ALASKA LEGISLATURE COMMITTEE FILES 1985-1986 8672

4158 SLAB INSURANCE INFORMATION 1038

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INSURANCE INFORMATION

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Alaska MUNICIPAL League

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To: Senator Fred F. Zharoff, Chairman
Members of Senate Labor and Commerce Committee

From: Scott A. Burgess, Executive Director

Date: March 12, 1986

Subject: Legislation Addressing Insurance Pooling (SB404 and SB377)

The Alaska Municipal League, representing 116 direct member municipalities, strongly supports legislation that would enable municipalities to pool their insurance costs, and losses. Currently, municipal insurance pools, sponsored by state municipal leagues, are operating in 23 states. Never has any municipal insurance pool gone into default. Never has any municipal insurance pool been unable to pay a claim. All have been very successful.

Municipal insurance pooling lowers costs, and increases availability of insurance to municipalities. Pools offer municipalities a chance to pay premiums based solely upon loss history. In addition, municipalities in an insurance pool can recoup a portion of that premium through a year-end dividend payment, based upon their success at controling losses. Under a pool, the availability of insurance to municipalities would no longer be subject to the cycles of the general insurance market.

If legislation allowing the formation of a municipal insurance pool were passed, the AML would most likely obtain reinsurance from the National League of Cities, which will begin offering reinsurance on May 1 of this year through a reinsurance pool supported by the 23 state municipal league pools currently in operation. In addition, several other reinsurance opportunities would be available to an Alaska Municipal League insurance pool, due to the success, and past performance, of the League's current insurance program. Though not a pool, the League currently sponsors a program which is providing insurance to over 75 municipalities and school districts in the State for worker's compensation, general liability, business auto, and errors and omissions coverage for law enforcement, public officials, and school board members.

Regarding SB 377, the Alaska Municipal League supports legislation that would increase availability and decrease costs of insurance for municipalities. In addition, the Alaska Municipal League encourages careful consideration by the Legislature of this and all insurance legislation affecting municipalities. Attached please find copies of a resolution and policy statement language adopted by the Alaska Municipal League during its annual conference November 16, 1985.

Thank you for your consideration of this important issue. If the League may be of further assistance in any way, please feel free to call.

SAB:TRS:phl

Attachments

PART III
PUBLIC SAFETY

A. FINANCIAL IMPACT

1. State Public Safety Responsibility: The League strongly urges the Legislature to provide full funding of the Department of Public Safety so that, at the very least, the current level of services Statewide can be maintained.

2. Detention Costs: The League recommends that costs associated with prisoner care and prisoner transportation be borne by the State. When a municipal police officer makes an arrest for a violation of a state law, the State should continue to assume the legal and financial responsibility for the prisoner as soon as the prisoner is incarcerated.

3. Financial Impact: The League supports full financial ssistance for programs impacted by mandatory services, enforcement, referral or sentencing.

4. Public Defenders: The League recommends the State resume full financial responsibility for the Public Defender Agency.

B. TRAINING

The League urges the Legislature to assure that local full-time and volunteer police, fire, and emergency medical personnel throughout the State have access to adequate facilities and program resources for training. Further, the League endorses public fire education and arson investigation, Village Public Safety Officers, and the Police Standards Council. The League urges full funding of these programs.

C. COURT SYSTEM

1. Use of TV Capacity: The League encourages the court system to make maximum use of TV capacity and other cost saving techniques for arraignment, grand jury, and similar court functions to release the burden on highly trained, public safety personnel.

2. Judicial Presence: The League supports the funding of a judicial system that would assure the presence of sufficient judicial officers in each community in the State when the need arises.

3. Local Trials: The League recommends local felony trials if adequate facilities are available in the community where the offense occurred.

D. STATE ASSISTANCE

1. Emergency Management: The League supports full State and federal funding of civil defense and emergency preparedness activities.

2. Fire Fighting Equipment: The League supports full funding for basic fire fighting equipment which meets minimum Insurance Services Office (ISO) or State criteria for small Alaska cities and fire service districts.

3. Substance Abuse Counseling: The League encourages state funding of positions for counseling on drug and alcohol programs, particularly in conjunction with the existing juvenile probation system

4. Substance Abuse and Domestic Violence: The League recognizes the serious individual and public safety problems that exist in all communities in Alaska as a result of substance abuse and domestic violence. It supports the enforcement of the domestic violence sections of Title 25, Marital and Domestic Relations (AS 25.35.010-AS 25.35.060), in all parts of the State as a public safety priority.

E. HAZARDOUS MATERIALS REPORT

The League supports legislation which would require producers, shippers, distributors, and commercial and industrial users to submit to all affected municipal governments, the Standard Material Safety Data Sheet on all toxic material physical agents being shipped to or through, or stored, manufactured, utilized, produced as a by-product, or otherwise found at any time, on the property or rights-of-way of any enterprise or site within the municipal boundaries.

F. TORT REFORM

The League urges the Legislature to review tort reform and to work for a viable municipal insurance system.

RESOLUTION OF THE ALASKA MUNICIPAL LEAGUE

RESOLUTION NO. 86-13

A RESOLUTION OF THE ALASKA MUNICIPAL LEAGUE URGING THE STATE LEGISLATURE TO INVESTIGATE TORT REFORM AND THE REASONS BEHIND THE UNAVAILABILITY OF CERTAIN LINES OF INSURANCE.

WHEREAS, insurance rates have increased astronomically and this has caused businesses to close and has created a financial burden on taxpayers in Alaska, and

WHEREAS, municipal insurance rates have increased as much as 500% in some areas, and

WHEREAS, day care operators, air carriers, truckers, contractors, CHARR-affiliated businesses, doctors, and architects are in many cases unable to obtain any insurance, and

WHEREAS, the Alaska Municipal League feels strongly that an investigation into causes should be made and a solution to this problem must be found this year;

NOW, THEREFORE, BE IT RESOLVED by the Alaska Municipal League that the Office of the Governor and the Alaska State Legislature are urged to immediately pursue all avenues available to solve this problem and find a way to provide insurance in Alaska.

Adopted this 16th day of November 1985.

LEO B. RASMUSSEN, President

ATTEST:

SCOTT A. BURGESS, Executive Director

TESTIMONY

of

Scott A. Burgess
Executive Director
Alaska Municipal League

October 8, 1985

Testimony, presented on behalf of Alaska's municipalities, for the Governor's Special Task Force on Insurance

Commissioner Lounsbury, members of the task force:

The town of South Tucson, Arizona went bankrupt. A police officer in the town was accidently shot in the back by his partner. The court awarded the officer damages thirty-six times the amount of liability insurance South Tucson was carrying, over $1 million more than the city's entire annual budget.

If South Tucson was in Alaska, it would be among the five largest municipalities in the state. If South Tucson was in Alaska, they would still have gone bankrupt. Though several approaches to the problem experienced by South Tucson are being practiced in other parts of the country, none is being practiced here in Alaska.

The Alaska Municipal League certainly encourages the effort being made today, and we certainly encourage the task force to turn today's effort into relief for municipalities, and others experiencing insurance problems.

As far as municipalities go, the problem is pretty basic. Insurance companies consider them a high risk. When the market gets tight, it is insurance for municipalities that experiences the first premium increase, and, later, the first cancellations. It is not that municipalities are more negligent than anyone else that makes them a greater risk in the eyes of insurers, rather it is the court system's lessons to the public which teach citizens that for the greatest compensation, you sue whomever has the most money, the "deep-pocket" theory. In Alaska, the State is exempt(09.50.250), and that leaves municipalities as the target at the top for frivolous and marginal liability suits, with no restrictions on damages.

What can be done? There are several solutions, none of them the total answer, but all of them currently being used successfully somewhere in the U.S. First, there are statutory limits in other states on the fees of trial lawyers, which can dramatically reduce the final amount of liability awards.

Secondly, there are statutory restrictions on what, specifically, municipalities can, and can not, be held liable for.

Thirdly, Alaska could follow the lead of 28 states which have set reasonable dollar limits on liability judgments.

The fourth solution, is providing for "liability insurance pools" by statute. The State tried to address this in 1983, but fell a little short in my view. Because the League has an insurance program, I want to address this potential solution in greater detail.

A liability insurance pool is being used in several states to allow municipalities to create a pool of money to insure themselves through a representative entity such as the Alaska Municipal League. The entity, using the pooled premiums, pays first dollar coverage up to an agreed amount and buys any required excess insurance on their own. Each participant pays premiums into the pool, then, at the end of the year, receives back a dividend payment based on the premiums minus expenses and losses. Therefore, the ability of the members of the pool to reduce their losses, potentially, saves the municipalities, and their taxpayers, money in the future premiums they pay, and in the dividends they receive back.

While the League is still interested in the State sanctioning of a self-insured retention program or pool, minor amendments to the 1983 law providing for "reciprocals", may allow municipalities to help themselves to solve many of their insurance problems under Chapter 75., Reciprocal Insurers.

Alaska has in place the enabling Statutes, called "reciprocal insurance agreements", but the statutes set front-loading, financial requirements that could unnecessarily prevent such agreements from ever being formed, at least among municipalities.

There are two solutions to this problem, both of them within the scope of this task force. The first is legislation that would reduce the amount of capital required on deposit or in surplus by reciprocal insurers. That section, AS 21.75.050, needs some clarification regardless of the amount required. Even the experts in the insurance industry, as well as those within the State's Division of Insurance differ on what the language actually requires as a minimum surplus amount.

The second solution also involves legislation. That language would allow groups forming insurance pools to build up their surplus to the required level over some set period of time. That would permit the use of premiums to meet the State's surplus capital requirements. Without these changes, the only way such a program could get off the ground is through a one-time assessment against participants in the program, which could run as high as $150,000 apiece. I can assure you, such a membership fee is a major deterrent to forming a reciprocal program under existing law.

The Alaska Municipal League has attempted to provide insurance for its municipal members, and to provide cost savings and some degree of stability to the participants by setting up the AML Insurance Program in April 1984. The League endorsed Frank B. Hall Company of Alaska to help the League set up the program. As of June of this year, the AML program has offered first dollar coverage for member municipalities from the Old Republic Insurance Company. Currently, 55 Alaska local government entities have signed up for coverage through AML.

Old Republic has a financial rating of A-15, and provides first dollar coverage on a basic Comprehensive General Liability policy form, up to $500,000. Errors and omissions coverage is provided separately by Markel Service, Inc. for Law Enforcement and Public Officials and School Board Liability up to a limit of $1 million. The AML program has topped $3 million in premiums, and offers coverage for Workers Compensation, General Liability, Business Auto, Law Enforcement, Public Officials, and School Board.

