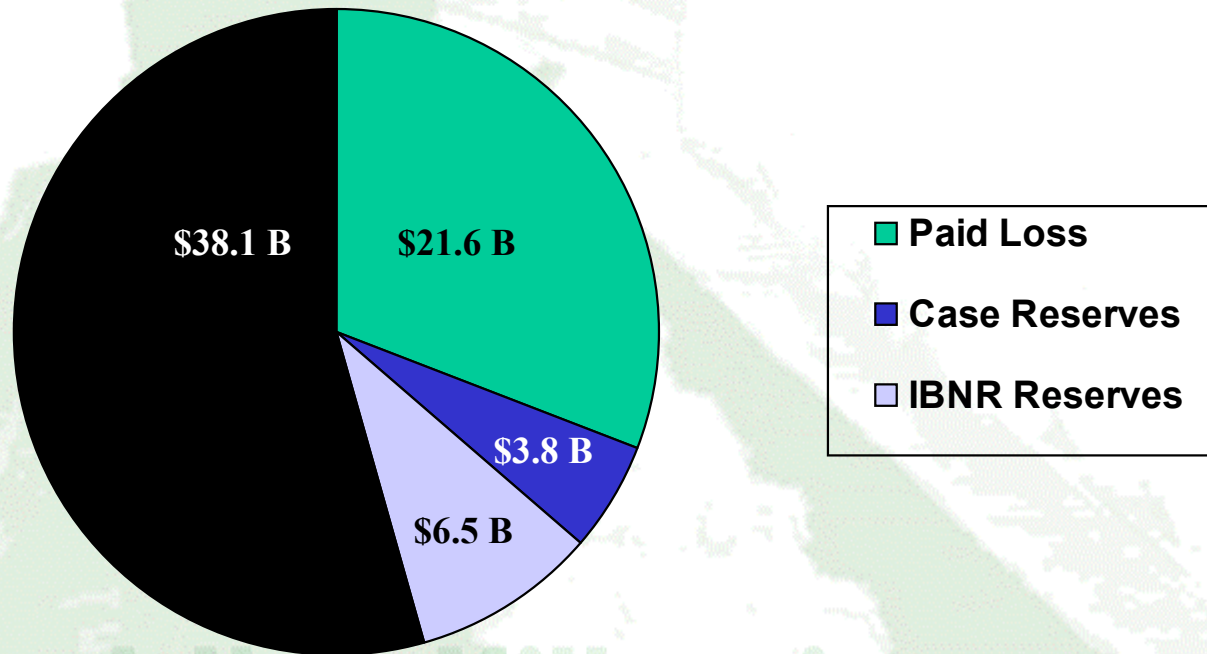
Milliman USA Estimates of Ultimate Loss and Expense Due to U.S. Asbestos Exposure



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Impact on U.S. Insurers

As of December 31, 2000



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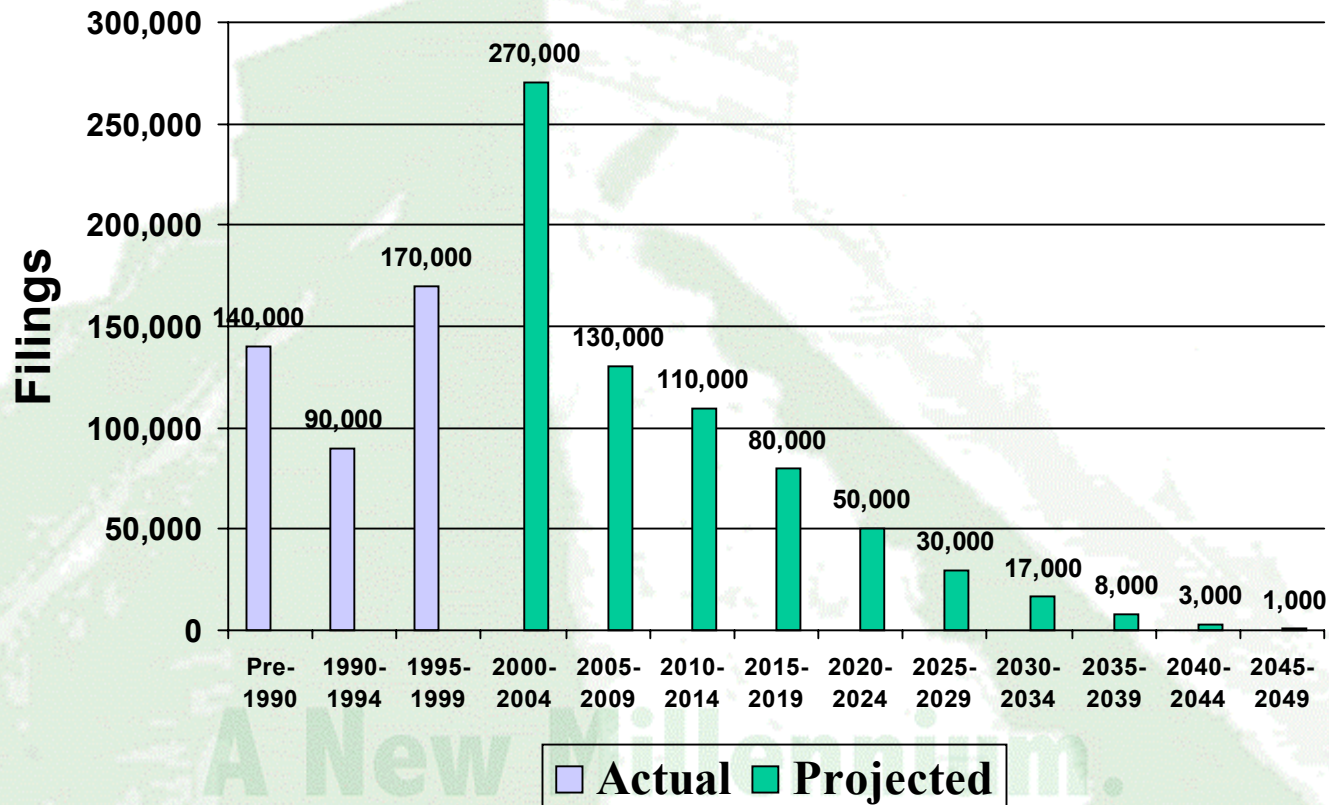
Data and Methodology

- Counts and averages method by disease type
- Individual defendant data by disease type
- Coverage profiles used to estimate direct U.S. and non-U.S. insurance splits
- Proprietary and A.M. Best information to get reinsurance assumed and ceded for U.S. and non-U.S.

