



The Actuarial Profession

making financial sense of the future

Latest Developments in US and European Asbestos Claims

Darren Michaels

Current Issues In General Insurance Seminar

Barbican, London

26 April 2004

Latest Developments in US and European Asbestos Claims

US Source Asbestos

- The continuing deterioration in the asbestos claims environment
- Recent increases in recognised asbestos liabilities
- Impact on the London Market
- Update on the “FAIR” Act

European Source Asbestos

- What asbestos-related diseases are compensated and by whom?
- Changes in the wind – recent legal cases across Europe
- Comparison between European and US asbestos compensation systems
- France, Germany, Italy, Netherlands, Spain and UK

The Deterioration in the Asbestos Claims Environment is Continuing

- The number of claims being filed has continued to grow
- The average size of awards has increased
- The number of defendants in the litigation has grown dramatically
- The number of companies filing for bankruptcy protection due to asbestos litigation has grown

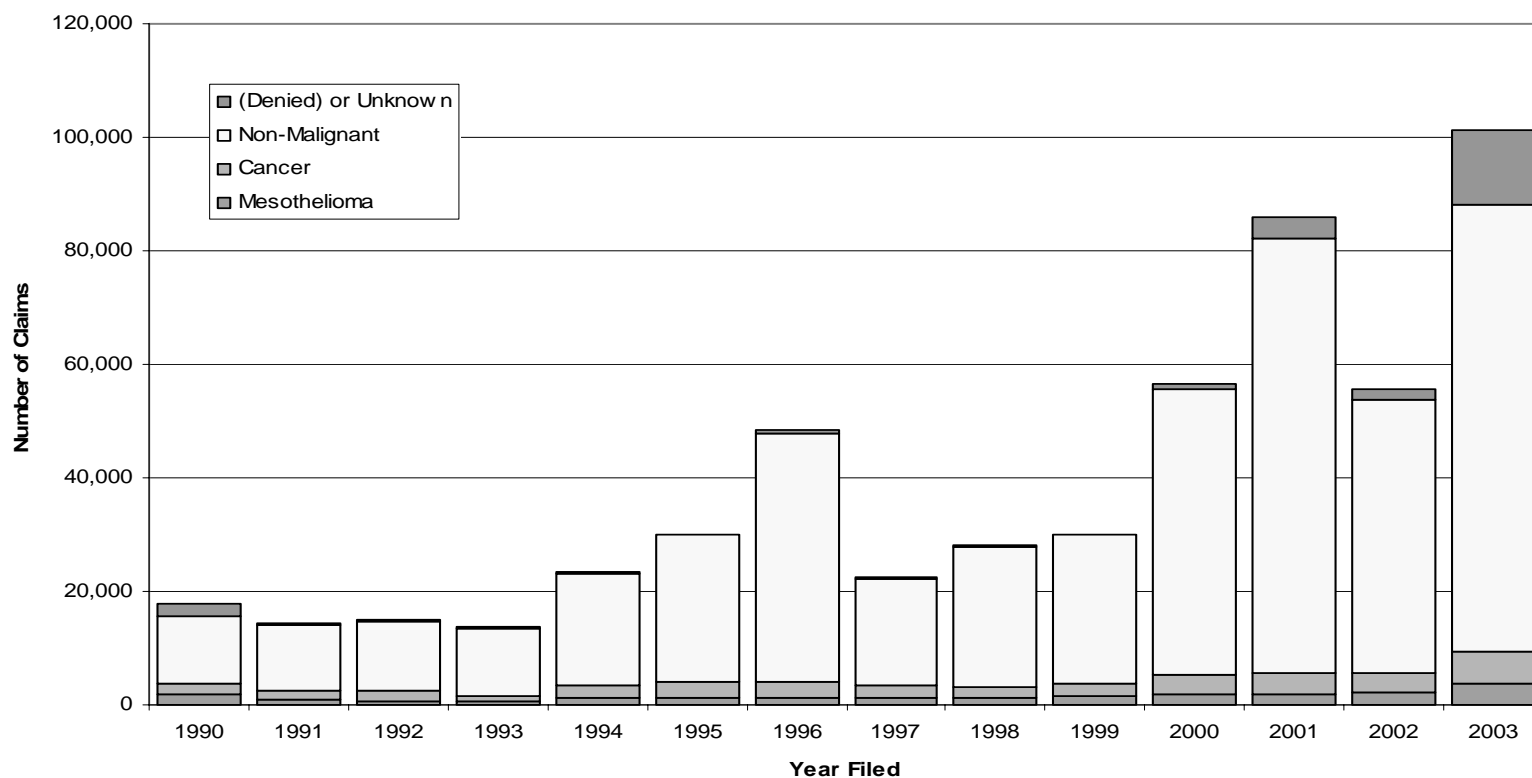
The Number of Claims being Filed has Continued to Grow