The current AML program cannot provide municipalities with much stability, however. If Old Republic decides to stop providing coverage, which they can do at any time, the AML program comes to a screeching halt. The other major shortcomings of the our relatively young insurance program is our inability to provide first dollar coverage higher than $500,000. That leaves a gap in coverage for most municipalities between $500,000 and $1 million, which is the lowest level at which they are able to purchase excess insurance coverage independently. Because the League's individually-participating, member municipalities are still subject to the current marketplace for first dollar coverage, the League program cannot offer the most stable, and lowest cost program to its members. The Board of Directors of the Alaska Municipal League believes a self-insured retention pool is the solution. If the League can accomplish the same result with revisions to the reciprocal insurer provisions of the Alaska Statutes, we would very much like to proceed in that direction.

The League appreciates the recognition of the insurance problems faced by the State, its political subdivisions, and others by the Governor and the members of this task force, and offers its assistance and support in finding solutions; those offered above and others. Thank you for your time.

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GROUP SELF-INSURANCE POOLS SPONSORED BY STATE MUNICIPAL LEAGUES

State	Type of Risk Covered				
	Health & Accident	Workers Compensation	Liability	Unemployment Compensation	Property
Alabama		x			
Arkansas	x	x	x		
Connecticut		x	(1)		
Florida	x	x	x		
Georgia		x			
Illinois		x	x		x
Iowa		x			
Kentucky		x		x	
Louisiana (3)		x	x		
Maine	x	x	(1)	x	
Massachusetts		x(2)			
Michigan		x	x	x	x
Minnesota	x	x	x		x
New Hampshire	x			x	
New Mexico		x			
North Carolina	x	x	(1)		
Oklahoma (3)	x	x	x		
South Carolina (3)	x	x			
Tennessee	x	x	x		
Texas		x	x		
Utah	x	(1)			x
Vermont		(1)		x	
Virginia		x			

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(1) Pool being developed (as of 8/85)
(2) Fronted safety group program rather than pure pool
(3) Not participating in NLC/RMPSP

Prepared by: National League of Cities
December, 1985

THE "CRISIS" OF COST

AND

LACK OF AVAILABILITY

OF

LIABILITY INSURANCE

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December 9, 1985

Preface

Problems regarding the cost and lack of availability of liability insurance are affecting a variety of insurance consumers. The following article is based on testimony which the Pennsylvania Trial Lawyers Association presented on this important issue before several committees of the General Assembly.

The first part of the article reveals that the problem is not the result of a crisis in our legal system--there has been no sudden increase in claims or litigation. Further, the total cost of paying liability claims has done nothing more than keep pace with the underlying rate of inflation for the goods and services for which the compensation is paid. It goes on to demonstrate that tort "reforms"--restrictions on the rights of injured citizens--have no effect on the cost and availability of liability insurance. One of the best examples of this is what has happened in the area of municipal liability insurance despite the extremely restrictive Pensylvania Political Subdivision Tort Claims Act of 1978.

The second part reveals that the root cause of the current problem is the cyclical economics of the insurance business and its relationship to underlying economic conditions. Competing insurance companies were engaged in a price war when interest rates were high and rising. When interest rates fell sharply, as a result of the economic recovery, the insurance companies began to raise prices dramatically and even cut off coverage in less profitable lines in order to increase their profitability. The following example demonstrates how this "crisis" of cost and lack of availability develops:

Hypothetical Insurance Company

Year	Surplus [1]	Total Permitted Written Premiums [2]	(Cost) Average Premium Per Policy	(Availability) Number of Policies Whic Can Be Written
1980	$1,000,000	$3,000,000	$1,000	3,000
1981	$1,000,000	$3,000,000	$900	3,333
1982	$1,000,000	$3,000,000	$800	3,750
1983	$1,000,000	$3,000,000	$700	4,286
1984	$1,000,000	$3,000,000	$600	5,000
1985	$1,000,000	$3,000,000	$1,500	2,000

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1 Insurance industry jargon for net worth.

2 Based on the typical 3 to 1 written premiums to surplus ratio permitted in most states.

Presuming that the 1980 average $1,000 premium per policy represents adequate rates, this insurance company proceeded over the next several years to engage in a price war with competitors by cutting premiums to expand its market share. This caused the average premium to become progressively more inadequate. This company became increasingly over reliant on investment income to make up the difference. Such a strategy may be successful when investment yields are high or increasing, but when yields fall and claims must be paid on the increased number of policies which were sold at inadequate rates, profitability suffers. The result is that the average premium rises dramatically. This, in turn, causes an equally dramatic decrease in the number of policies which can be written.

Examining the cost side of the "crisis"--even if it were necessary for the average premium to go from $1,000 to $1,500 five years later, that should only have required a relatively tolerable 8.45% annual rate increase, instead of the average 150% one year increase from $600 to $1,500 to improve profitability because of previously unwarranted premium reductions.

Looking at the availability side of the "crisis"--when an insurance company is forced to reduce the number of policies it is writing due to changes in surplus or rates, it naturally looks at the profitability of each line of insurance it is writing in order to select where the cutbacks will occur. For example, if it writes six lines, each having a return on investment of 25%, 20%, 17%, 15%, 12% and 10% respectively, to improve profitability it will, wherever possible, stop writing those lines where the profit is lowest. It makes no difference what the claim history is of the individual policyholders in any of these less profitable lines. The company may also stop writing a few of its more profitable lines where it has relatively little data and some reason for uncertainty. For example, the company may be writing fifty insurance policies for day care centers yielding a 20% return with little or no claim history. Being aware of a case involving mistreatment of children in a day care center in California, it may choose to drop this line to help achieve the necessary overall reduction in policies, rather than drop 500 policies in lines, such as auto or homeowners insurance, which may be yielding a highly predictable and steady 17%.

There is simply no way to justify the abrupt increase in cost and lack of availability of liability insurance occurring in the current phase of the insurance cycle, except to suggest that there is a "crisis." Clearly, this problem could be avoided by better discipline in the insurance market exercised by both the companies involved in this conduct and those charged with the regulatory responsibility.

The third part of the article suggests some of the types of solutions which would provide prompt and effective relief. The accompanying exhibits will also be of particular interest.

Only by understanding the true nature of a problem can appropriate remedies be developed. This article was written in the hope of furthering that understanding.

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Table of Exhibits

I. The Tort System and its Impact On Liability Insurance Costs

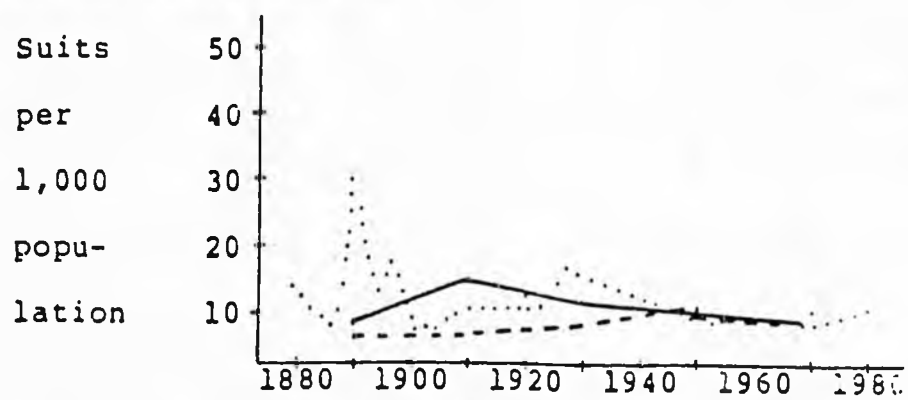
Whether it is an article or editorial on rising liability insurance costs for municipalities, day care centers, doctors, nurse midwives, tavern owners, manufacturers of various products from asbestos to autos, from chemicals to drugs, or the owners of commercial vehicles or private passenger automobiles, or any number of other areas, the focus always seems to be that we live in a "litigious society." The basic tenents of this perception are that we, as a people, are not only more likely to sue than other people, but that we are also more likely to sue than we used to be. Neither turns out to be true.

A. The Myth of Litigiousness

A recent survey by Professor Marc Galanter, published in the UCLA Law Review, of the litigiousness of citizens of major industrial nations clearly showed that Americans are really quite normal in terms of their tendency to sue:

> "[T]he United States rate of per capita use of the regular civil courts in 1975 was just below 44 per thousand. This is in the same range as England, Ontario, Australia, Denmark, New Zealand, somewhat higher than Germany or Sweden, and far higher than Japan, Spain or Italy. ... According to a recent report, some five million cases are filed in Yugoslavia each year, an astonishing figure for a country of 22 million persons."[1]

If we are not more likely to sue than the citizens of other major industrial nations, are we more likely to sue than we used to be? Again, the answer is no. There is no clear trend toward an increase in the tendency of Americans to bring a civil lawsuit. Recent articles by Stephen Daniels, Ph.D., "We're Not a Litigious Society: The Facts Do Not Support the Rhetoric Surrounding the Litigation Explosion," published in _The Judges Journal_, Spring 1985, and "Ladders and Bushes: The Problem of Caseloads and Studying Court Activities over Time," published in the American Bar Foundation _Research Journal_, Volume 1984, Fall, Number 4, support this. Also note the following graph, showing litigation trends in three major California counties, a state with a reputation for litigiousness.



Los Angeles County, CA = ...
Alameda County, CA = ———————
San Benito County, CA = - - - - - - -

Sources: Galanter, supra at fn (1), p.40; Selvin, M. and Ebener, P., Managing the Unmanageable: A History of Civil Delay in the Los Angeles Superior Court, The Institute for Civil Justice, Rand Corporation (1984), p.34.

As Professor Galanter explains, "the pattern of use [of the law to resolve disputes] is conservative, departing relatively little from earlier patterns."[2]

What, then, of such facts that nearly twice as many civil actions were filed in federal district courts in 1983 as in 1977?[3] Doesn't that prove we are more likely to sue than we used to be? No, as Professor Galanter explains:

> "[O]ne third of the whole increase consisted of a jump from 600 to 41,000 cases filed by the federal government to reclaim overpayment of veterans' or Social Security benefits or to collect on student loans. The next largest gain was an increase from 3,000 to 20,000 in claims to restore disability payments cut off by the Reagan Administration. ... These numbers reflect specific social and political events and don't point to any across-the-board increase or decrease in litigiousness."[4]

In Pennsylvania, noted Philadelphia author, John Guinther, found that filings of civil actions in Pennsylvania courts have risen at an average rate of 1% per year over the last five years, a rate of increase which is one-third of the national average. Further, most, if not all of this negligible increase can be accounted for by increases in those civil actions involving family law matters such as support, alimony, custody and divorce which account for the overwhelming bulk of all civil preceedings in our courts. Whereas liability insurance comes into play in personal injury cases, which actually account for only a small percentage of the cases in the courts. There has been virtually no difference in the rate of filing personal injury cases from year to year since about the mid-1970's.[5] (See Exhibit A)

While the overall rate of filing personal injury cases is stable, there will always be subtle changes in the types of cases brought. This would reflect the continuing evolution of the increasingly complex society in which we live. For example, there may be more pollution or drug liability cases now than there were fifty or one hundred years ago. Now there are thousands of complex chemical compounds being released into our environment and we are better able to determine the harm they can cause. In the past there were not nearly as many chemicals and it was far more difficult, if not impossible, to prove that they were the cause of the harm people suffered. Surely, there are less travelers involved in railroad accident cases per capita today, but more involved in airplane accident cases, and so on.