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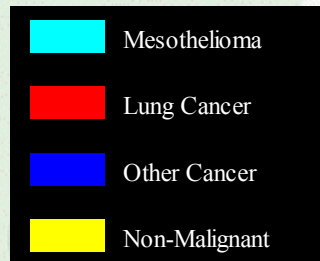
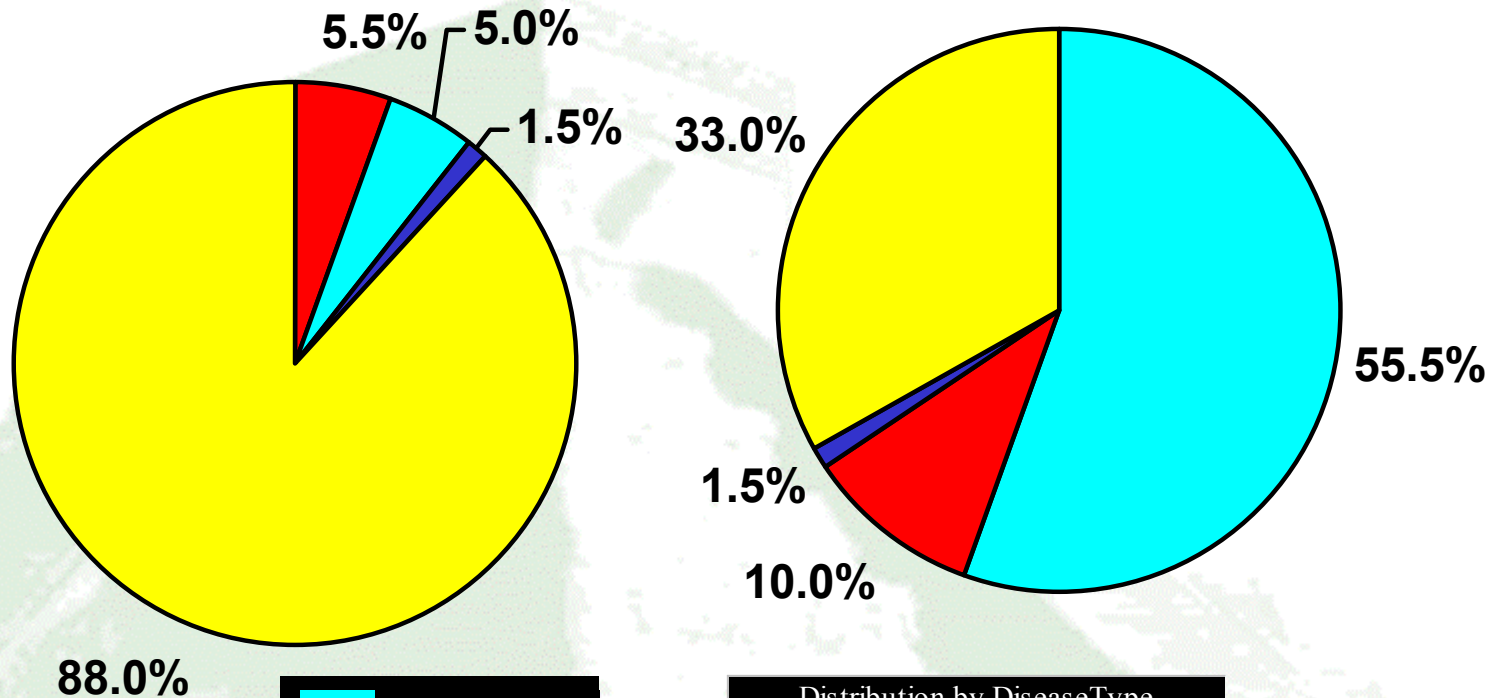
Milliman USA

Projected Claim Filings



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Milliman USA Projection of Ultimate Filings and Losses by Disease Type



Distribution by DiseaseType		
	<u>Filings</u>	<u>Losses</u>
Mesothelioma	5.0%	55.5%
Lung Cancer	5.5%	10.0%
Other Cancer	1.5%	1.5%
Non-Malignant	88.0%	33.0%

Key Factors Underlying Milliman USA Projections

- 0.5M claims filed as of June 2001; ultimately 1.1M estimated
- Our estimate of future filings of 0.6M is significantly less than the 1.4M Manville is expecting under a middle scenario
- Our future projections are 80% of Manville projections for Meso claims; 40% of Manville projections for non-malignant
- We assume stricter medical criteria will be imposed in the future and that the 2000/01 surge is partially caused by acceleration due to bankruptcies
- The average differentials of settlement values between disease types will be similar to OCF NSP and close to what is achieved in a tort system
- The \$175B uninsured portion could be lower if gaps cannot be filled in the future. This will not lower insured losses
- Expense estimated to be approximately a third of losses

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Reserving Issues

- For ground-up or top-down methods, consider the issues that drive losses and use up-to-date data
- Few large claims and/or large policies may distort results obtained using top down methods
- Are there any claims/policies that do not have product aggregate limits?
- Exposure to premises/operations – Review settlement agreement language and be aware of insureds who were involved in installation and manufacturing
- Track the claims from new insureds to check reasonableness of IBNR provision
- Check the reasonableness of reserve estimates reported by pool managers – when were the actuarial estimates made?
- Impact of bankruptcies on payment of claims – possible speed up?

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How to Quantify Asbestos Liabilities?

- Actuaries typically like to use past experience to predict the future
- However, for asbestos we can't use traditional actuarial methods (e.g., accident year loss development projections)
 - Long latency from exposure to disease manifestation
 - Potential involvement of multiple policy periods for individual claims

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How to Quantify Asbestos Liabilities?

- Many use benchmarks or rules of thumb
 - Market share techniques
 - For example, 5% of GL premium volume for affected years translates to 5% share of ultimate liabilities
 - Survival ratio techniques
 - equals ratio of total reserves divided by average annual payments
 - U.S. net asbestos survival ratio was 7.6 (excluding Fibreboard) as of 12/31/2000
 - A.M. Best now using a discounted survival ratio of 12.0
 - Comparisons to peer companies (e.g., significant reserve additions)
 - \$5 - \$10 billion in U.S. insurer reserve additions during 2001 estimated by Standard & Poors
 - CNA - \$1 billion pre-tax per A.M. Best; \$750 million after tax (August 3, 2001)
 - ECRA - \$1 billion pre-tax estimated by A.M. Best (February 2002)
 - Equitas
 - £1.5 billion as initially undisclosed portion of total strengthening as of March 31, 2000
 - £1.7 billion (\$2.4 million) as of March 31, 2001 (announced July 2001)
 - Aggregate development
 - multiples of paid losses, case reserves, or reported losses

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How to Quantify Asbestos Liabilities?

- Exposure-based modeling will improve understanding of ultimate A&E liabilities
- For an insurer or reinsurer, it considers
 - Mix of insureds
 - Types of coverage
 - Policy wording
 - Attachment points and limits
 - Years of coverage
 - Claims handling and settlement activities
- Greater understanding equips the defendant, insurer, or reinsurer to deal strategically with its exposure

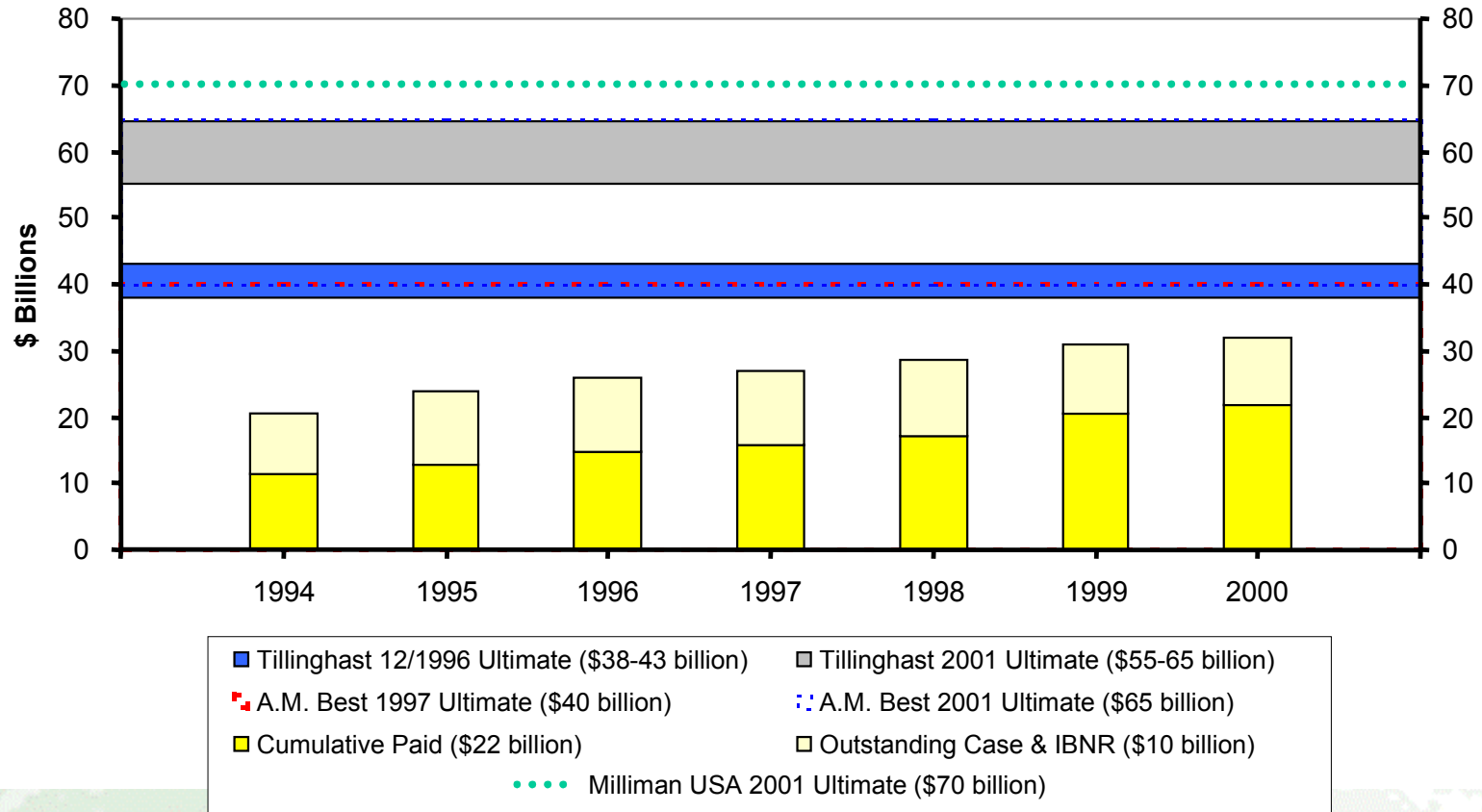
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Estimates of the “Universe”