- Over 730,000 claimants have filed claims to date
- Estimates of the ultimate number of claimants range from 1 million to 3 million
- Number of claims filed against Manville Trust in 2003 exceeded 100,000
 - Continuing aggression of plaintiff lawyers
 - Change in Trust Distribution Process criteria (2002 TDP applies more stringent medical criteria; shifts awards to more severely injured)
 - Lawyers seeking additional claimants prior to passage of legislation?
 - Publicity generated by pending legislation encouraging more claimants to come forward?

⇒ **Key Question: Is this an increase in the ultimate number of claims or just an acceleration?**

Surge in Claim Filings

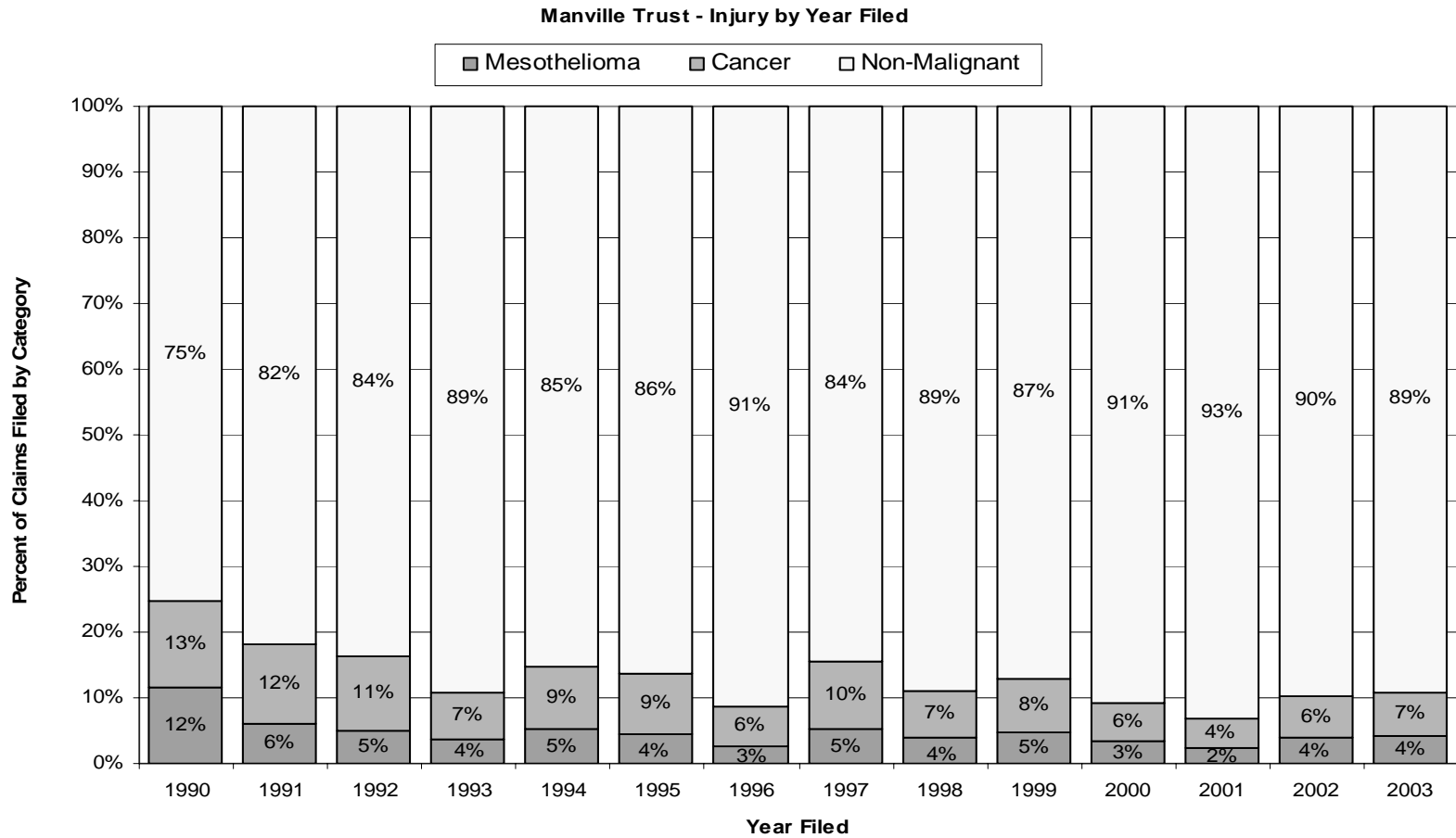
Manville Trust - Injury by Year Filed



Most of the Increase Relates to the Functionally Unimpaired