Finally, some critics have the idea that the increased number of lawyers is somehow meaningful in terms of litigation. What they overlook or forget is that a legal education has come to be viewed as having value beyond the practice of law. Thus, many lawyers today never practice law. Further, even for those who do, most of the modern practice of law does not involve litigation.

B. The Cost of Paying Liability Claims

Generally, the cost of paying all liability claims annually rises at a predictable rate, roughly parallel to the underlying rate of inflation in the economy for the goods and services the compensation is based upon, including medical expenses, lost income, etc. This is pointed out by a number of recent studies. For example, a Rand Corporation study of jury verdicts in Cook County, Illinois (Chicago), revealed that when inflation is considered, verdicts today are, generally speaking, no higher than they were in 1960. Mark Peterson and Audrey Chin, both of the Rand Corporation's Institute for Civil Justice were quoted in the National Law Journal of November 11, 1985, as follows:

> "Our research shows that juries are usually sensible and that their decisions have been remarkably stable over 20 years."

It should be pointed out that verdicts account for only a small percentage of claims paid, but are generally thought to have the greatest potential for volatility in terms of cost.

Another example, a recent study of medical malpractice in Pennsylvania revealed that the Medical Professional Liability Catastrophe Loss Fund loss costs are precisely where they should have been predicted to be 10 years ago when the fund was started. This study, by Professors Alfred E. Hofflander and Blaine F. Nye, also revealed that there is no discernable trend in Pennsylvania in the number of malpractice claims (frequency) and the cost of paying those claims (severity) when the underlying rate of inflation in health care costs is considered. (Note: There is a phenomenon, called "pseudo-growth" by the authors of this study, which accounts for the current appearance of substantial growth in the number of claims, and, therefore, cost, because of the way claims are reported into the system and the fact that the bulk of malpractice insurance is handled by insurers which did not exist before the 1975 "crisis.")

Unfortunately, the media tends to report only extraordinarily large personal injury verdicts. This gives the public the distinct impression that the exception is the general rule. It is never reported that the average of all awards, settlements and verdicts in personal injury cases of all types is probably less than $15,000--with substantially less in many cases. Further, the overwhelming harm which justifies the rare big verdict is often overlooked. For example, a person who has been turned into a brain-damaged quadriplegic can require $15,000 or more <u>per month</u> in care for the rest of his or her life. This can amount to many millions of dollars when the victim is young and has a long life expectancy. Likewise, when these large awards are appealed and reduced, or when the total reported represents the value of an annuity which actually costs a fraction of the reported amount, this is never mentioned. No evidence has ever been produced that Pennsylvania, when compared to other states with similar demographics, is a "big verdict" state, in fact, it is probably true that Pennsylvania produces, on a per capita basis, less "million dollar verdicts" than most other similar states.

Further, it is the total cost of paying all liability claims, not the cost of a single, or even a few, large claims, that is really important. As already pointed out, the total cost of paying all liability claims annually rises at a predictable rate, roughly parallel to the underlying rate of inflation in the economy, for the goods and services the compensation is based upon.

C. "Easy" Answers: Ineffective and Inapproporiate Solutions

When liability insurance premiums are soaring, it is just so easy to believe the simplistic notion that the problem is "all those lawyers, lawsuits and big verdicts." It just fits so neatly into the general perception of the way things are. Why should experts in the field give a detailed and lengthy answer to a complex problem when it is so easy and perhaps a little self-serving to give an answer which is likely to be accepted without question?

Worse, however, are the easy solutions to the problem of soaring insurance premiums which are all too readily preferred. The most frequently mentioned "solution" to liability insurance problems is placing limits on awards. Certainly, in the rare case which would exceed the limit, the attorney's contingent fee will be reduced, but the real cost of such solutions will be borne by the victims and the tax-paying public. This is because the only effect of a limit on awards is to shift the cost of harm in the most catastrophic cases away from the person or persons whose carelessness caused the harm and onto the backs of the victim and the victim's family. Ultimately a large share of the cost is shifted to the tax-paying public through various public and medical assistance programs which end up picking up the burden, but only after the victim is forced into poverty to qualify for benefits. A poor solution indeed.

Importantly, such solutions do not prevent soaring insurance premiums. A study, "State Responses to the Malpractice Insurance 'Crisis' of the 1970s: An Empirical Assessment," published in The Journal of Health Politics, Policy and Law, Volume 9, Number 4, Winter 1985, found the following:

> "Almost all states enacted legislation in response to the rapid rise in malpractice insurance premiums which occurred during the mid-19''s. After describing the types of statutory changes enacted, this study evaluates the influence of these changes on levels and growth of premiums paid by general practitioners, opthalmologists, and orthopedic surgeons during 1974-78. The empirical results of the study presented here give no indication that individual state legislative actions, or actions taken collectively, had their intended effects on premiums."

Likewise, Pennsylvanians need only examine what has happened to municipal liability insurance premiums in the face of the Political Subdivision Tort Claims Act of 1978, with its severe restrictions, including a limit on awards, for proof of the failure of such solutions to control soaring rates.

In the search to control periodic surges in the cost of liability in urance premiums, it must never be forgotten that the purpose of liability is not only to compensate the victims of careless conduct, but also to deter such conduct in the future. In the absence of liability, carelessness and its true cost to society would likely be far greater.

II. The Insurance "Crisis"

What now follows is not intended to throw stones at the insurance industry, but to describe the phenomenon at the root of the current "crisis." A crisis that no one, consumers or insurers, should want.

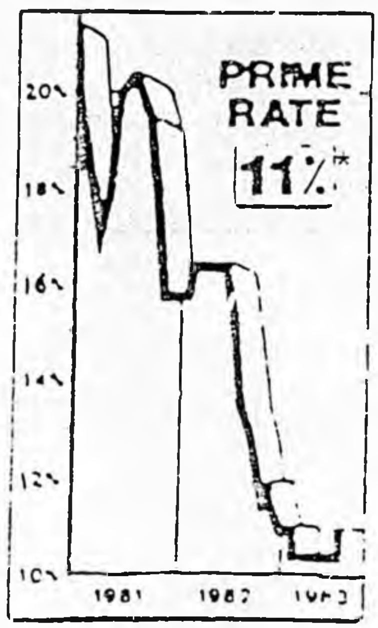
A. Factors Causing Periodic Fluctuations in Premiums

As we have seen, the recent, sometimes severe, increases in liability insurance premiums have virtually nothing to do with either the frequency with which claims are being filed, or with the size of jury verdicts. This perhaps has never been made more clear than this year, as the following statement from Best's, the insurance industry bible, reveals:

> "In 1984, insurance industry's own estimate of incurred loss and loss expense payments increased by the smallest amount since 1977. Yet, at the same time as the rate of growth of losses was declining, premiums increased by the largest margin since 1976, over 13%."[8]

Premiums should, over the years, have been rising steadily, in line with and controlled by the appropriate underlying rates of inflation, if they were to reflect accurately the underlying cost of the liability system alone. This has not happened. There are periods where rates stay level or even decline despite inflation and others where rates surge upwards far more rapidly than inflation. The reasons are to be found both in the nature of the property and casualty insurance marketplace and its relationship to general economic trends and, like the economy, the problem is cyclical.

Insurance claims are paid out of the total of premium income and the income earned in the investment of these premiums. Price wars among competing insurance companies to gain market share, hopefully increasing premium income, or at least investment income, when interest rates are high, create havoc when interest rates fall. Profitability declines and each insurance company is faced with a no-win choice: raise rates and lose market share to the competition, or continue to compete with increasingly inadequate rates in order to maintain or increase market share--hoping that the competition will be forced to raise their rates first so that it can then follow suit. It is tough to win back policyholders; it is a lot easier to hope that investment income will rise to improve the corporate bottom line.



*NOTE: The prime rate is currently 9.5%.

As the chart above might indicate, property and casualty insurers have seen the income that can be earned on the investment of premium dollars cut in half or more by falling interest rates during the current economic recovery, necessitating premium increases on top of those rate increases currently required to overcome previously inadequate rates which were the result of the competitive price wars within the insurance industry as interest rates rose to record heights earlier in the economic cycle.

The phase of the insurance cycle where property and casualty insurers become over reliant on investment income and premiums become increasingly inadequate has been euphemistically described as "cash flow" underwriting. As Professor Alfred Jaffe pointed out in a recent letter to the editor published in The New York Times on August 25, 1985:

> "That phase of the cycle commenced about the fourth quarter of 1978 and turned around about the third quarter of 1984. We had close to six years...during which American businesses, institutions and municipalities got their insurance well below "manufacturers' costs" and saved billions of dollars on premiums....Premium growth is a function of population increase, G.N.P. growth, inflation and other economic and social factors. Premium rate level is what impacts on one's pocketbook, not overall premium growth. A more meaningful statement would be: 'Rate levels for commercial insurance dropped approximately 50 percent on average between 1978 and 1984.'" (See Exhibit B)

The current situation has also been exacerbated by the fact that health care costs continue to rise more rapidly than other costs and the value of personal injury claims is, to a very large extent, quite understandably controlled by the underlying economics of health care costs. It should be noted that health care costs are continuing to rise in the greater Philadelphia area at the highest rate in the nation, 11.51 percent, double the national average, according to the U. S. Bureau of Labor Statistics as reported in <u>The Philadelphia Inquirer</u> on Sunday, March 10, 1985. (See Exhibit C)

In addition to all of the foregoing, other factors are also impacting on the property/casualty reinsurance market which include: 1) recent and enormous losses in the United States as a result of storms, airplane crashes and fires; and 2) the decline of the British pound and other foreign currencies relative to the strong U. S. dollar.