<u>Source</u>	<u>Net U.S. Insurer/Reinsurer Ultimate Loss & ALAE</u>	<u>Comments</u>
A.M. Best	\$65 billion	From May 7, 2001 Special Report
Tillinghast	\$55 - \$65 billion	Released May 30, 2001
Milliman USA	\$70 billion	From the September 2001 edition of Best Week

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Paid and Reported Loss and Expense Compared to Estimates of Net U.S. Ultimate Liability



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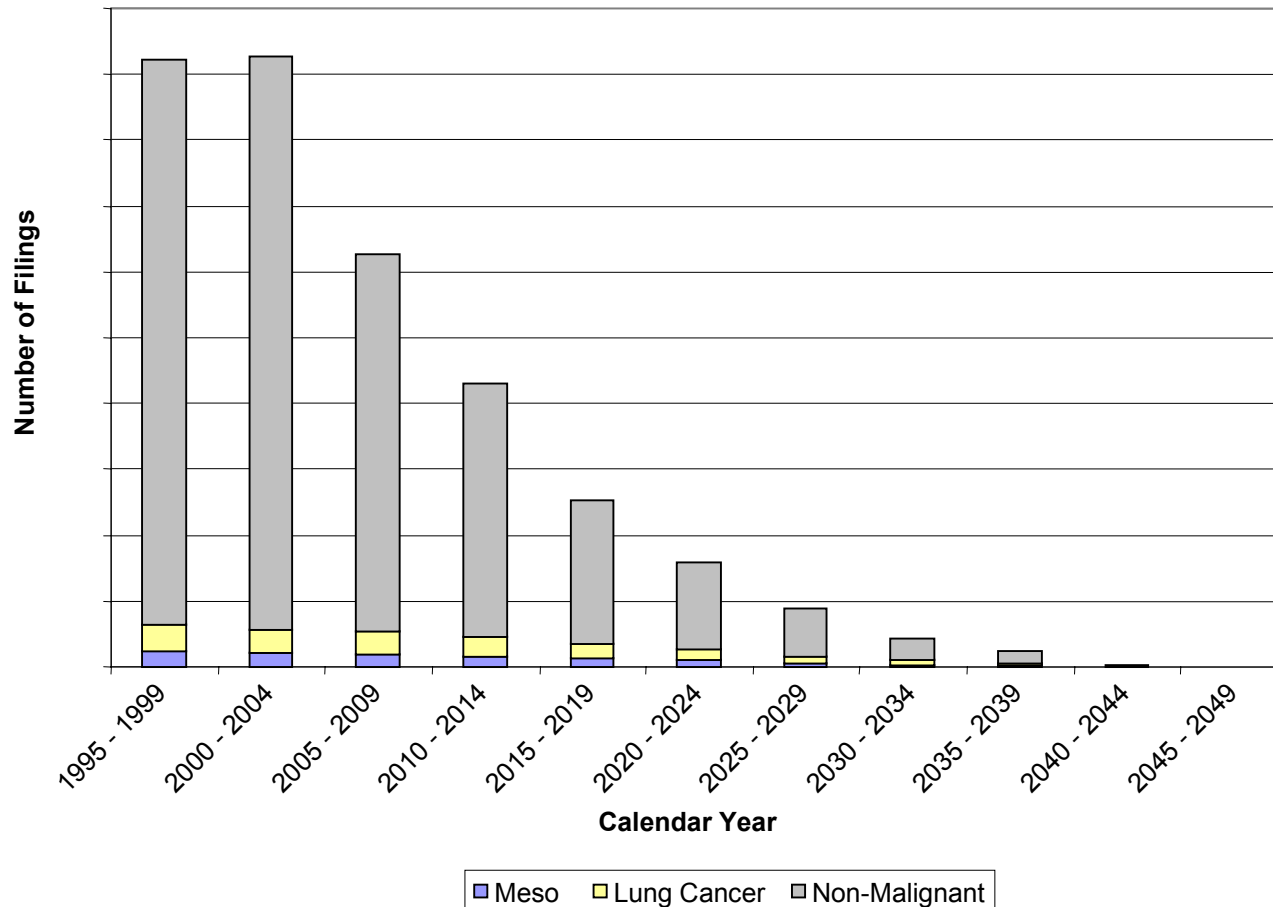
Estimation of Ultimate Loss and Expense – Tillinghast –Top Down

- Estimate total awards to plaintiffs ~\$200 billion
 - Estimate number of personal injury filings by disease by calendar year
 - Estimate average indemnity by disease
 - Trend to future years
 - Multiply future filings by trended severities
 - Load for expense

Year	F = # Claims			S = Avg. Indemnity			Total Cost Incl. Expense
	Meso	LC	NM	Meso	LC	NM	
≤2000	Reflects <ul style="list-style-type: none"> • exposure • latency • disease incidence, and • propensity to sue 			Trended			$(F \times S) \times (1 + \text{expense})$
2001							
2002							
2003							
2004							
⋮							
2010							
⋮							
2020							
⋮							
2030							
⋮							
2040							
⋮							
	~1 million						~\$200 B