- In the early days less than 5% showed no signs of asbestos-related injury
- Increased to around one-half by the early 1990s'
- And to nearly 60% by the late 1990's
- Currently estimated at between two-thirds and three-quarters

Change in Disease Mix



The Average Size of Awards has Increased

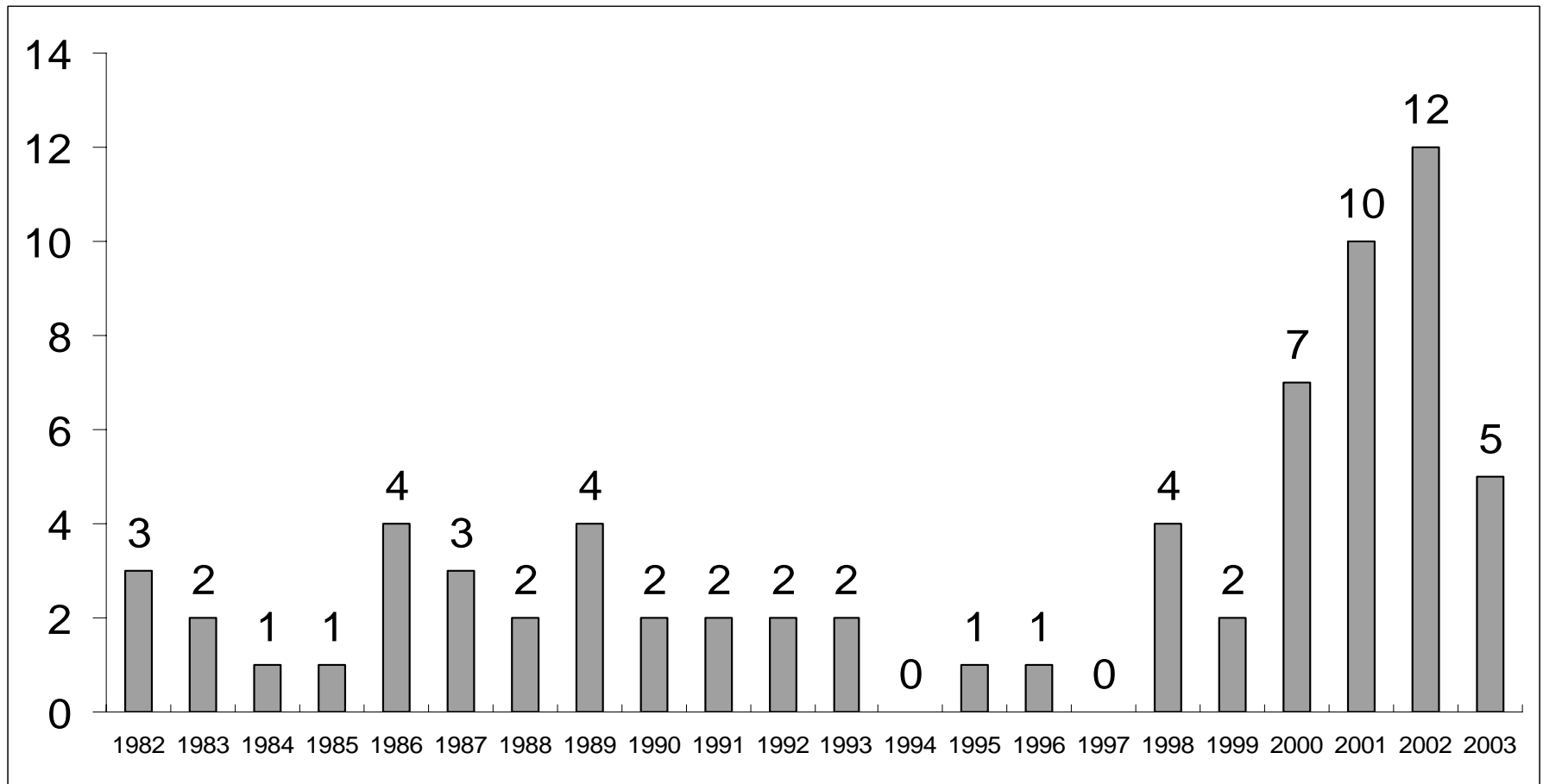
- Mean verdicts increased dramatically from 1998 to 2001 (RAND)
 - Mesothelioma: ~US\$ 2 million to ~US\$ 6.5 million
 - Other cancers: ~US\$ 1 million to ~US\$ 2.5 million
 - Asbestosis: ~US\$ 2.5 million to ~US\$ 5 million
- Whilst few claims reach verdict, values influence negotiations for claims that are settled
- Mesothelioma claims tend to be settled for a few million dollars
- Non-malignant claim settlements can also be sizeable due to “inventory” settlements