What is now happening with rates was summed up by Grover Czech, regional vice president of the American Insurance Association, as follows:

> "Companies are doing what they feel they have to to get back to price adequacy...Competitive pressure drove rates down for many years. Generally prices today are coming back to what they were in 1977 or 1978 when adjusted for inflation." (See Exhibit D)

B. The Current Phase of the Insurance Cycle and the Outlook for the Future

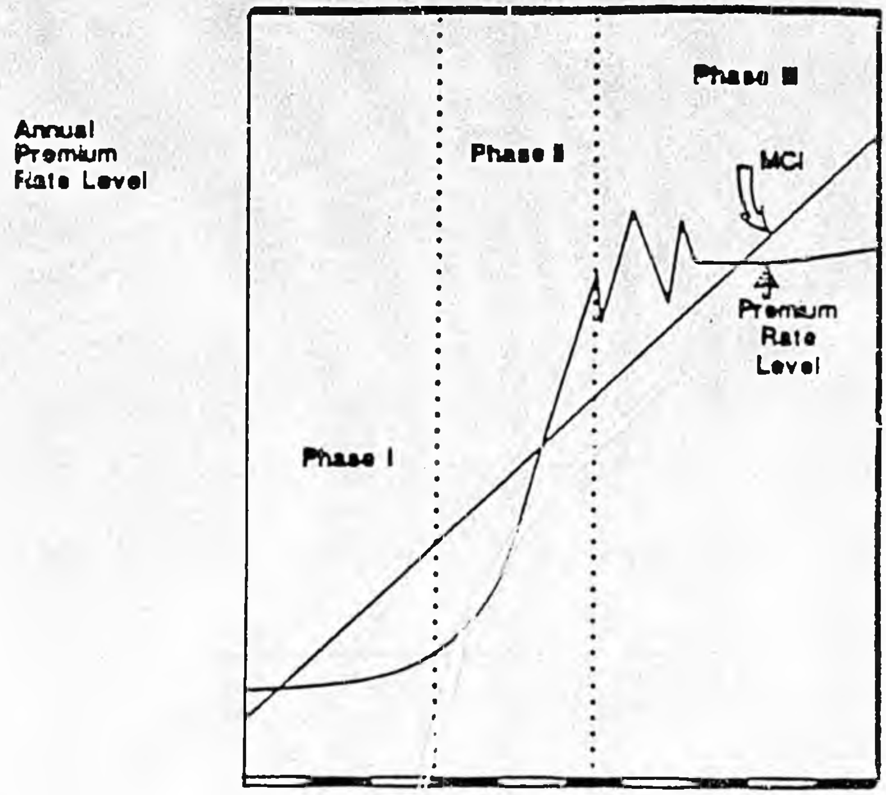
Because of declining profitability, insurance companies have become unwilling to utilize their capital (capacity) to insure risks, causing a "crisis of availability." In the competitive free market, investment capitol tends to flow to those investments where profits are highest and most reliable. After all, "the business of business is profits." Unfortunately, this is not necessarily good for insurance purchasers or, in the long term, for many sectors of the industry itself. When profits are reduced, insurance companies become very selective. They naturally want to maximize profits. Therefore, they try to avoid insuring risks, preferring, instead, to invest in those lines which are a "sure bet" and, in any event, they will charge what the market will bear. In choosing which lines to write when profits are reduced in the insurance business cycle, certain property/casualty lines suffer from a lack of adequate data which prevents proper underwriting, including such things as the consideration of individual claim experience, in the rate making process. Potential purchasers of insurance in these lines are at a disadvantage relative to others under current market conditions.

When profits are down, insurers, like other businesses, will stick with the lines they know the most about and are the most profitable. It does not mean that insuring other lines is not profitable, but rather, that some lines are considered more likely to yield higher profits than others. The slightest indication of risk, any uncertainty or unanticipated event, can lead virtually the entire industry to radically increase prices, reduce or cancel coverage or withdraw from the market, whether or not such actions are justifiable by any objective standard.

<u>Best's</u> says it most succinctly; the net effect was to reduce the incentive of insurers to take risks and to increase the incentive to raise premiums - the dual crises of availability and cost.[9] Observers of the industry, understanding this relationship between this "cycle of profitability" and premiums, predicted in the early 1980's that, once interest rates started to fall significantly, premiums would once again rise, probably sharply.[10] An example of the correctness of this prediction can be seen when comparing the earlier chart depicting the fall of the prime rate to the following charts concerning medical malpractice insurance.

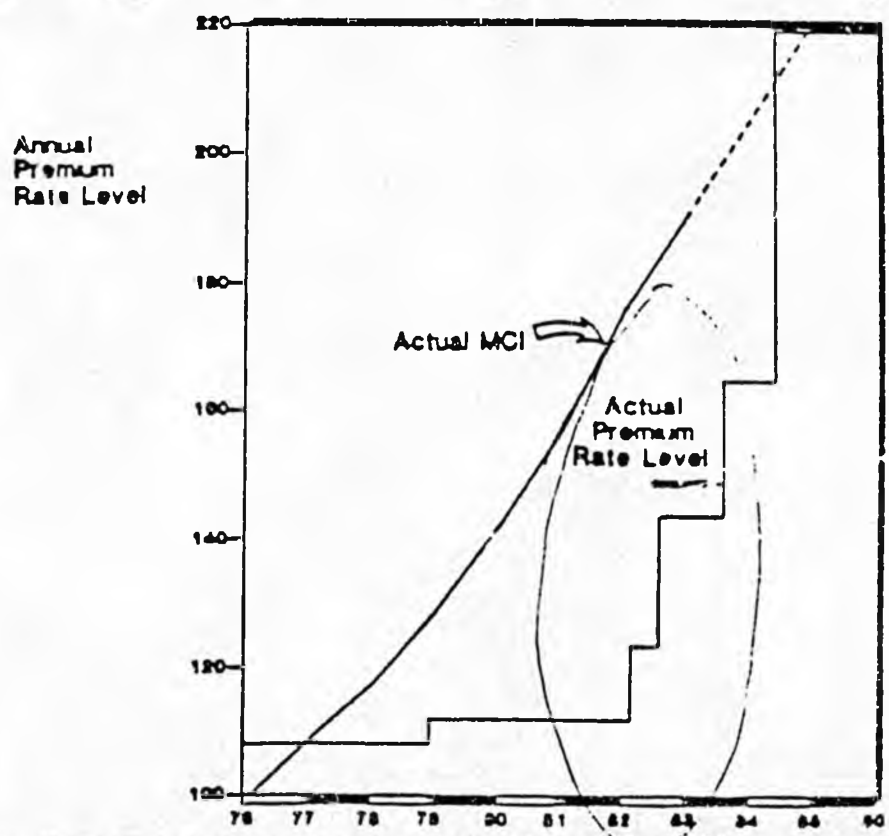
Theoretical Malpractice Premium Rate Cycle

FIGURE III-1



Stylized Actual Malpractice Premium Rate Cycle

FIGURE III-2

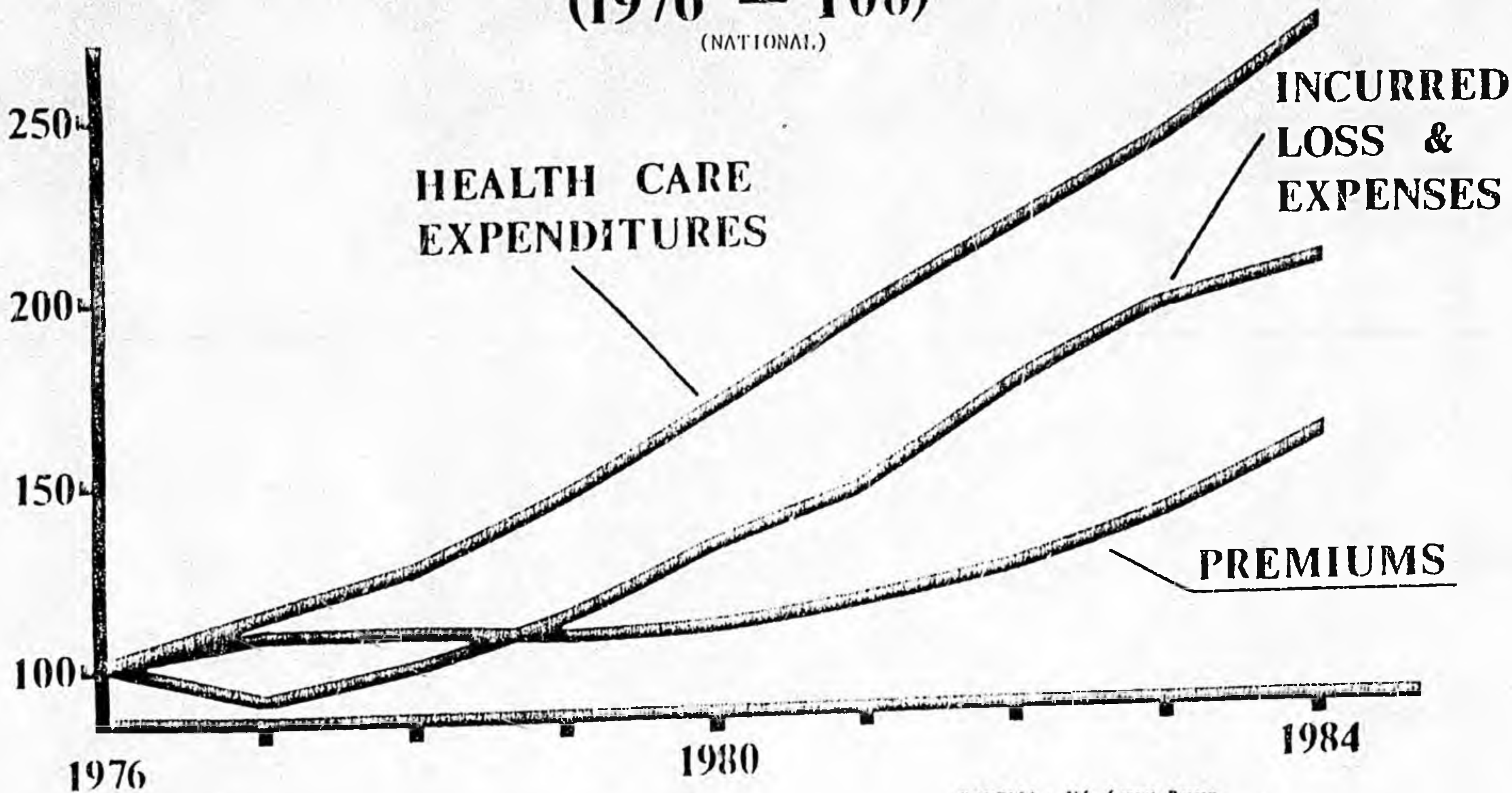


Source: Hafflander and Nye, "Medical Malpractice in Pennsylvania", 1985.