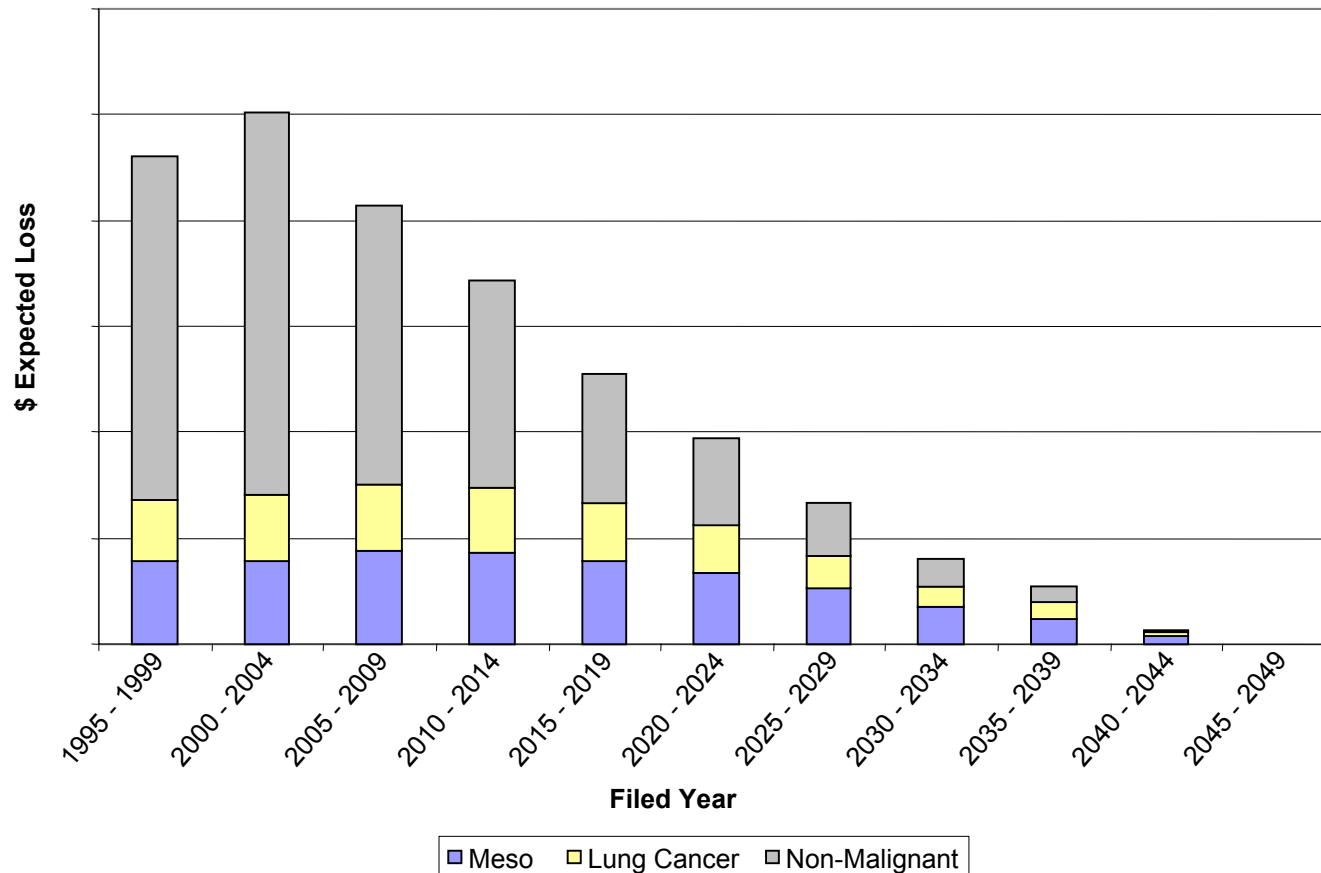
Estimation of Ultimate Personal Injury Claim Filings

Tillinghast Projection of Asbestos Related Filings



Estimation of Ultimate Loss and Expense

Tillinghast Projection of Asbestos Related Ultimate Losses



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Estimation of Ultimate Loss and Expense – Tillinghast – Bottom Up

- Estimate total cost to defendants ~\$200 billion
 - Develop database of defendant experience to year-end 2000
 - Number of filings against defendants
 - Average indemnity (defendant's share)
 - Expense-to-indemnity ratios
 - Resulting distributions vary by tier
-

The Types of Asbestos Defendants

Tier 1: Manufacturer/producers in litigation since inception

- Will use all available insurance coverage

Tier 2: Became involved shortly after Tier 1 companies

- Some will exhaust all insurance coverage
- Others will not hit highest layers due to smaller share of industry

Tier 3: Manufacturers, distributors and installers brought into litigation due to Tier 1 and Tier 2 bankruptcies

- Lesser exposure due to encapsulated products or limited distribution

Tier 4: Owned/operated facilities where asbestos used and third parties exposed on premises



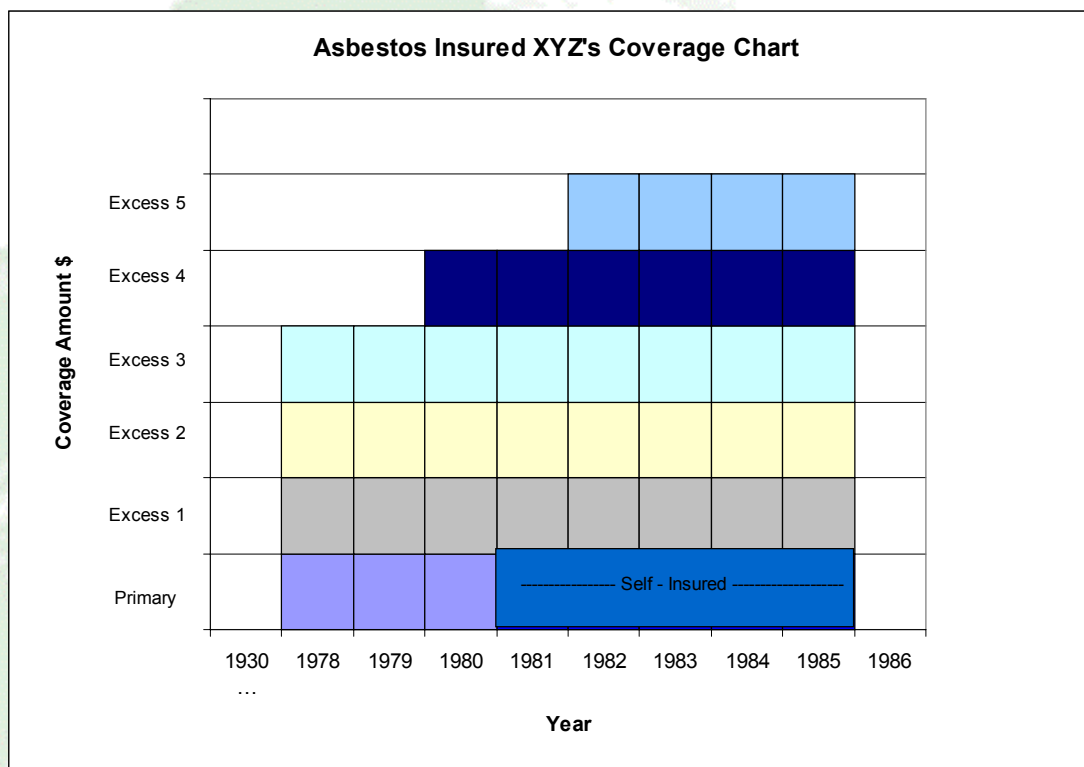
Estimation of Ultimate Loss and Expense – Bottom Up

- Project future filings for each defendant
 - implies ~60 defendants per plaintiff case
- Project future severities by defendant
 - implies average ultimate severities of \$1,873 to \$5,550 – vary by tier.
- Project future expenses (defense costs) by defendant
 - Implies average ultimate expense loads of 20% to 116% – vary by tier.
 - Reflects a reduction in expenses for Tier 3-Low defendants over a five year period.

