"CLAIMS MADE: CHAOS, COLLAPSE OR CURE"
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I had been asked to talk to the November, 1988 meeting of the British Insurance Law Association. The subject of the talk was to be the status of the 1986 form of the commercial general liability (CGL) policy in the United States and, in particular, the claims made version.

By coincidence, two days before the BILA meeting, I addressed a Management Centre Europe seminar in Zurich. There, the topic was an update on tort reform in the United States.

At about this same time, election day had taken place in the United States and Proposition 103 was passed by a narrow margin in California. Finally, I had been watching with interest the developments in the antitrust litigation commenced earlier this year against a significant segment of the insurance industry.

As a result of the confluence of these four phenomena (the 1986 CGL, tort reform, the antitrust litigation and proposition 103), I began to think of them as a whole and to wonder about the intercausal relationship, if any, among these developments. Even though this process is only in its formulative stages, I thought it might be interesting and, perhaps even fun, to put these ideas, albeit embryonic, on the table for discussion.

First, however, a few brief comments about the announced topic, the 1986 CGL, are in order. According to my latest information, forty-six jurisdictions (out of a total of fifty-two in which the Insurance Service Office makes filings) have approved both the claims made and occurrence forms. Five states (New York, Nebraska, Texas, Massachusetts and Vermont) have approved only the occurrence form and one state (New Jersey) has approved neither.

But this does not tell the whole story. Of the several substantive and mechanical changes adopted into the 1986 CGL forms, the general consensus is that the three most significant changes are the so-called "total" pollution exclusion, the separate aggregates for the products/completed operations hazards and all other coverages and the claims made form. Of these, there is little doubt that the claims made issue was by far the most controversial.

While the changes to the pollution exclusion are truly significant on an ongoing basis, the claims made aspect turned out to be the greatest non-event of the decade, insofar as

insurance is concerned. After all of the hullabaloo over its concepts and *details*, now that the dust has settled, it is clear that it just didn't happen.

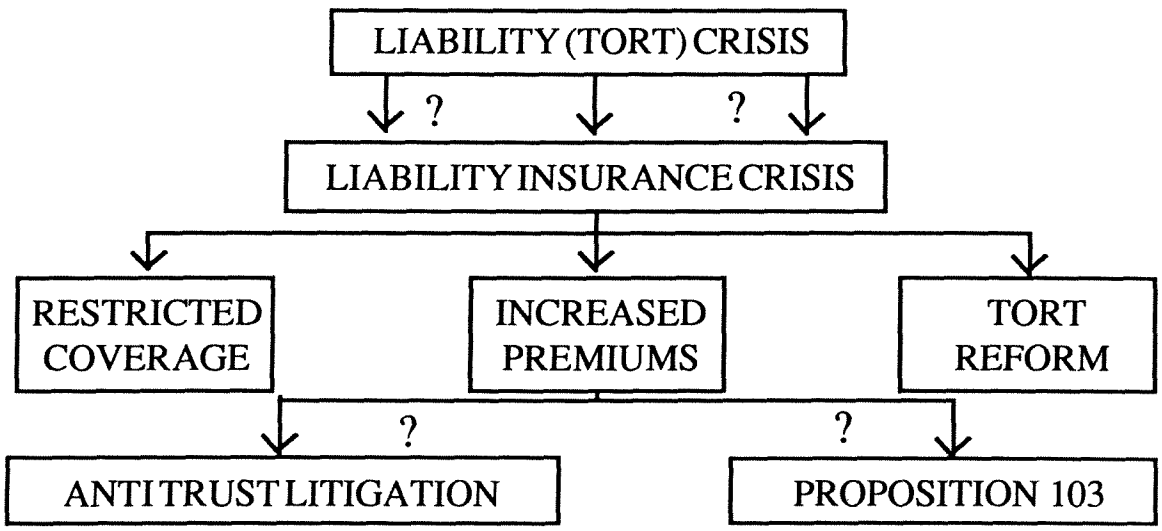
The claims made form has for years been the standard and accepted form of liability coverage in areas such as professional liability, directors and officers liability and products liability for certain industries such as pharmaceuticals, petrochemicals and the like. This remains true; but it is not what the 1986 debate was about.