PREMIUM GROWTH

MEDICAL MALPRACTICE
(1976 = 100)

(NATIONAL)



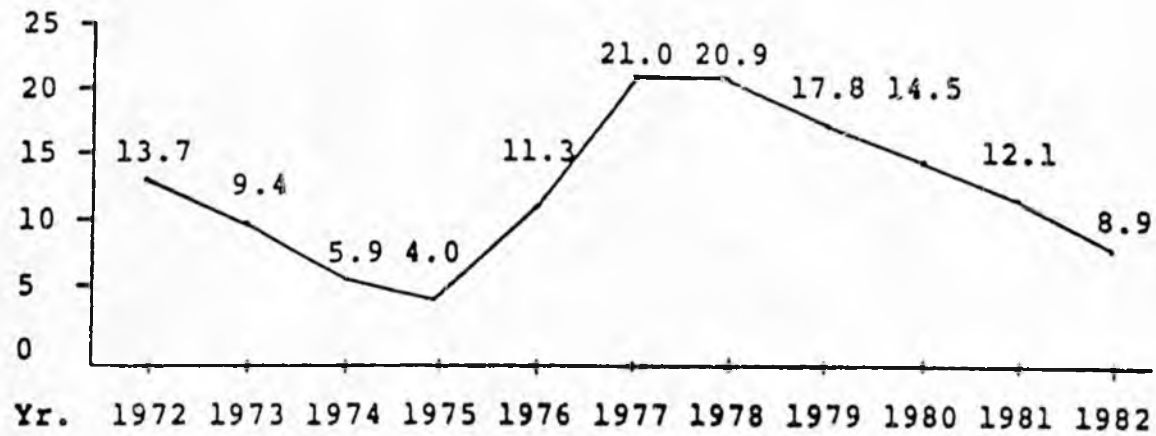
SOURCES: U.S. Census Bureau
A.M. Best

The "boom-bust" cycle in the insurance industry is reflected in the behavior of insurers:

> "It is amazing to see what happens in an insurance cycle to the mental state of underwriters. At the top of the cycle, in 1981, insurers were willing to not only take all of the risks thay are shunning today, but were willing to go so far as to insure the liability of MGM after their Grand Hotel burned down. Compare that with today's doomsday attitude toward risks that the underwriters have subjectively declared to be taboo."[11]
>
> (See Also Exhibit E)

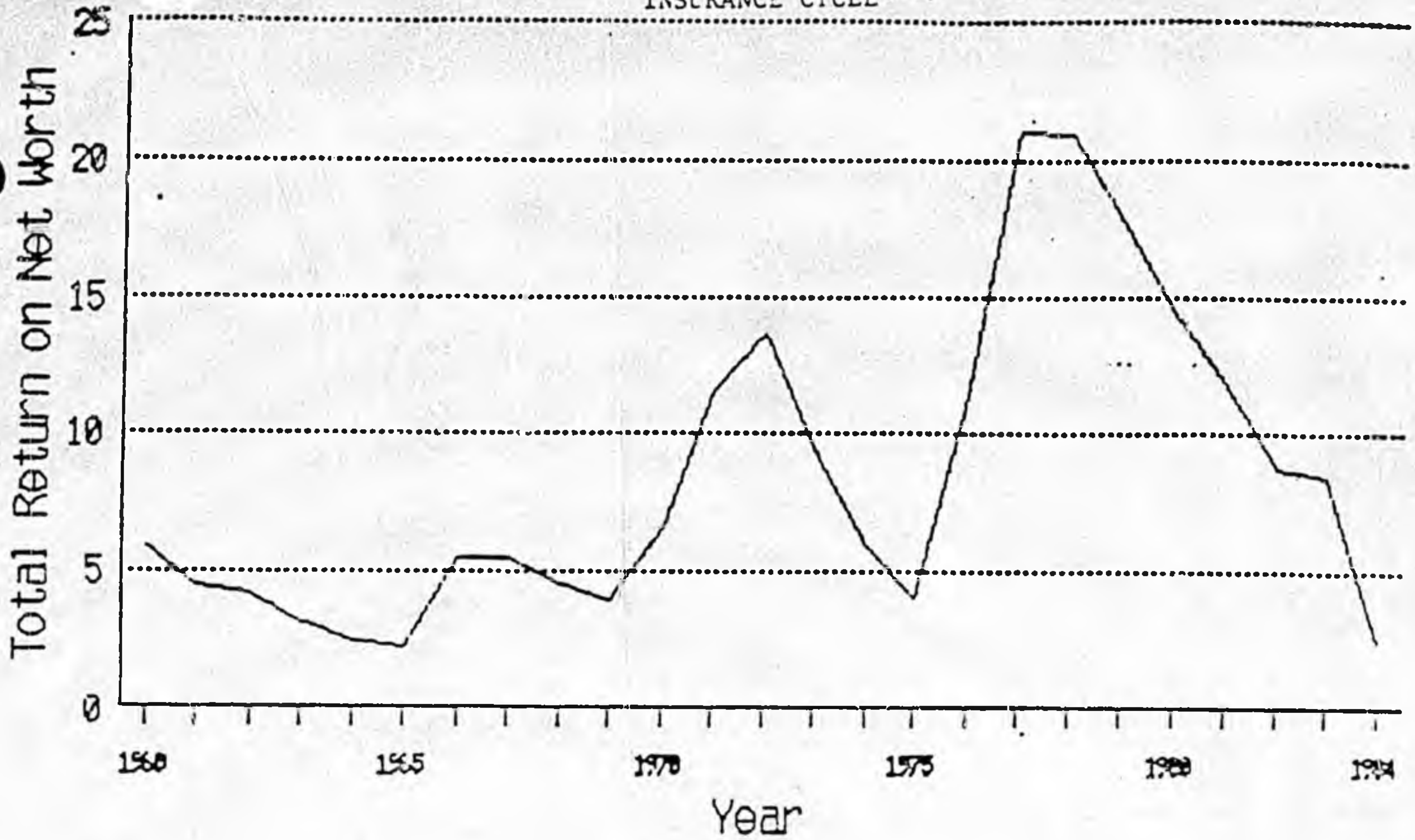
This cycle of profitability for insurers can perhaps best be seen in the following chart showing

Average Annual Rates of Return on Net Income After Taxes as a Percent of Net Worth 1972-82 (12)



A longer term look at this cycle can be seen in the following chart.

INSURANCE CYCLE[13]



As the above charts demonstrate, insurance crises are both cyclical and predictable. What we are experiencing now in 1985 is just such a "crisis," a crisis in the insurance marketplace, created by the economics of the insurance business and its interrelationship with underlying economic trends and conditions, born from the struggle between competing insurance companies for market share and profits.

During the current phase of the insurance cycle, insurers are demanding and receiving substantial increases in rates in order to substantially increase their profitability. Once higher profits are restored, the current crisis of availability and cost will disappear and the next round of competitive pricing is likely to reemerge.

It is interesting to note that auto insurance policyholders in Pennsylvania were cushioned against the full impact of the present crisis by the state's new auto insurance law which took effect just as the current phase of the market cycle was beginning. For example, in 1985, State Farm, the largest auto insurer in both Pennsylvania and the United States, took a rate increase averaging 6% for the entire nation, but State Farm's increase was only 3.9% in Pennsylvania. The cost of insuring an automobile in the United States in 1985 has risen at an annualized rate of 18.2%.[14] Pennsylvania appears to be below the national average for the first time in years.

Significantly, a recent article in the _Journal of Commerce_ reported on a new study entitled "1985, A Critical Year," done by the insurance industry itself, through the Insurance Services Office and the National Association of Independent Insurers. The study concluded, "The property/casualty industry must accept the major responsibility for its current financial condition." (See Exhibit F)

However, it is not yet time to mourn for the property/casualty industry or fear for its demise. Dr. Michael E. Hogue, President and

Managing Director of the Philadelphia Insurance Research Group, in recent remarks to the annual convention of the National Association of Professional Insurance Agents, said:

> "The property-casualty insurance industry today is in a stronger capital and surplus position than it has ever been in and it clearly has enough capital and surplus to meet the needs of the insurance industry today and in the near future." (See Exhibit G)

The National Underwriter reported that Dr. Hogue "also predicted a quicker than expected return to 'a period of a lack of price discipline';" in other words, a return to competitive price cutting.

The National Underwriter report continued:

> "Dr. Hogue said A.M. Best reported consolidated policyholder surplus of $64 billion as of Dec. 31, 1984, and then in a July 15, 1985, report indicated an adjusted surplus of $92 billion. Thus, he said, Best saw an equity in the balance sheet of $28 billion which he said arises out of undervalued assets and overstated liabilities. He said it comes primarily from the unearned premium reserve for that portion already paid out in acquisition costs and from the estimate of the loss reserves on a discounted basis.
>
> "'In general, what that means,' he said, 'is that the property-casualty industry, if it were put into a runoff situation and assuming the reserves are accurate, when the period of runoff is completed, not only would there be $64 [b]illion in capital and surplus, but there would be another $28 billion left over.'

"Even assuming a reserve deficiency of as much as 20 percent, he said, after the period of runoff, the industry would have not only the $64 billion of reported surplus, but another $8 billion or $9 billion of undisclosed profits.

"'It is for this reason,' Dr. Hogue said, 'that we believe the property and casualty insurance industry is overcapitalized; and that, frankly, is going to be a detriment, not an advantage.'...

"'It's for that reason,' he continued, 'that we maintain that the industry does not have a capacity problem.'...

"...What it does indicate, he said, is that the insurance industry is not pleased with the profitability of the market and is unwilling to release the capacity in search of taking risk. 'There lies our major concern,' he said.

"When the profitability appears in the financial statements of the carriers, particularly in the regional and other small companies that have not had the extent of problems that many of the larger carriers have had, they will begin to release the surplus in anticipation of growth of market share.

"Dr. Hogue said Chubb and Ohio Casualty recently released nine-month results showing that earnings per share have already doubled in 1985.

"'It is our concern,' he said, 'that we're going to find a more rapid release of that surplus in search of market share than is otherwise being predicted relative to when the markets will turn. It is our belief that that is going to result again in a period of lack of price discipline.

"We believe that the requirement to allocate the surplus because of the necessity to leverage that surplus against returns to meet the target return on investments of many of these corporations, we will begin to start the process of market competitiveness.'