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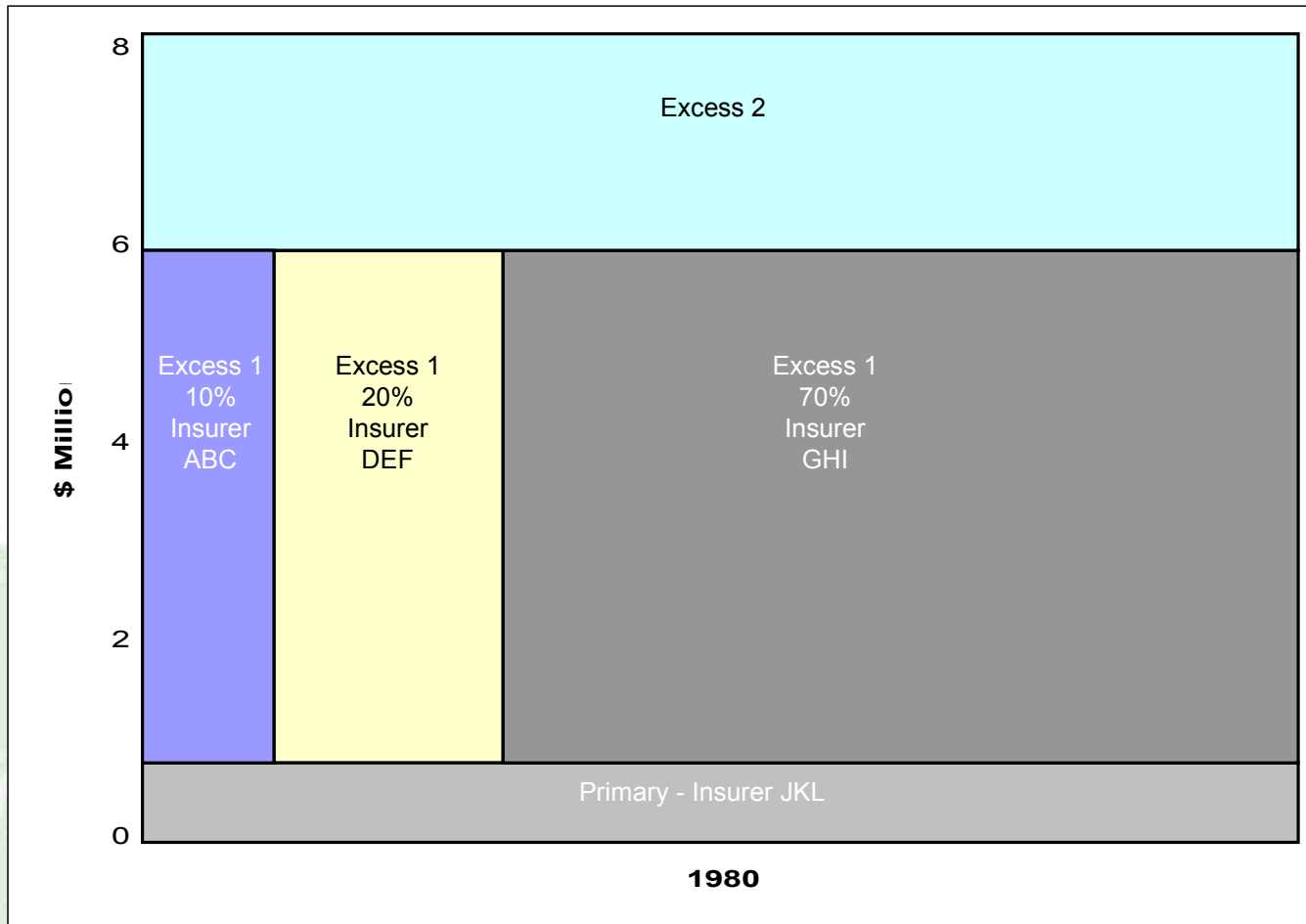
Estimation of Ultimate Loss and Expense – Bottom Up

- Determine percentage insured
 - Allocate indemnity and expense to year
 - Compare to average coverage profiles
 - Expense treatment varies by policy



- Consider reinsurance cessions

More Detailed Coverage Description of Excess 1 Layer in 1980



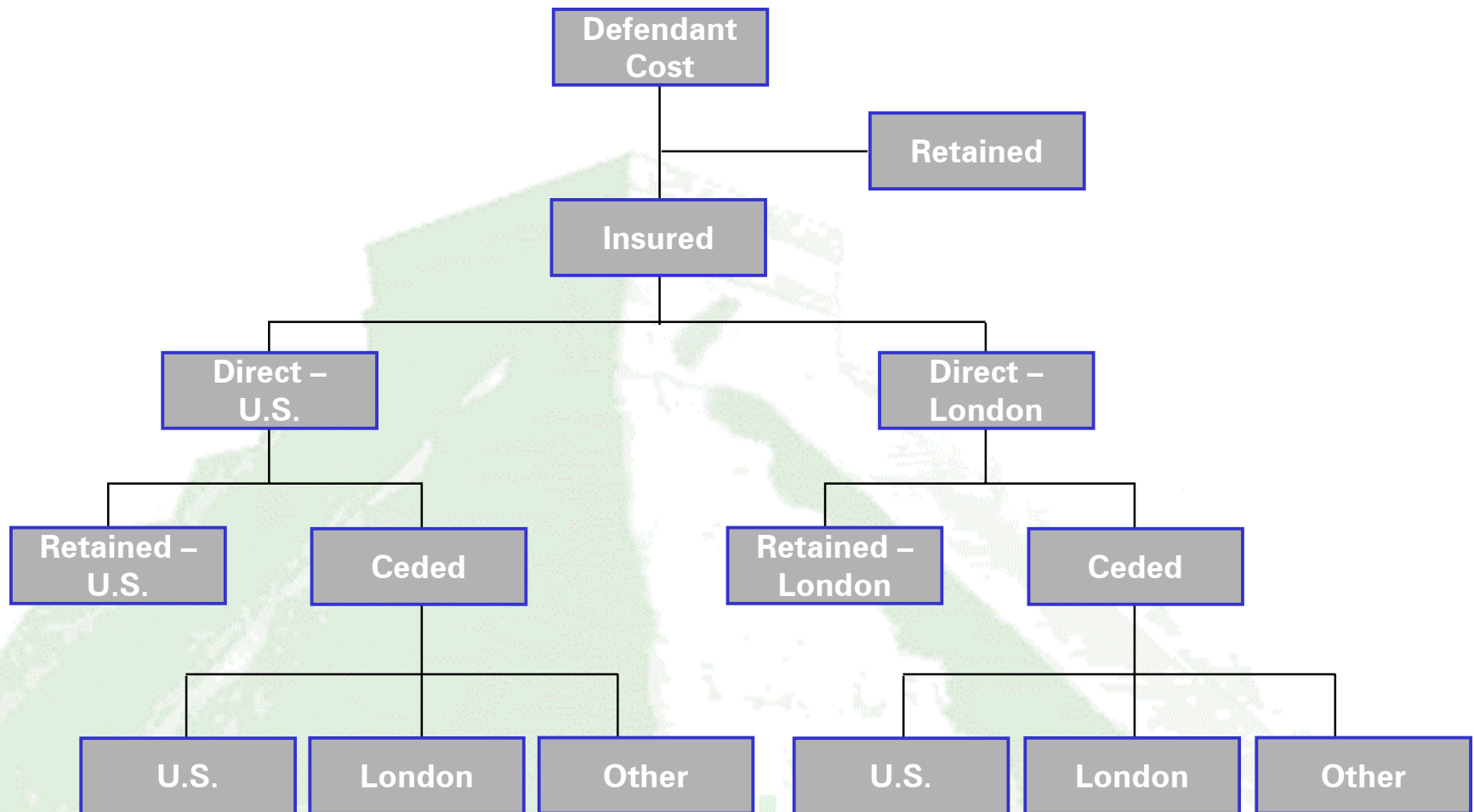
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Comparison of Loss Allocated to 1980 to Available Coverage of Insurer ABC

- For example, if Insurer ABC wrote 10% of \$5 million xs of \$1 million in 1980, and ultimate losses allocated to 1980 totaled
 - $\leq \$1,000,000$, then Insurer ABC's gross liability would be \$0
 - \$4,000,000, then Insurer ABC's gross liability would be \$300,000 ($= 10\% \times (\$4,000,000 - \$1,000,000)$)
 - $\geq \$6$ million, then Insurer ABC's gross liability would exhaust its limit of \$500,000

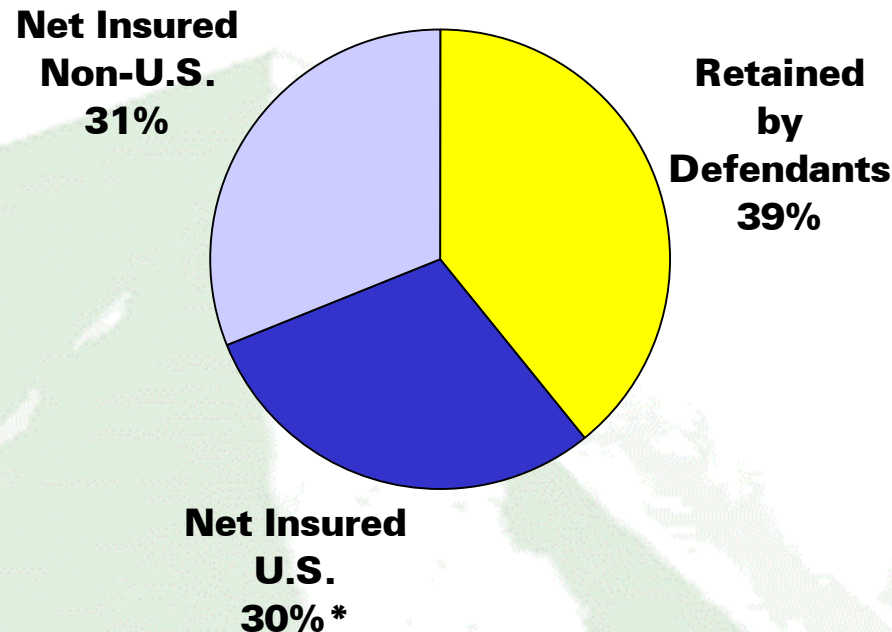
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Allocate Ultimate Loss and Expense of \$200 Billion Among Multiple Payers



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Portion of \$200 billion Ultimate Loss and Expense – Retained, Net Insured U.S., Net Non-U.S.**



*\$60 billion mid-point of \$55 – \$65 billion range of the “Universe” of net liabilities to the U.S. P/C market.