The Number of Defendants in the Litigation has Grown Dramatically

- Asbestos claimants typically name 60 to 70 defendants per lawsuit
- Approximately 300 named defendants in the early 1980's
- Estimated at around 8,400 today (RAND), spanning the majority of industries in the US economy
- The number of claims being filed against the peripheral defendants has increased
- As has the number of peripheral defendants
 - By the late 1990's non-traditional defendants account for over 60% of expenditures
 - Partly in response to the increasing number of major defendants filing for bankruptcy
 - Approximately 70 in total
 - Over 30 since 1 January 2000,

The Search for the Solvent Bystander

The Number of Companies Filing for Bankruptcy has Grown



Bankruptcy has Knock-on Economic Effects

- Estimated up to 60,000 job losses to end 2002 ¹
 - Each worker losing \$25-\$50k in wages
 - And 25% of the value of 401(k)
 - Direct costs of bankruptcies: \$850m - \$1.7bn
- For every 10 jobs lost in asbestos bankruptcy, additional 8 lost in surrounding community ²
 - \$2bn of secondary impacts on the economy
- Uninsured compensation paid from retained earnings hence reduced investment and difficulties raising capital
- Fewer jobs will be created in the future
 - Failure to enact legislation could reduce economic growth by \$2.4bn, meaning 30,770 jobs will not be created each year ³
- Some of money paid in compensation will be reinvested

1 "The Impact of Asbestos Liabilities on Workers in Bankrupt Firms" Joseph E. Stiglitz, Jonathan M. Orszag, Peter R. Orszag December 2002

2 "The Secondary Impacts of Asbestos Liabilities", NERA 2002

3 "Reducing the Asbestos Litigation Penalty: An Economic Benefit of Asbestos Reform Legislation", Navigant Consulting Group, 2003

Defendants are Passing the Costs to Insurers

- Faced with an onslaught of claims, defendant companies are seeking to increase their available insurance coverage
 - Reclassification of products claims as non-products claims by traditional products defendants with installation activities with exhausted (or nearly exhausted) products coverages
 - reinstates previously exhausted products coverages
 - opens up previously “untapped” non-products coverages
 - non-products coverages may not have aggregate limits
 - Expansion of previously agreed coverage blocks into more years of cover
- Disputes may increase going forward?