"He called it 'gross mismanagement' of a property-casualty insurance company to attempt to increase market share unless there are indicators available showing where the price and relative exposure are at any point in time. He said it has been his experience that there are few insurance companies in the U.S. market which are fully aware of the current price and exposure relationship in their portfolio on a recurring basis..."
(See Exhibit G)

In other words, Dr. Hogue apparently believes that the insurance cycle, with its peaks and valleys, is most likely to be repeated again in the future just as it has in the past. (For further discussion and other views on the capacity aspect of Dr. Hogue's remarks, see Exhibit H)

While it appears certain that the insurance industry will continue and profitability will improve, there will be some inevitable changes. The nature and extent of these changes remains to be seen. There may be increased government intervention to attempt to control the swings of the insurance cycle and to assure availability of coverage and provide adequate data for rate making purposes for certain lines, as well as to prevent such abuses as midterm cancellations. There will certainly be some structural changes in the marketplace, including increased reliance on self-insurance. Insurance purchasers have much at stake. Will they continue to be at the mercy of the insurance cycle or will they take an active role in improving their situation? Changes are constant in our society and, just as the law adapts to these changes, so must insurance. So far, the competing insurance companies have apparently found it easier to agree among themselves to try to shift the blame for their problems onto the legal system than to agree on how to solve them.

III. <u>The Search for Effective Solutions</u>

As must be clear by now, the reality of the "crisis" is far different and more complex than is commonly perceived. The answers to these problems do not lie in cost shifting devices such as various arbitrary limitations on the rights of the citizens of Pennsylvania. The answers are numerous and what follows is not intended to be an all inclusive list. Part of the answer lies in assuring that the insurance industry does real underwriting, considers individual experience in rate making and has adequate data in order to do this job. Further, while competition may be desirable as a general rule, insurance companies cannot be permitted to charge rates which are inadequate or excessive. In some lines, the market in a state may be so concentrated as to not be conducive to open competition. This must be carefully examined. Also necessary is action to reduce dependence on the foreign reinsurance market and particularly the dominance of Lloyd's of London over the American insurance market. Another part of the answer lies in reexamining the investment laws governing property and casualty insurance companies so that they can engage in appropriate modern investment practices which might enable them to smooth out the effects of changing economic conditions on their corporate bottom lines. Pennsylvania's law governing insurance company investments dates from 1921. An additional answer lies in increased insistence on risk management on part of both insurance providers and consumers in order to prevent injuries from occurring in the first place. A further part of the answer lies in increased knowledge on the part of insurance consumers as to how to buy insurance and who to buy it from. This would include increasing use of self-insurance and pooling mechanisms.

Through the pooling of risks many groups needing insurance coverage, including Pennsylvania's political subdivisions, could accomplish several objectives. First, they could collectively self-insure their low-end exposure.

Second, they could use the strength of their numbers and the stability of risk inherent in such an arrangement to negotiate the most favorable rates from the private sector for their collective high-end exposure. Thus, the pooling mechanism would work very much like a group insurance plan with a high deductible.

Third, the pooling mechanism could provide a data base on all claims against its participants which would enable effective risk management--claim prevention--the only real way to cut costs.

Fourth, such a data base would provide its participants with the ability to determine if their insurance rates are fair and reasonable.

The pooling mechanism I am describing could be run by a private insurer with the appropriate expertise. Most importantly, such a program would effectively free groups such as Pennsylvania's political subdivisions from the vicissitudes of the insurance cycle. This is because they would have created their own capacity to the extent they self-insure, thus hoarding the sometimes extremely limited capacity available in the private sector for their high-end exposure. Further, it would give them the data necessary both to prevent claims and negotiate insurance rates far more effectively.

In remarks to the Florida Senate Commerce Committee regarding property and liability insurance on October 8, 1985, Florida Insurance Commissioner, Bill Gunter, supported the views expressed herein as to the solutions which would appear to be appropriate under the circumstances. (See Exhibit I)

In this regard, it should be remembered that insurance first began in England when the owners of merchant vessels decided that the best way they could handle the risks inherent in their business was to share that risk. Maybe it is time to return to the basics in insurance. Importantly, the solutions I am suggesting are applicable to others, besides political subdivisions, who are affected by this problem of cost and availability of liability insurance.

This cyclical problem with liability insurance rates will remain with us until decision makers in government, business and the professions, as well as the observers in the media, shift their focus. We must stop dealing with perceptions and begin to address reality. Prompt and effective relief can only be acheived by addressing the reality of the problem through the type of solutions suggested herein.

IV. More on Pennsylvania's Experience

The need for this shift of focus could not be any clearer in Pennsylvania than with the problem of municipal liability insurance. The Political Subdivision Tort Claims Act of 1978 is among the most restrictive laws with regard to tort law as has ever been passed in any state. For example, it contains an absolute bar on tort claims against local governments with only eight areas where exceptions are granted. In those areas where claims can be brought, there is an absolute limit, a cap, on the amount of liability and any compensation is further reduced because the victim cannot recover any damages which are paid or payable from any other source, with the exception of life insurance. This law even contains a "threshold" including the requirement that the injury be permanent, which must be met before a claim can be instituted. (For a synopsis of the Political Subdivision Tort Claims Act, see Exhibit J). Lawyers who represent political subdivisions throughout Pennsylvania have testified that there is not a crisis of claims here in Pennsylvania. There has not been some sudden or recent increase in litigation against political subdivisions. (See Exhibit K) Despite these facts, municipal liability insurance rates in Pennsylvania are currently soaring, just as they are in other states without tort restrictions, demonstrating that so-called tort "reform," the restriction of the rights of our citizens, does virtually nothing to affect insurance rates.

It is interesting to note that the Political Subdivision Tort Claims Act grants the political subdivisions the authority to establish a pooling mechanism and help themselves as described above, (See 42 Pa. C.S.A. Section 8564), but they have failed thus far to act. Of course, they could wait until the current crisis is over and allow the cycle to recur, and there is evidence that this phase of the cycle is ending. Best's reports as follows:

> "In the first half of 1985, property/casualty stocks on Best's Index have advanced 31%, investor excitement being generated by a reasonable consensus that the longest industry down-cycle in history has finally turned, albeit by a small margin. They were rewarded on average, by advances twice the size as those reaped by the general stock market."(See Appendix I)

V. Conclusion

If solutions to the problems confronting those who need insurance coverage, including political subdivisions and others are to be effective, these solutions must address the real problems, not the common misconceptions, however popular they may be. These problems are the result of a "cycle of profitability" in the insurance industry born from the struggle between competing insurance companies for market share and profits. They are not the result of some sudden increase in litigiousness or in the total volume or cost (considering inflation) of claims.

The current phase of the insurance cycle, with its "crisis" of cost and availability, is apparently ending. Will this cycle be allowed to recur unabated?

This article was written in hope that it will not. The Pennsylvania Trial Lawyers Association is sympathetic to the problems confronting all groups of insurance consumers and is always willing to be involved in the search for constructive solutions.

Footnotes

1 Galanter, Marc, "Reading the Landscape of Disputes: What We Know and Don't Know (And Think We Know) About Our Allegedly Contentious and Litigious Society," 31 U.C.L.A. L. Rev. 4, 55-56 (October, 1983).

2 Galanter, supra at fn (1), at 70.

3 "Federal Judicial Workload Statistics During the Twelve Month Period Ended December 31, 1983," Administrative Office of the United States Courts, (1984).

4 "Americans' 'Litigation Binge' Is A Myth," U.S. News & World Report (November, 1984).

5 Guinter, John, "Stalking Burger's Wild and Elusive Litigation Flood," The Barrister, Vol. #XVI, No. 2, Summer, 1985.

6 M. A. Peterson and G. L. Priest, 1982. Rand Corporation, The Institute for Civil Justice, Santa Monica, CA Civil Jury, Trends in Trials and Verdicts, Cook County, Illinois, 1960 - 1979

7 Hofflander, Alfred E., and Nye, Blaine F., "Medical Malpractice Insurance in Pennsylvania," 1985, Management Analysis Center, Inc., Menlo Park, CA.

8 A. M. Best's Casualty Loss Reserve Development, 1985.

9 Id.

10 Id.

11 "The Insurance Crisis of 1985: What Can Be Done?' National Insurance Consumers Organization, Alexandria, VA (June, 1985), p.2.

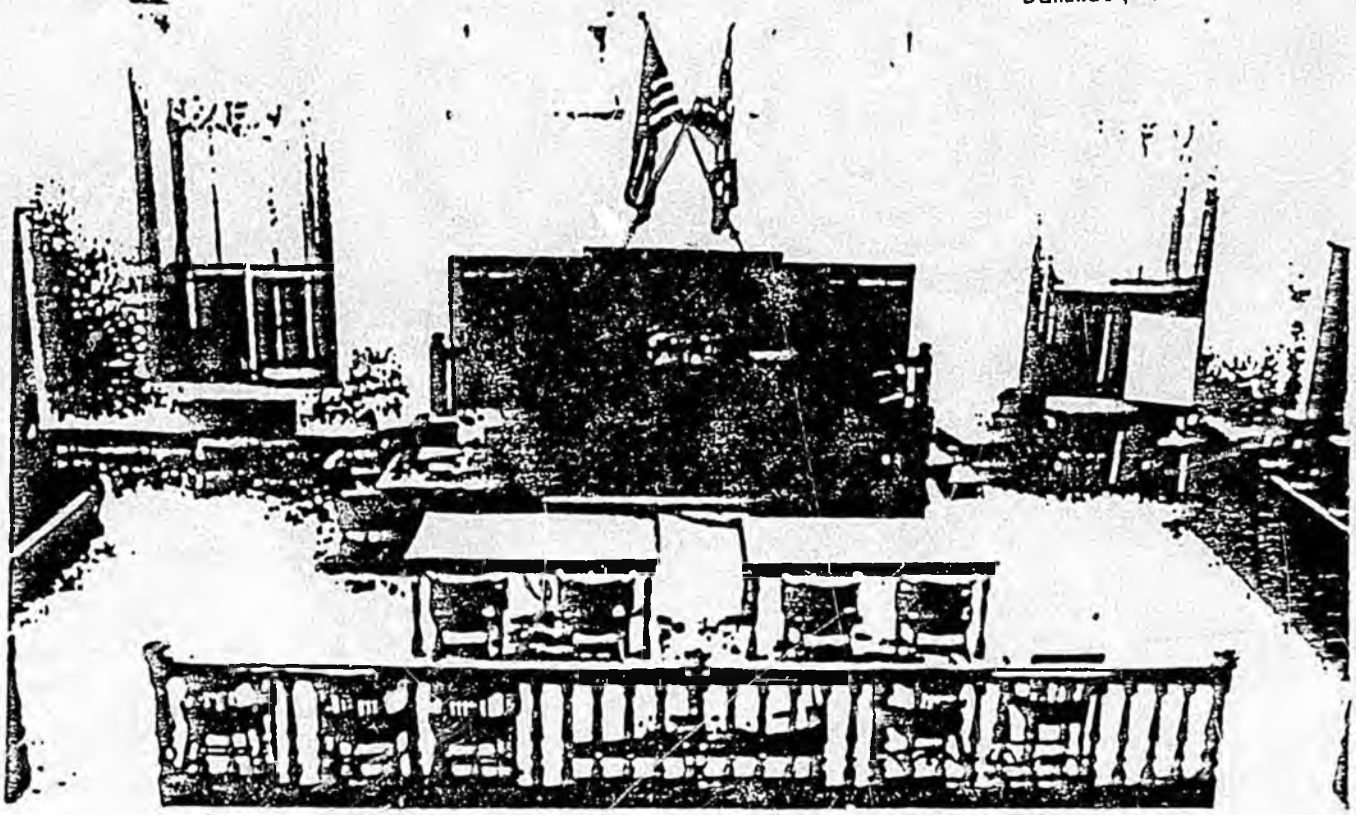
12 Refers to capital stock property/casualty insurers only. Figures are from "Congress Should Consider Changing Federal Income Taxation of the Property/Casualty Insurance Industry," U.S. General Accounting Office, GAO/GGD/85/10, March 25, 1985, p.7.