**Additional details available in Emphasis 2001/3, “Sizing Up Asbestos Exposure,” a publication of Tillinghast – Towers Perrin, at www.towers.com.

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Where Do We Go From Here?

Recent Changes in Claims Handling

- Asbestos claims handled differently than other torts
 - volume/docket pressure
 - bundling
- Center for Claims Resolution (CCR) changes its procedures
 - abandons practice of routinely settling cases on a group basis and requiring members to share settlement costs (February 2001)
 - stops settling new asbestos claims for remaining 14 members effective August 1, 2001; in run-off
- Equitas leads London insurers, requiring evidence of injury and product identification effective June 1, 2001

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The Coalition for Asbestos Justice

- Formed in 2000 as a nonprofit association to address and improve the asbestos litigation environment
- Currently has eight members: Ace, Argonaut, Chubb, CNA, Fireman's Fund, The Hartford, Liberty Mutual, and St. Paul
- Mission: To encourage fair and prompt compensation to deserving current and future asbestos litigants by seeking to reduce or eliminate the abuses and inequities that exist under the current civil justice system
- Coalition is not involved with insurance coverage issues
- Working to effect change through public education (including the judiciary), amicus briefs, and jurisdictional litigation efforts



Public Education

- A primary mission of the Coalition is to foster a better understanding of the current asbestos litigation environment
 - Research and Studies (e.g., RAND Study update (www.rand.org))
- Academic Scholarship
 - Victor E. Schwartz & Leah Lorber, “A Letter to the Nation’s Trial Judges: How the Focus on Efficiency Is Hurting You and Innocent Victims in Asbestos Liability Cases” 24 Am. J. Trial Advoc. 247 (2000)
 - Mark D. Plevin & Paul Kalish, “Where Are They Now? A History of the Companies That Have Sought Bankruptcy Protection Due to Asbestos Claims” Vol. 1, No. 1 Mealey’s Asbestos Bankr. Rep., Aug. 2001
- “This is NOT your father’s asbestos defendant”

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Jurisdictional Litigation Efforts

- Identifying jurisdictions that pose the biggest challenges for asbestos defendants and truly sick claimants
 - Key states: CA, IL, LA, MD, MA, MS, NJ, NY, PA, TX, WV
- Meeting with counsel from these states to understand the current case management orders and identifying other due process issues
- Advancing inactive dockets / pleural registries
- Challenging consolidations and joinder rules

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Changes in the Wind?

- There are a few signs in the asbestos litigation environment that business may not be as usual
 - A split in the asbestos plaintiff's bar between those representing “real” cases versus those representing the non-impaired
 - Judge Weiner's ruling in the Federal MDL dismissing all cases that were initiated through mass screenings
 - Efforts in current bankruptcies to establish medical criteria and the consolidation before U.S. District Judge Alfred M. Wolin
 - Hearing held by Judges Weinstein and Lifland in the Johns Manville bankruptcy proceeding



Changes in the Wind?

- There are a few signs in the asbestos litigation environment that business may not be as usual
 - Judge Pickard's ruling in Mississippi that he will no longer allow out of state plaintiffs to file suit in Mississippi
 - Various challenges to the West Virginia mass trial scheduled for June 2002
 - Pennsylvania Asbestos Litigation (SB 216) dealing with asbestos-related liabilities acquired via merger or consolidation
 - Many more articles in the business press and from investment analysts advocating the need for an asbestos solution

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Recent Headlines

- “Asbestos & Environmental Losses Nearly Doubled in ‘99” – BestWeek (July 10, 2000)
- “Asbestos Claims Still Killing” – The Economist (August 19, 2000)
- “Equitas significantly increases reserves for asbestos liabilities” – The Review (September 4, 2000)
- “Insurer Asbestos Woes Grow” – National Underwriter (October 16, 2000)
- “How Plaintiffs Lawyers Have Turned Asbestos Into a Court Perennial” – The Wall Street Journal (March 5, 2001)
- “The Energizer Bunny of Toxic Torts” – Emphasis (First Quarter 2001)
- “Asbestos Claims Surge Set to Dampen Earnings for Commercial Insurers” – A.M. Best Special Report (May 7, 2001)
- “Asbestos Litigation in the U.S.: A New Look at an Old Issue”- RAND Institute for Civil Justice (August 2001)
- “The \$200 Billion Miscarriage of Justice” – Fortune (March 4, 2002)
- “The Asbestos Pit” – Time (March 5, 2002)

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Possible Federal Legislation

- The Fairness in Compensation Act (H.R. 1283/S758) did not advance
 - would have established the Asbestos Resolution Corp.
 - opposed by President Clinton and the plaintiff's bar
- Likely prospective proposals supported by the Asbestos Alliance (led by the American Insurance Association and the National Association of Manufacturers) will focus legislation on four areas
 - establishing objective medical criteria of asbestos-related impairment
 - liberalizing statutes of limitations
 - eliminating consolidations
 - eliminating forum shopping

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Quotes from Clients and Colleagues

- “The claims are continuing.”
- “We have more open accounts today than we did ten years ago. We’re seeing more claims against Main Street America – distributions, hardware, HVAC.”
- “Claim filings have remained steady; we expected a decrease by now.”
- “Asbestos is the energizer bunny of toxic torts; it keeps going and going and going...”
- “We are seeing operations claims from new defendants (contractors, distributors)”
- “We’ve been approached by producers seeking finite cover. The cover might be a positive influence on financial analyst opinions ... The defendants must anticipate that filings will continue ... A small number of deals are being done.”
- “I expect to see at least five more bankruptcies of asbestos defendants in the next 12 to 18 months.” *(This was stated in September 2000; since then, numerous defendants have declared bankruptcy ...)*
- “The life of HR1283 hinges upon the outcome of the presidential election.”
- “Asbestos litigation is a profit-driven industry.”
- “Don’t think of them as lawyers, think of them as venture capitalists.”
- “... factories (be they lawyers) generating paper ... Here’s the form, fill in the blanks ... won’t end by when I die, even when my kids die ...”

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Current Status Recap – U.S.

- Significant deterioration in liabilities at all levels
 - Defendants, insurers, and reinsurers
- Generated by filing activities
 - Mitigated by shift in disease mix to claims with lower settlement values
- Continue to see more bankruptcies or finite deals
- May see increased attention to what the defendants are carrying on their balance sheets
 - Current focus has been from financial analysts, not auditors
- More scrutiny from insurance regulators

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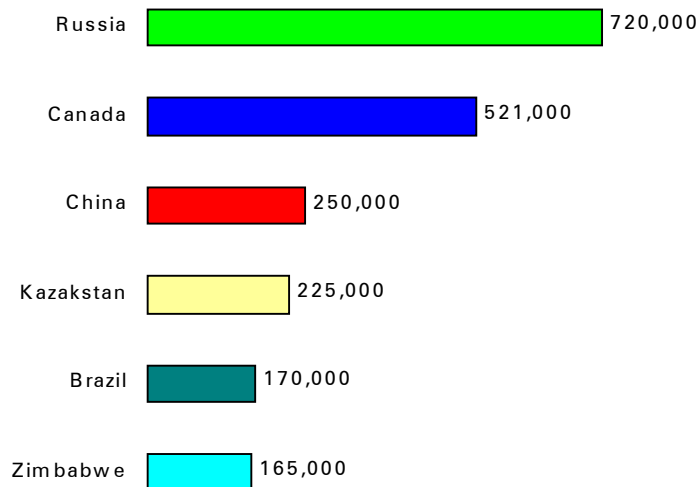
Current Status Recap – U.S. (cont'd)

- More than 25 years after peak usage, we still see significant activity on the claims side
- It's the “Energizer Bunny” of toxic torts
 - It just keeps going and going and going ...