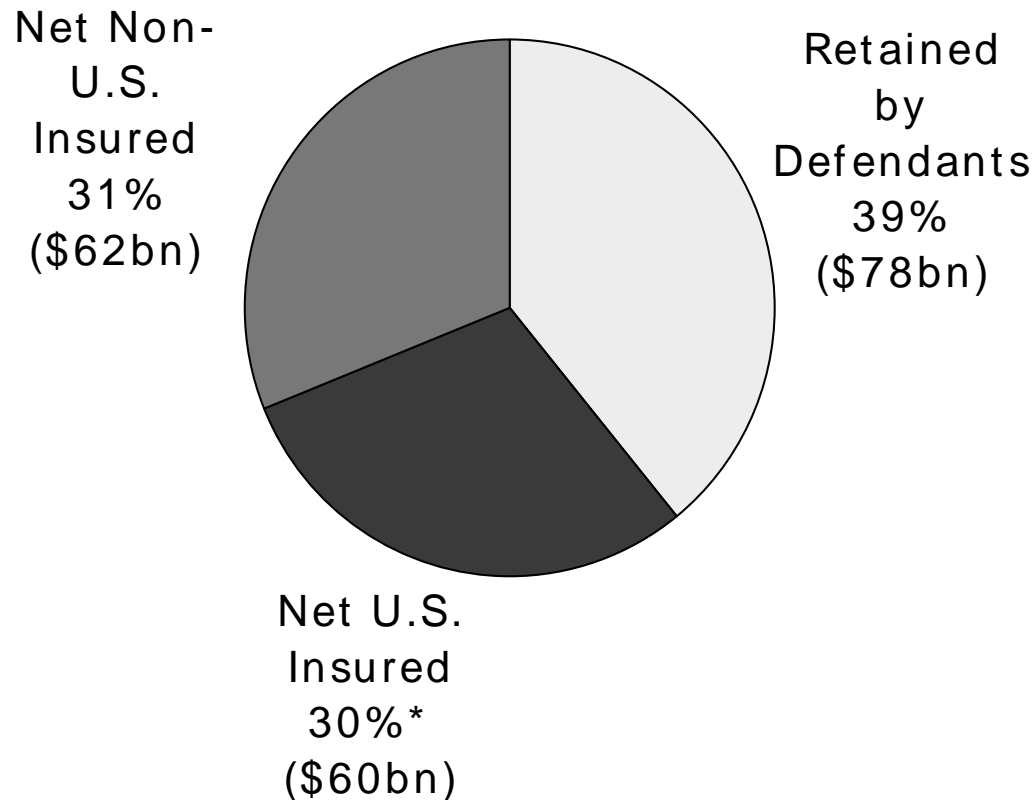
Transaction Costs Have Consumed More Than Half of the Total Spending to Date

- RAND estimates that total cost of resolving asbestos claims through 2002 was US\$70 billion
 - Defense Costs ~30%
 - Claimants Legal Fees ~29%
 - Net Compensation ~41%
- Expenses may increase in future
 - CCR now in run-off
 - as more and more peripheral defendants enter the litigation

How Much is this all Going to Cost?

- Tillinghast estimate of total cost of asbestos “universe”: \$200 billion (US exposures only)
- Tillinghast estimate of ultimate net cost to US insurance industry - \$55-65 billion
- AM Best corresponding estimate of cost to US insurance industry - \$65 billion

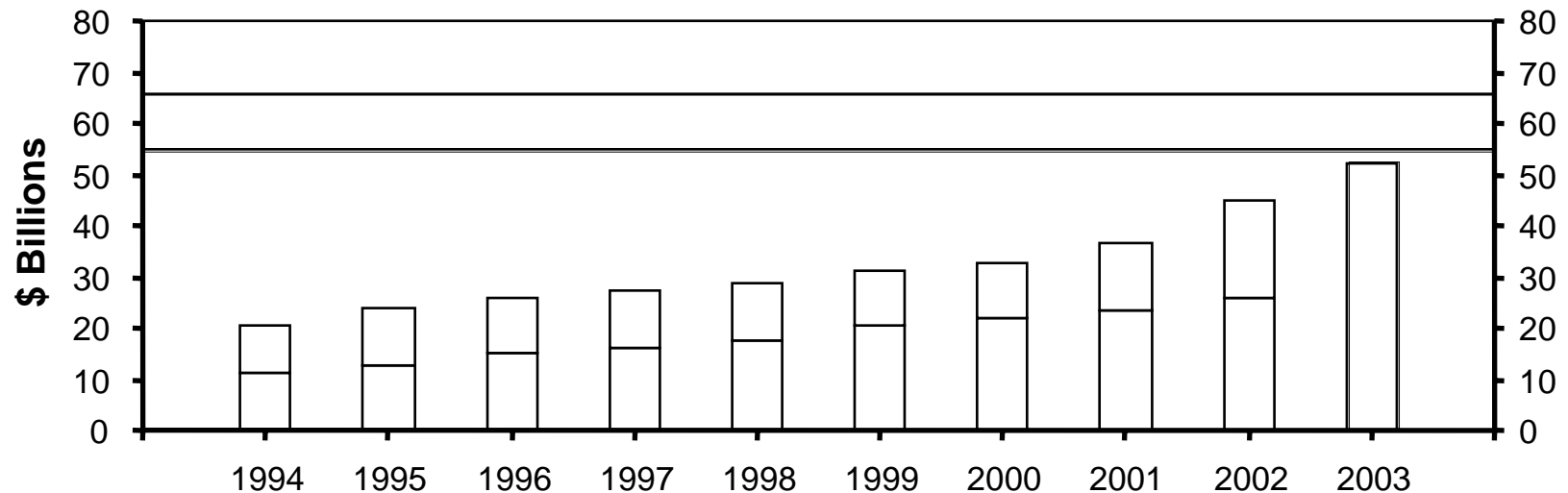
How will the \$200 billion Ultimate be Shared between Defendants and the Insurance Industry?**