13 Chart is from National Insurance Consumer Organization press release of August 15, 1985, which identifies the source of the data for the chart as Citibank Economics and Insurance Services Offices.

14 Testimony of J. Robert Hunter, President, National Insurance Consumer Organization, before the Subcommittee on Commerce, Transportation and Tourism, U. S. House of Representatives, on "Liability Insurance" which identifies the source as CPI data on "auto insurance," U. S. Bureau of Labor Statistics.

EXHIBIT A

The Barrister
Vol. #XVI, No. 2
Summer, 1985



STALKING BURGER'S WILD AND ELUSIVE LITIGATION FLOOD

by John Guinther

Whenever someone in power announces that we Americans are facing a crisis—swine flu, for example—my experience has been that the crisis rarely exists, but the cure is likely to kill us.

Some crises have as their purpose to allow gentlemen-warriors to go shooting second-hand—(the blood spilled is ours, not theirs), in foreign climes, be they Vietnam or Nicaragua. Other crises, less sanguinary but no less lethal, seem designed to convince us to give up some Constitutional right that it is no longer convenient for us to have.

An adept practitioner of the latter variety of crisis-mongering has been the Chief Justice of the United States Supreme Court, Warren Burger. For about the past 10 years, he has been trooping through every Middlesex village and town (i.e., every American Bar Association meeting) telling us we are in the midst of a great "litigation crisis" that has so flooded our courtrooms that our right to free access to the courts and to a jury to hear our case should be sharply curtailed. He has found allies in the popular press, who write sensational articles about Americans indulging in an "epidemic of hair-trigger suing," causing our multi-billion-dollar multi-national corporations so weep with sheer vexation at the money they have to pay out when they put products on the market that maim people. All this has been caused, Burger says, by the "inherently litigious nature of Americans," who, in the rather elegant phrasing of another commentator, display "an abandoned eagerness to hail into court all and sundry."

Out of curiosity, I decided to take a look at the statistics, to see exactly how greedy we Americans are. Certainly, if we are as avid for money as Burger says we are, then something ought to be done to stop us for our own good. after all, our suits force insurance companies to pay verdicts, their costs are passed on to their customers, who in turn pass them on to us—both the contentious and the passive among us.

The federal court figures seem to back Burger. They show that between 1980 and 1984, the number of civil cases filed jumped from about 170,000 to 260,000, more than a 50% increase which, if it doesn't mean a crisis, means something close kin to one.

That is, it did until I let my eyes wander down the long rows of figures that show where the increase in cases is coming from. I then learned that nearly two-thirds of the increase was brought about by cases in which the United States government was either the plaintiff or defendant. Of these, almost all the plaintiff cases were ones in which the government was trying to collect defaulted student loans or alleged overpayments to veterans. Of the ones in which the government was the defendent, almost all of them involved people who were suing to stop the Reagan administration from cutting off their Social Security supplemental benefits.

Without arguing the merits of these governmental policies, such suits hardly come under the heading of "hair-trigger suing" by "an inherently litigious" citizenry.

But, thought I, since federal cases make up only about four percent of all those that are filed in the United States each year, what I should be looking at are state court statistics. I found them, too, in several huge volumes filled with hundreds of pages of tables, which, when the browsing among those numerical thistles was complete, reveals that—since about the mid-1970's—civil case filings in state court have been increasing at about three precent a year, or one-quarter of the federal rate.

It's all a matter of perspective, no doubt, but to me that increase doesn't even amount to a kissing cousin of a crisis.

While I was at it, I thought I'd try to find out the origins of the increase, such as it was. Although, it seems, no two states keep their statistics the same way, as nearly as I could tell—and I had a sample of states making up about 50% of the population—personal injury cases, the ones where we're supposed to be doing all that hair-trigger greedy suing—were strolling along with virtually no difference in the rate of filing from year to year.

I did, however, find one category in which there was a sharp increase, and a predictable one considering the doubling of the divorce rate in the United States between 1970 and 1980, and that was in domestic relations cases, including child custody matters. There, the rate had grown by a hefty 30%. Apparently, if Americans are contentious, it's manifested mostly in their marriages.

I also learned that, if we Americans are litigious, we certainly vary a lot from state to state in that quality. The peaceful Pennsylvanians, for example, filed civil suits at a one percent increase in 1983 over 1978; the laidback Californians were right at the national average, while the big bad New Yorkers were way above it. In 1980, New Yorkers filed—according to their official statistics—about 730,000 civil suits; in 1983, a walloping 1.2 million. Now, there's a crisis of headline-making proportions, and headlines have been made of it. The only problem is that it is a false figure. A call to a New York court official revealed that the 1983 statistics included counts from two courts that previously had been omitted, and they weren't any small omissions, either—about 400,000 of them a year.

In other words, as the official noted, the real rate of increase in New York is about two percent a year since the late 1970's, not more than 70% in three years, as the published statistics seemed to indicate.

Perhaps, just perhaps, we should hang on to our right to trial and jury a wee bit longer and not let those who would save some money for insurance companies and big businesses scare us out of it. Perhaps our real crisis comes from the quality of those who advise us.

ABOUT THE AUTHOR

John Gutnuber is one of the most able and distinguished journalists in the Philadelphia area. Long-recognized for his readable style and his careful research, Gutnuber has often written on legal matters for such Delaware Valley publications as Philadelphia Magazine and the Welcomat (where this article originally appeared).

PERSONAL FINANCE / Frances Cerra   THE NEW YORK TIMES, SUNDAY, JULY 28, 1985

EXHIBIT B

The Hard Search for Property Insurance

To hold down costs, consumers may have to chase discounts. 'Bad risks' may be turned away altogether.

RECENT news reports have described the drastic rate increases inflicted upon businesses seeking property and casualty insurance, but little has been said about the prospects for individual drivers, homeowners and renters. Unfortunately, the huge losses that insurers have suffered recently are putting rate pressure on the so-called personal lines as well as on commercial insurance. Although the increases have been far less dramatic, personal premiums are continuing their steady climb, with auto rates leading the upward trend. Industry spokesmen also warn that insurance will be harder to get for "bad risks," including those people with poor driving records, for example, or whose homes are far from fire stations.

Individuals who want to hold down their insurance costs may find it necessary to do some sophisticated shopping, to assume more risks themselves, and to be aggressive about getting every possible discount.

The reason rates are under such pressure derives from a practice known as "cash-flow underwriting." For a three-year period that ended last fall, insurers focused much more on investing premium income than on the quality of the risks they were insuring. Lured by very high interest rates, companies competed intensely for dollars to invest.

The insurers were gambling that the cash flow from their investments would be great enough to cover their underwriting losses. But unexpectedly high commercial losses and dropping interest rates combined to bring about an industry underwriting loss last year of $21.3 billion, according to the A. N. Best Company, the widely respected insurance industry rater and analyst. In a year-end report, Best said, "The penalty for trying to substitute finance for underwriting is now being paid."

For businesses, at least, the period of cash flow underwriting brought substantial premium savings. Individuals, however, enjoyed no such bargains, points out J. Robert Hunter, president of the National Insurance Consumer Organization. From 1981 through 1984, premiums on commercial lines of property and casualty insurance went up only 10 percent, on average. Premiums for personal lines rose 20 percent over that period, notes the Insurance Services Office, an industry organization that tracks trends and issues rate guidelines.

This 20 percent increase was what the I.S.O. had said was needed, according to a spokesman, David Ostwald. Similarly, the I.S.O. had recommended commercial increases of 30 percent, but the industry ignored that recommendation. Now, with the property/casualty companies facing severe losses and needing to rebuild their reserves against future claims, some commercial customers face premium increases of 200 percent to 500 percent.

Fortunately, individuals face no such budget-breaking changes, partly because their rates have risen all along. The average premium for individual drivers nationally was up 8.1 percent for the first quarter of 1985 from a year earlier, according to the I.S.O. Homeowners premiums over the same period went up 5 percent. Experts expect near-term increases to stay within a similar range.

However, Mr. Ostwald advises that auto rates may move up somewhat faster. The number of auto collisions is up, and with it came a 6 percent rise in the number of claims for physical damage in the fourth quarter of 1984 compared with the period a year earlier. More important, he says, there will be pressure on the industry to "limit the availability of insurance to people in less desirable risk categories" for all types of coverage.

Individual insurance buyers who want to control their insurance costs can take the following steps:

- When policy renewal time approaches, shop for comparison prices. Be sure to get a quote from at least one company that does only limited commercial business — because it will probably not be facing such serious losses. This group includes such companies as State Farm, Nationwide, Geico, Allstate and Safeco.
- On auto policies, consider accepting a deductible as high as $1,000. Mr. Hunter, of the National Insurance Consumer Organization, points out that this form of self-insurance is nearly always worth the risk. Among other reasons, he says, someone with a $250 deductible who suffers a $500 loss often decides not to file the claim because the action might force up future premiums. Over the years, the premium savings from the larger deductible should more than outweigh the cost of paying for a minor accident yourself. "Let time be your insurance company," Mr. Hunter advised.
- If you have a poor driving record, ask an independent insurance agent to check the Assigned Risk Plan rates. They are sometimes cheaper than those available from individual companies.
- Check to make sure you are getting the benefit of all possible homeowner or renter discounts. Although only a few companies advertise discounts for homeowners who have smoke alarms, for example, almost all companies offer them. Discounts are also commonly offered to senior citizens and to people with dead-bolt locks protecting their homes.
- Co-op owners should take advantage of new policies available to them. Until recently they were restricted to tenant policies, but now they can purchase the same kind of policy that homeowners have — often at a 30 percent to 40 percent saving over the old coverage, according to Anthony Giaccone, an agent in Huntington, L.I.
- In the past, some companies have been charged with "redlining," or refusing to write insurance coverage within a given neighborhood, usually one in the inner city. Companies deny these charges, but Mr. Hunter advises that individuals who live in such areas and find themselves unable to get coverage for reasons that seem illogical should consider complaining to their state insurance department.