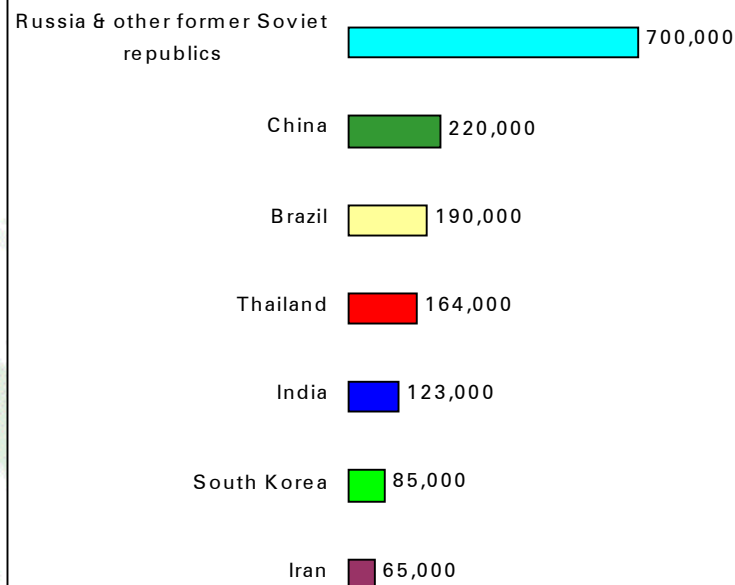
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Asbestos: Around the World

Largest Producers, 1996
(in metric tons)



Largest Consumers, 1994
(in metric tons)



Source: USA Today, "The Asbestos Epidemic," February 1999.

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Asbestos: Around the World

- World production has declined significantly since 1973
 - 1973 approximately 5.1 million metric tons
 - 1996 approximately 2.3 million metric tons
- In past two decades, consumption has increased dramatically in many developing countries

	Consumption (in metric tons)		
	<u>1970</u>	<u>1994</u>	<u>Growth</u>
Thailand	21,000	164,000	781%
India	51,000	123,000	241%

Source: USA Today, "The Asbestos Epidemic," February 1999.

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Asbestos: In Developing Countries

- Consumption has increased but safety precautions have not been implemented.
- Why the increase?
 - low cost
 - high quality
 - immediate health benefits for the consumer
 - suited to the economics of poor countries
- Why the lack of safety precautions?
 - lack of awareness
 - apathetic governments
- Implications:
 - According to epidemiologist Julian Peto, the surge in use “will result in several million cancer deaths over the next 30 years”
 - By comparison, over past 30 years USA has had 171,500 premature asbestos-related cancer deaths

Source: USA Today, “The Asbestos Epidemic,” February 1999.

Asbestos: In Europe

- European Union banned amphibole types of asbestos in 1991. Chrysotile banned 9/27/99; to be fully implemented by 1/1/2005.
- Belgium — claims filed under workers compensation system
- France — asbestos use prohibited effective 1/1/1997
- Italy — asbestos use prohibited in 1992
 - claims to be paid by The Italian National Security (INAIL), employers (compulsory EL coverage), and insurers
- Netherlands — 1997/1998 creation of the Institute for Asbestosis

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Identified Exposures

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Identified Exposures

- Asbestos
- Pollution
- Breast Implants
- Sexual Misconduct
- Year 2000 (Y2K)
- Repetitive Stress
- HIV/AIDS
- Fen-Phen
- Electromagnetic Fields

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Pollution – Estimates are Stable

- Slow growth in number of sites on the National Priority List
- No dramatic changes in coverage case precedents, thereby encouraging settlements
- Ongoing settlement activity has stabilized payment levels
- Risk based corrective action has resulted in lower clean-up costs than originally expected by EPA
- Greater PRP participation in site remediation – incentive to reduce / control costs

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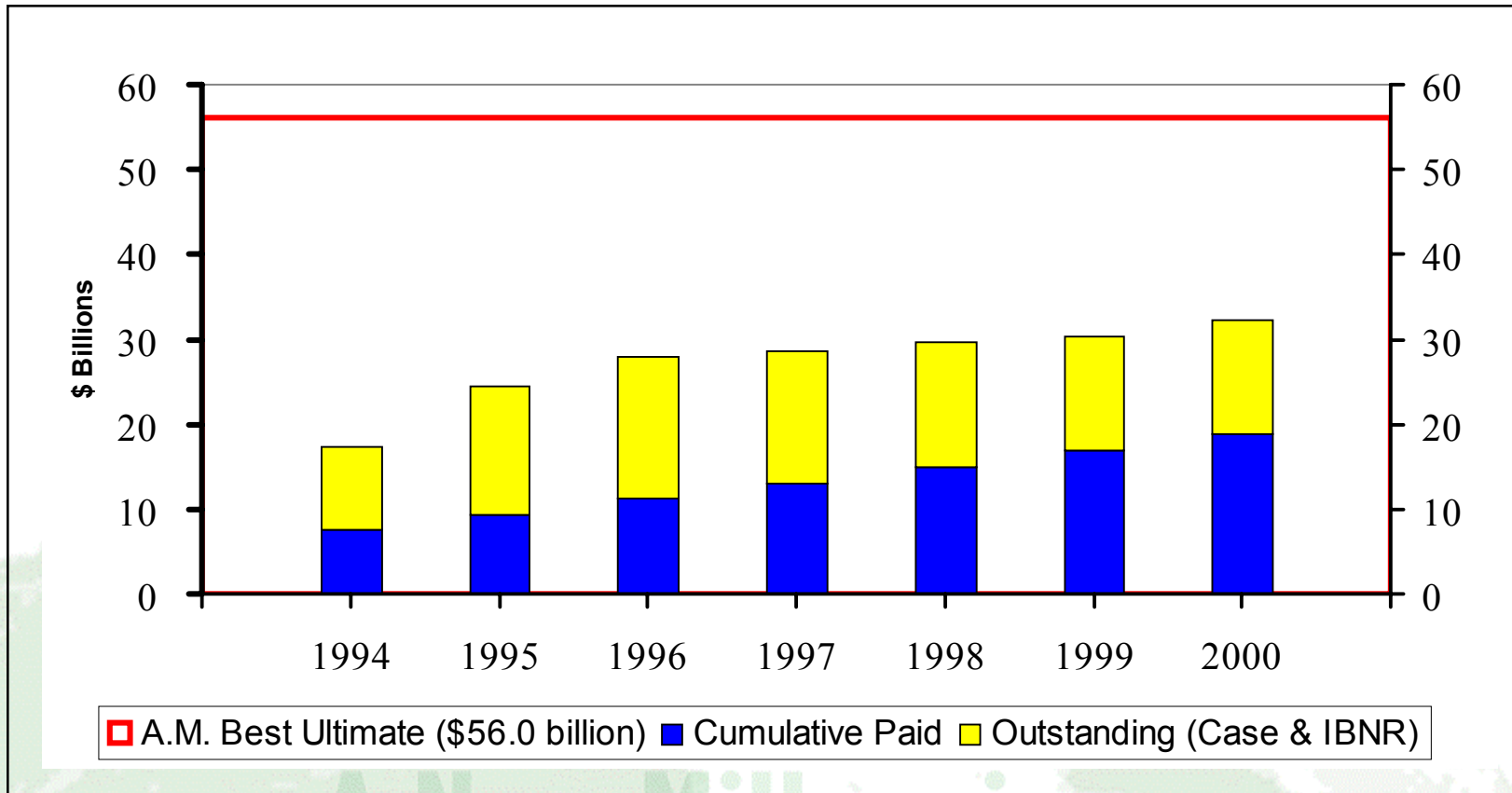
Pollution – Net U.S. Estimates

- A.M. Best's estimate of ultimate losses & ALAE = \$56 billion
- More recent estimates from other sources have been lowered to \$30-\$40 billion
- A.M. Best believes that its estimate is still reasonably accurate, if not somewhat on the conservative side.