*\$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.

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



□ Tillinghast 2001 Ultimate (\$55-65 billion)

□ Cumulative Paid (\$26.0 billion at 2002)

□ Outstanding Case & IBNR (\$19.0 billion at 2002)

□ Estimated Reported (\$52.0 billion at 2003)

Recent Increases in US Asbestos Liabilities

- US Carriers have increased gross asbestos reserves by at least **\$12 billion** since the start of 2003 (net \$8 billion)
 - The Hartford – \$4.0bn gross, \$2.6bn net (May 2003)
 - Travelers - \$3.2bn gross, \$2.6bn net (Jan 2003)
 - ACE USA - \$2.2bn gross, \$0.3bn net A&E (Jan 2003)
 - Swiss Re America - \$520m gross, \$458m net (Q4 2003)
 - CNA - \$517m net A&E (Q3 2003)
 - Allstate - \$514m net (Q2&Q3 2003)
 - AIG - \$440-450m net (Q4 2003)
 - Liberty Mutual - \$405m gross, \$331m net (Q3 2003)
 - Chubb \$250m net (Q4 2003)
 - Argonaut - \$52.8m (Mar 2003)
- Follows significant increases in 2001 and 2002
- Pressure on peers to make similar disclosures

Some Increases have also been seen amongst non-US carriers

■ Equitas (amounts in Sterling)

- £1.5bn year-end 31 March 2000

- £1.7bn year-end 31 March 2001

- No change for year-end 31 March 2002

- £0.4bn year-end 31 March 2003

■ Royal & Sun Alliance (amounts in Sterling)

- £371m for US and UK (Feb 2002)

- Further activity indicated in rights issue Q3 2003

Impact on the London Market (1)

- London market carriers potentially face greater challenges than US carriers in accurately assessing asbestos liabilities
 - Greater proportion of London business was reinsurance
 - Exposure typically attaches at higher levels
 - Tend to be provided with less information
 - Do not necessarily have direct access to underlying defendants
 - Determining precisely where coverage sits relative to ground
 - Claims take longer to reach layers and typically develop slower
- London market carriers may need to take similar action as US carriers
- Some London market carriers have already increased asbestos reserves
- US carriers have been mixed in their rate of recognition

Impact on the London Market (2)

- Three main factors driving the increases reported by the US carriers:
 - Claims from major asbestos defendants reaching higher layers and later years
 - fair proportion likely to flow through to London market
 - The emergence of additional peripheral defendants
 - less likely to flow through to London market
 - Reclassification of products claims as non-products claims by traditional products defendants
 - very uncertain due to aggregation issues

Update on the “FAIR” Act (1)

- Establishment of a no-fault “trust fund”
- Remove claims from tort system
- Privately funded by defendant companies and insurers (US and Non-US)
- Defined set of medical criteria and award levels
- Considerable disagreement over the size of the fund and how it should be funded between and within defendants and insurers categories
- Also concerns as what might happen if the fund runs out of money - sunset clause means claims revert to tort system
- Originally introduced as S1125 recently revised as S2290 incorporating changes as a result of revisions from Senate Judiciary Committee hearing (July 2003) and subsequent negotiations

Update on the “FAIR” Act (2)

- Does not have the support of a number of key stakeholders
 - Labor
 - Unions
 - Democrats
 - Plaintiff Attorneys
- Insurance community divided
 - A number have publicly said that the bill will not work
 - Even those that support the bill disagree on allocation
- Cloture vote for floor debate failed 22 April 2004
- ➡ Negotiations likely to continue but significant compromises needed