Rather, the issue in 1986 involved an effort by the industry to impose the claims made trigger not upon the special risk but upon the Main Street business which presented none of the long-tail, stacking problems presented by professional liability, petrochemicals, pharmaceuticals and the like. It is in that context that the effort must now be viewed as a failure.

Industry statistics reflect that, even at the pinnacle of the "tight" market, the high water mark of penetration by the claims made form into the Main Street market was only about twenty percent. Today, only two percent of the typical insureds in the United States have claims made coverage.

The reasons for this lacklustre performance are several. They include the confusion caused by the great variety of excess liability forms and the manner in which they related to the CGL, the return of capacity and the resultant softening of the market leading to a shift in bargaining power, and the fact that the claims made form was simply unacceptable to the run-of-the-mill insured in the United States nor was it apparently necessary to the insurers of those risks.

And what is the result of all of these efforts and troubles? This is what leads one to the musings to which I alluded earlier. I submit the following visual as an aid to this discussion.



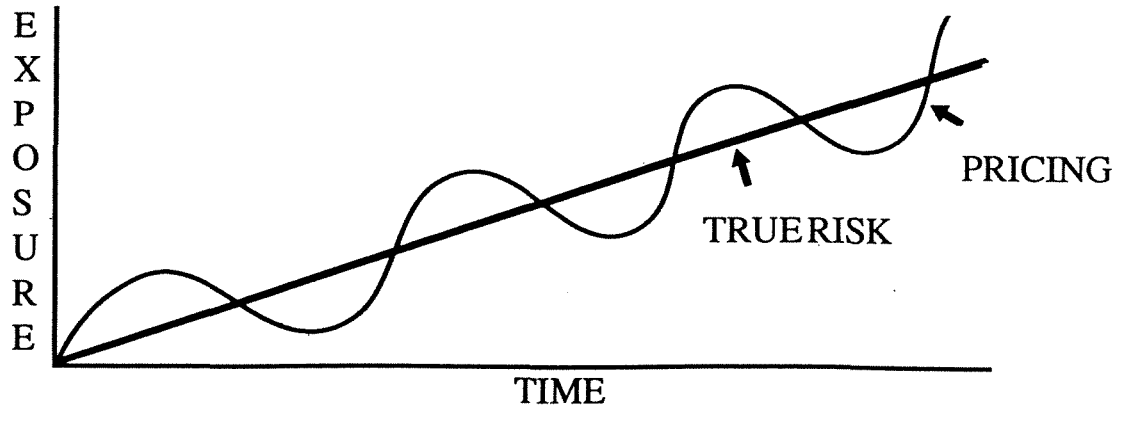
The question presented for discussion is whether the downward arrows in this diagram are representative of cause and effect relationships in the directions indicated.

There is no question but that the tort system in the United States has experienced significant expansion over the past decade or two both in terms of theories of liability and amounts of awards. The question is, however, whether this expansion can be properly characterized as a crisis and, more importantly, whether this expansion, crisis or not, caused the crisis in liability insurance which took place beginning in 1985 and extending for about two years into 1987.

The insurance practitioner will offer an immediate and hearty affirmative to this question. But, in truth, the answer is not so simplistic. For example, I recently heard a leading and highly respected underwriter at Lloyds say to a public gathering that the only factor which dictates insurance pricing is capacity. This statement tends to deemphasize the causal connection between the liability crisis and the liability insurance crisis, at least in the short run.

Another factor which tends to indicate against this causal relationship is the fact that as I write this paper, the tort system remains intact, relatively undaunted by reform; and yet, the market is dramatically softening. If what goes on in the courtroom truly dictates what goes on in the underwriting room, this softening should not be taking place. But it is; so that one must wonder whether it is other factors, such as capacity, rate of return and/or other competitive forces, which drive the price and availability of liability insurance.