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Net U.S. Pollution Liability:

Paid and Reported Loss and Expense versus A.M. Best Ultimate Estimate



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Developing Exposures

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Developing Exposures

- Mold
- Lead
- Alcohol
- Firearms
- Tobacco
- Latex Sensitivity

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Mold – What is it?

- Mold is a fungus, not a bacteria, that occurs naturally in the environment
 - Toxic Molds containing mycotoxins – aspergillus, penicillium and **stachybotrys**
- Three things mold needs:
 - Water
 - Food Source (paper, wood, etc.)
 - Temperature



Mold – The Problem

- Can cause health problems depending on individual sensitivities and levels involved
 - Alleged to cause internal bleeding, skin irritations, respiratory problems, chronic fatigue
- No proven link but many in scientific community believe health effects are probable
- There are no state or federal guidelines on acceptable levels



Mold – The Insurance Issue

- Significant increase in claims
- Media attention of illnesses & litigation
- Very costly to investigate and remedy claims
- *Ballard v. Farmers Insurance* – \$32M verdict
 - \$6.2M in actual damages
 - \$5.0M in mental anguish
 - \$12M in punitive damages
 - \$9M in legal fees

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Mold – Claim Handling Issues

- Timely response – mold can grow in 24-48 hours
- Appropriate response (e.g., health issues)
- Identification of coverage issues
- Appropriate consultants and experts
- Adequate remediation & prevention

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Mold – Coverage Issues

- Several coverages affected
 - Homeowners, Commercial Liability, Commercial Property, Workers Compensation
- First Party Property (e.g. water damage)
 - Exclusions for mold, wear & tear, deterioration, seepage, etc.
- Third Party Liability
 - Does the Pollution Exclusion apply?
- ISO mold endorsements approved in 21 states (30% market share)



Mold – Recent Events in Texas

- Companies have reported significant losses for Texas mold claims
 - Farmers = U.S.\$400 million
 - Allstate = U.S.\$180 million
- Significant rate increases for homeowners insurance
 - State Farm average statewide increase = +34%

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Lead

- Primary cause of human contamination is lead paint
- Nearly 1.7 million children in the U.S. have elevated blood lead levels ($BLL > .10$)
- At high levels, lead can cause a variety of health problems, including death

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Lead

- Primary defendants include:
 - Building owners
 - Paint and pigment manufacturers or distributors
 - Plumbing manufacturers and distributors
- Frequency and severity of claims have been less than the industry's initial expectations
 - Plaintiffs have failed in certifying class actions
 - Concern that Market Share Distribution could result in significant liability



Alcohol

- The intoxicating ingredient in alcoholic beverages is **ethyl alcohol**
- Types of claimants:
 - Consumers of alcoholic beverages
 - Third parties injured by alcohol consumers
 - Victims of FAS (fetal alcohol syndrome)
 - Government agencies and health care providers who provide care for alcohol related injuries

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Alcohol

- The annual cost of alcohol abuse in the U.S. is estimated at \$167 billion (1995 figure)
- To date, the alcohol industry has successfully defended itself against all alcohol consumption suits
- Concern over products liability exposure similar to asbestos

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Firearms

- Product liability actions are a recent phenomenon
- Lawsuits include:
 - Private recovery actions
 - Public recovery actions modeled after the government's efforts against the tobacco industry

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Firearms

- '99 Journal of the Amer. Medical Assoc. report: “estimate \$2.3 billion annual cost for treatment of gunshot wounds” ('94 data)
- Oct. '98 Cal. State/Tulane Univ. study: “29% of high school boys possess a firearm”
- The Bureau of Alcohol, Tobacco and Firearms estimates handguns are used in 71% of all armed crimes

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Firearms

- Typical defendants include:
 - Gun manufacturers
 - Gun retailers and resellers
 - Firearms trade associations
- Recent Developments
 - U.S. District Court in Brooklyn, NY found 15 of 25 gun manufacturers guilty of negligent distribution
 - Cities across U.S. filed product liability/cost recovery actions against firearm industry

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Firearms

- Since claim activity is recent, it is difficult to predict insurance implications
 - Several manufacturers have placed their carriers on notice
 - There are generally no specific applicable exclusions
 - Market share distribution of liability remains speculative but of concern for industry



Tobacco

- U.S. tobacco litigation remains active
- Types of exposures include:
 - Private lawsuits
 - Reimbursement actions
 - Government recovery of medical costs
 - Private reimbursement actions
 - Ancillary exposures
 - Professional liability



Tobacco

- State medical cost recovery actions
 - Settlement of 46 states Medicaid actions
 - Payment of at least \$206 billion
 - Includes changes in business practices
 - Voluntary settlement did not remove potential for future liability
- Insurance industry exposure remains uncertain

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Tobacco

- The Engel Verdict
 - \$145 Billion in Punitive Damages
 - \$12.7 Million in compensatory damages awarded to three smokers representing the class
 - Class is comprised of 300,000 to 700,000 sick smokers in the State of Florida only
 - Recent commitment to pay \$710 Million

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Tobacco

- Foreign Exposure
 - Canada has several reimbursement actions pending (Quebec suing for \$200 million)
 - EU, Columbia, Guatemala, Israel and others have also filed actions (Spain has first European local government action)
 - There may be no operable exclusions

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Latex Sensitivity

- Natural rubber compound used to make protective gloves and other products
- About 2.5% of the population is sensitive to the proteins contained in latex
- Increased demand due to AIDS led to higher levels of protein in gloves
- Powder in gloves carries irritants into the air



Latex Sensitivity

- Hyper-sensitivity can cause skin and respiratory reactions leading to disability or death
- Types of Claimants:
 - Healthcare workers
 - Patients
- Latex glove use in the U.S. rose from 800 million in 1987 to 10 billion in 1995

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Latex Sensitivity

- The potential impact to the insurance industry appears manageable
 - Courts have generally frustrated the plaintiff bar's attempts to certify class actions
 - Most courts now address product identification before allowing additional discovery

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Other Developing Exposures

- Advertising Injury / Intellectual Property
- Managed Care
- MTBE
- Genetically Modified Crops

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The Effect of Latent Exposures on Company Valuation and Possible Mergers & Acquisitions



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Overview

- Industry estimates of liability from latent exposures are significantly higher than the sum of amounts disclosed by companies
- Some companies:
 - are slow to identify/quantify latent exposures
 - are under-reserved
 - have elected the business strategy of recognizing the liabilities as claims develop

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Acquisition Considerations

- Buyers perform due diligence when considering an investment transaction
- A major concern for investors is identifying and quantifying latent exposures
- Many transactions are terminated due to latent exposures uncovered in due diligence

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Acquisition Effect

- When company is faced with a merger/ acquisition situation, values are magnified
 - \$1 of liability \rightarrow $\$1+x\%$ adjustment in transaction price ($x\%$ for uncertainty)
 - You don't want others to uncover your exposure during due diligence!!

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Effect on Company Value

- Quantitative Effects:
 - Immediate and direct effect on current earnings and equity/surplus
 - Uncertainty of future earnings drag if future costs exceed established reserve

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Effect on Company Value

- Qualitative Effects:
 - Lack of management proactively addressing liabilities can create uncertainty about overall management ability
 - What else has not been adequately addressed by management?

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Solution

- Identification of Exposure
 - Coverages that might result in exposure
 - Time span coverage was afforded
- Quantify Ultimate Cost
 - Potential frequency
 - Potential severity
 - Timing of future claim filings & payments
 - Potential defense costs

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Moral of the Story

- Be Proactive
 - Identify Exposure
 - Measure Exposure
 - Develop Solution
 - Monitor Progress
- Don't wait for it to come to you

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