Emergence of Asbestos Diseases in Europe

- Emergence of asbestos-related disease in Western Europe appears to be repeating that seen in the US
- Projections anticipate higher incidence rate per head of population
- Time-lag – European emergence appears on average to be around 20 years behind the US
 - Worse affected generation in the UK born in 1940's (US 1920's)
- Exposure in the US is likely to be earlier due to:
 - Heavy exposure in US during WWII due to ship building effort
 - Tighter controls were introduced earlier in US
 - Imports in some European countries continued until mid-1990's
 - Mined in some European countries (France, Greece, Italy)

Asbestos Compensation Systems in Europe

- Significant variations exist between different countries
- Occupational diseases are typically compensated through different channels:
 - no-fault: workers compensation or social security
 - tort: employers liability, public liability or general/products liability
- The potential sources of compensation differ not only in what must be proven but also in the diseases and damages they will compensate
- In general, no-fault systems do not pay for non-economic losses, which are, at least in theory, available from the tort systems
- In general, awards from tort system are higher than those from the no-fault systems

What is Compensated and by Whom? (1)

- France – Historically claimed on a non-fault basis against FIVA. 2002 court ruling made it easier to invoke “inexcusable fault” against employer through law suit.
- Germany – Compensation to date met entirely by Occupational Health System (no allowance for pain and suffering). Insurance industry has not been involved.
- Italy – Compensation typically paid by social security system (INAIL) which can subrogate against employer. Employer can then recover under RCO policy. INAIL has typically not enacted its subrogation rights to date. Uncertainty over how long State willing to continue to bear cost.

What is Compensated and by Whom? (2)

- Netherlands – While some Mesothelioma victims can claim through government agencies, the remaining cases as well as other diseases are an issue for commercial insurance.
- Spain – Compensation to date met from Social Security. Recent court case accepting link between exposure to asbestos and disease has led to higher compensation awards and possibility of private sector involvement.
- UK – Typically compensation is from NHS & private sector via law suit against employer and subsequent recovery under Employers Liability policy. Some state benefits available. 2002 Fairchild ruling in cases with exposure from different employers. Insurers subsequently found to be joint and severally liable.

What is the Impact for the Insurance Industry? (1)

- Exposure of insurance industry to European asbestos varies from country to country
- Despite recent increases in legal activity sporadic insurance involvement from European asbestos exposure
- This means that important insurance issues still need to be resolved in some countries:
 - trigger of coverage
 - allocation across triggered policies
 - application of exclusions
 - lost policies
 - treatment of uninsured periods (intent or insolvency)
 - application of reinsurance

What is the Impact for the Insurance Industry? (2)

- Impact of European exposures on the insurance industry may differ from that of US exposures due to differences in:
 - Legal systems
 - Compensation systems (i.e., who pays)
- Recent legal developments in some countries suggest a narrowing of some of those differences

Estimating the Cost of European Asbestos to the Insurance Industry

- In some countries asbestos-related costs are only recently beginning to shift from social security to commercial insurance
- Macro level estimates remain difficult; insurance costs depend on many parameters, such as:
 - disease incidence patterns by disease type and across time
 - legal/social decisions as to what diseases/degree are compensable
 - the likelihood that eligible people will seek compensation
 - the probability that compensation will be granted
 - the average amount of compensation for various cohorts
 - the frictional costs for the plaintiffs' and defendants' lawyers
 - the probability that the costs are insured

Key Features of US Asbestos Litigation

- Litigious culture
- Tried by jury
- Unimpaired claimants
- Consolidated trials
- Forum shopping
- Contingent fees
- Strict liability
- Union involvement
- Product liability coverages
- Punitive damages insurable in some states

Comparison of US and European Asbestos Litigation

- Litigious culture
- Tried by jury
- Unimpaired claimants
- Consolidated trials
- Forum shopping
- Contingent fees
- Strict liability
- Union involvement
- Product liability coverages
- Punitive damages insurable in some states
- Less litigious
- Tried by judges
- Currently not compensated
- Typically not permissible
- Judicial systems more uniform
- Not permitted in most of Europe
- Causation more of an issue
- Not as active?
- Workers' Comp/EL/ Public Liab?
- Less common, much smaller and typically not insurable

Significant differences remain between the US and the European legal systems, despite European evolution towards tort and insurance involvement



The Actuarial Profession

making financial sense of the future

Latest Developments in US and European Asbestos Claims

Darren Michaels

Current Issues In General Insurance Seminar

Barbican, London

26 April 2004