I offer these ideas not as conclusions but as postulations for analysis and thought. Not that anyone really cares, but, for what it's worth, my opinion in this regard is that while capacity, competition and other similar factors can impact the marketplace in the short term and cyclically, in the long term, the risk controls the rate. Viewed thusly, cycles do and will continue to occur, that's only natural; but the general overall trend will track the exposure. The following unscientific graphic is offered to visualize the point:



Turning now to the second level of the causation chain in the diagram, it is submitted that the liability insurance crisis (whatever one concludes caused that), did causally contribute to tort reform, increases in insurance premiums and restrictions in coverage. It seems obvious that the increase in premiums for liability insurance from 1985 through 1987 was the result of the insurance liability crisis. Indeed, it was a part of that crisis. It also seems clear that certain of the coverage restrictions, claims made and others, would not have been achieved were it not for the crisis which was taking place as respects liability insurance at the time. And finally in this regard, I do not believe that the successes the tort reform movement achieved in this period could have been accomplished absent the environment of crisis then existent in the liability insurance arena.

This, then, brings us to the base of our schematic, a consideration of whether these three developments (increased premiums, restricted coverage and tort reform), in turn, caused or contributed to the antitrust litigation and/or the passage of proposition 103. As to the former, there is no question whatsoever, but that the antitrust litigation now pending in some eighteen states against significant segments of the insurance industry in the United States, the United Kingdom and the Continent is the direct result of the events leading up to the adoption of the 1986 CGL forms. The complaints in these suits centre around those events exclusively.

Whether proposition 103 is the result of the increased premiums - restricted coverage - tort reform triumvirate is not so clearly evident. And yet, the connection is probably there. Ralph Nader, a principal proponent of proposition 103, is also a leading opponent of tort reform almost in all forms and wherever it appears and, I believe, was a vocal spokesman against the 1986 CGL changes. In this sense, one can view proposition 103, at least insofar as its sponsors are concerned, as an integral part of the battle against tort reform specifically and the insurance industry in general. With respect to the voters, and even ignoring the confusion which must have existed in their minds due to the presence on the ballot of five conflicting propositions on the same subject, one must give credit indeed to the selflessness exhibited by the forty-eight or so percent of the voters who cast their ballots against a proposition promising an immediate twenty percent reduction in their insurance premiums.

Proposition 103 is a clear and present danger to the viability of the insurance industry in California and, if it survives the constitutional challenge and spreads, to many other areas of the United States. As of this writing, the matter is before the courts in California with the effective date of the premium rollback and the provisions calling for the creation of a non-profit consumer protection corporation being stayed pending the litigation. Other aspects of proposition 103 have gone into effect. These include a

prior approval rate system for the first time in California, the repeal of the exemption of the insurance industry from the State antitrust and unfair business practice laws, the extending of the ability to form risk retention groups to insureds with diverse (as opposed to similar) risks, the permitting of California banks to sell insurance, the providing for an elected as opposed to appointed Insurance Commissioner, and the restricting of the ability of insurers to cancel or nonrenew auto insurance. When one studies the specifics of this proposition, the thought comes to mind that it may not only be a result of the aforementioned triumvirate, but it may well be in retribution for them.

In any event, the confluence of all of these phenomena within a short period of time and in the order in which they occurred does provide food for thought. As stated at the outset, many of these hypotheses are just that and not conclusions. I think, however, that these issues are worthy of thought in view of the severity of the bottom line of the schematic and keeping in mind the words of George Santayana that: "Those who do not learn from history are condemned to repeat it."

"1992 AND ALL THAT"
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1. 1992 is a topic of highest interest. There is no meeting with clients when I am not asked about it. Insurers too discuss the creation of the internal market. This is surprising for various reasons:

   a) Since Reimer Schmidt addressed the CII Conference in 1962 on "The Treaty of Rome, as it affects Insurance" - what a nostalgic heading! - much towards the Common Market has happened, although slowly at first. Consider the much increased exchange of goods within the market. Consider the 4.8 million foreigners living in the Federal Republic (7.9 % of the total population) of whom many are EC citizens and an insurance potential.

   b) Freedom of Establishment has been with us now for about 15 years. The impact on the German market has been small: For 1986 less than 3.5 % of the market's gross turnover of DM 111 billion (about £ 34 billion at today's exchange rate) can be attributed to EC subsidiaries or branch offices.

   c) The date set by the 2nd Directive for the creation of free services within the Common Market is not 1992 but July 1st 1990.