INSURANCE is a cyclical industry, but the current downturn is more severe and prolonged than most, and some companies may go under. Consumers are protected by state law if their insurance company fails. New York, for example, created a guarantee fund to honor consumer claims against bankrupt companies. However, payment can be much slower than normal. As a precaution, consumers should check company ratings in Best's Insurance Reports, available in libraries, or with an agent. Best's top rating is A-plus; industry experts advise that consumers deal only with companies rated B-plus or better. ■

THE NEW YORK TIMES, SUNDAY, AUGUST 25, 1985

LETTERS

Insurance

To the Editor:

Frances Cerra made some misleading statements concerning commercial insurance ("The Hard Search for Property Insurance," Personal Finance, July 28). She referred to the period of "cash-flow" underwriting as "a three-year period that ended last fall." That phase of the cycle commenced about the fourth quarter of 1978 and turned around about the third quarter of 1984. We had close to six years — not three — during which American businesses, institutions and municipalities got their insurance well below "manufacturers' costs" and saved billions of dollars on premiums.

She stated that premiums on commercial lines went up only 10 percent on average, from 1981 to 1984. Premium growth is a function of population increase, G.N.P. growth, inflation and other economic and social factors. Premium rate level is what impacts on one's pocketbook, not overall premium growth. A more meaningful statement would be: "Rate levels for commercial insurance dropped approximately 80 percent on average between 1978 and 1984."

Finally, Ms. Cerra stated that co-op owners "can purchase the same kind of policy that homeowners have." Not so; but change "homeowners" to "condo owners," and you have it.

ALFRED I. JAFFE
Associate Professor (retired)
The College of Insurance
New York, July 28

EXHIBIT C

The Philadelphia Inquirer
business

Sunday, March 10, 1985

Area has the nation's fastest-rising medical prices

By Cilbert M. Gaul
Inquirer Staff Writer

The prices consumers pay for medical care in the eight-county Philadelphia area are rising faster than anywhere else in the nation.

Not only that, but they are rising from levels already considered among the highest in the nation and at a time when the pace of price increases for medical care in other cities appears to be slowing.

From January 1984 to January of this year, the price of medical care in the Philadelphia area increased by 11.51 percent, double the national average of 5.8 percent.

The data gathered by the regional office of the Bureau of Labor Statistics, have left health-care experts groping for explanations.

"Why we're going up while the other cities are slowing, I can't say," said Charles Scott, the bureau's regional economist.

"That's hard to rationalize," agreed Wharton School professor Robert A. Zelten.

The only city whose health-care price trend mirrors Philadelphia's is Houston, which, like Philadelphia, has a high concentration of medical schools, teaching hospitals and medical research centers. Prices for medical care in the Houston area rose 11.5 percent, a whisker behind Philadelphia's rate.

In many cities commonly thought to have higher costs of living than Philadelphia, medical-service prices rose at much slower rates.

For example, in New York, often considered the nation's most expensive city, medical prices rose 7 percent. In Boston, prices climbed 7.7 percent; in Los Angeles, 6.7 percent; San Francisco, 5.3 percent, and in Washington, prices rose 2.9 percent.

The rapid price increase here comes at a time when the rise in medical-care prices elsewhere is slowing. In January 1984, the medical-price index for Philadelphia stood 5.1 percent higher than the national figure. A year later, the index in Philadelphia was 10.7 percent higher than the national average.

When compared with other components of the Consumer Price Index (CPI), which measures price changes on a broad range of goods and services, the rate of increases in medical care stands out starkly.

Housing prices in the region, for example, increased 5.03 percent in 1984. Food and beverage prices rose 1.59 percent. Transportation prices were up 3.49 percent, and clothing prices inched up just 0.39 percent.

The overall CPI for the Philadelphia region — Philadelphia, Bucks, Chester, Delaware and Montgomery Counties in Pennsylvania and Camden, Burlington and Gloucester Counties in New Jersey — rose 4.04 percent in the year ended January 1985. In the same period, the national Consumer Price Index climbed 3.57 percent.

Why are prices for medical care here rising so quickly? And, more particularly, why is the Philadelphia region out of line with price trends in the rest of the country?

"We think we know why it has increased in Philadelphia. But I don't know why with other cities," said Labor Statistics economist Scott.

Scott said prices for services from hospitals, nursing homes and dentists here all had increased at a rate greater than the national average. Also rising quickly were premiums for health insurance. But price increases for prescription and nonprescription drugs and medical equipment did not exceed the national average, Scott said.

"We record what the increase is, but the reason why, we really don't know. There could be an element of 'this is just our year,'" Scott said.

Scott and others at the Bureau of Labor Statistics caution that the regional CPI survey is subject to some distortion because it uses a small sample. But those distortions tend to be smoothed out when viewed over longer periods, the BLS officials say.

CONTINUED

CONTINUED

Medical prices here are nation's fastest-rising

"We always tell people not to place much emphasis on a monthly shift because it could be wrong. But over long periods of time those things tend to wash out. Looking over a calendar year you expect to see a consistent pattern," said Daniel Ginsburg, supervisory economist for the BLS in Washington.

Officials here and in the 27 other BLS regions use the same methodology to gather the price data. Starting with the main components of health care — hospitals, nursing homes, physician fees, drugs — they survey prices of individual items at varying locations. The same items are selected each month so economists can measure the rise in prices from the index base of 100, the price level in 1967.

The weight given to each component of the CPI varies from city to city, reflecting the diversity of their medical-care economies. The CPI here, for example, reflects the high concentration of hospitals.

What the CPI does not purport to measure is the cost of goods and services. "We're measuring the changes in the prices of those goods, not the costs," Scott said.

Since the Bureau of Labor Statistics began keeping the medical-care index, prices here have climbed 333 percent as of January. The only metropolitan area in the nation where prices have risen more quickly is Houston, where medical-care prices have increased 352 percent since 1967.

"I think there's several explanations for that," said Sharon Cohany, a BLS economist in Dallas. "One is that since 1967, Houston has been one of the fastest-growing areas in the country. That phenomenal growth has put upward pressure on all prices, including those for medical care."

A second explanation offered by Cohany is one that also might apply to the Philadelphia medical marketplace.

"Houston is at the forefront of medical technology," the economist said, "and that also is very likely to put upward pressure on prices. As technology expands, the cost of developing those services also grows. A tremendous financial cost is associated with that".

Albert Zerulinski, managing partner in charge of health care for the Philadelphia accounting firm of Laventhol & Horwath, offered a view similar to Cohany's.

"My feeling in a speculative way is that . . . it could be a function of our highly developed medical area here," he said. "It is a highly intensive medical community in terms of physicians per capita and specialists per capita. They are all selling higher-cost services. Prices don't go up unless costs go up."

Other health-care experts, economists and officials offer other reasons why prices for medical care in Philadelphia and its surrounding counties are rising much faster than those in other areas, including many cities with sophisticated medical complexes, such as New York, Boston and Cleveland.

"Many cities have different ways of containing health costs. That may have something to do with it," said Kay Ford, a BLS economist in Washington.

Carol M. McCarthy, president of the Delaware Valley Hospital Council, which represents more than 90 hospitals, said medical institutions here increased their charges by 23 percent last year to make up for $207 million worth of uncompensated care — a 25 percent increase — that they provided to poor and uninsured people.

McCarthy said that blaming the hospitals for the region's increase in prices would be a mistake. In fact, she said, annual increases in hospital spending here have dropped sharply, from 20.7 percent in fiscal year 1982 to 6.6 percent in fiscal year 1984.

Moreover, McCarthy said, hospital profits rose only 6.06 percent in fiscal 1984. "At least from the hospital side, what we're saying is that we think we have a pretty good story tell. We think we have expenditures pretty wall under control."

Another partial explanation for the price increases might be the aggressive building programs recently undertaken by many hospitals and nursing facilities in the area, said Zelten, an assistant professor of insurance and health-care systems at the Wharton School.

Between March 1982 and February 1984, more than $467 million worth of new construction was approved for the five Southeastern Pennsylvania counties by the Health Systems Agency of Southeastern Pennsylvania, a federally mandated planning agency. Hospitals increase room rates to cover the costs of new construction.

EXHIBIT D

POST-GAZETTE: Fri., Nov. 8, 1985—9

Nader, insurance firms differ on need for liability rate hikes

By Gary Rotstein
Post-Gazette Harrisburg Correspondent

HARRISBURG — Ralph Nader, the spokesman for consumer causes who built his reputation attacking the auto and oil industries, branded insurance companies worst of all yesterday for driving up liability coverage costs.

Although insurers contend huge increases in liability premiums this year were necessitated by $3.8 billion in industry-wide operating losses in 1984, Nader told the House Insurance Committee the losses had been exaggerated.

"Never in economic history has there been such a precipitous increase," the maverick activist said. "We're seeing increases and cancellations at a level totally unsupportable on an actuarial basis."

Nader claimed the dramatic price jumps are designed to aid insurers' political goals of pressuring lawmakers to restrict consumers' rights to sue for damages.

"Horsefeathers — they're being paranoid," an industry representative said when informed of the remarks by Nader and J. Robert Hunter, federal insurance administrator in the Carter administration.

Grover Czech, regional vice president of the American Insurance Association, said, "Companies are doing what they feel they have to to get back to price adequacy . . . Competitive pressure drove rates down for many years. Generally prices today are coming back to what they were in 1977 or 1978 when adjusted for inflation."

Nader and Hunter, who now heads the National Insurance Consumer Organization, acknowledged the industry had inadequate revenue last year.

They contend, however, that it would have taken just a 5 percent boost in premiums across the board to meet standard profitability levels. They based the estimate on a U.S. General Accounting Office report that companies showed a 3 percent return on net worth last year when investments, depreciation and other factors were added to operating costs.

Instead, liability insurance costs are going up 100 percent or more for many local governments, transportation firms, day care providers, taverns and others.

Representatives from those areas in previous Insurance Committee hearings, appealed for state help in controlling those increases. They also complained of being denied coverage at any price because of insurers trying to keep only the most profitable lines of business.

"The key point is . . . this crisis is a crisis generated by the industry as a reaction to low profits," Hunter said.

"If the profit potential is there that you say, I can't believe there aren't [insurers] going out there to write it," commented Rep. Robert Godshall, R-Montgomery County.

Nader and Hunter pointed to solid stock market performance of insurance companies this year as another indicator that the industry is not in the dire straits it says it is.

Czech countered that a 30 percent increase in stock prices of insurance companies is related to their low value last year and assumptions that they will be able to return to proper profitability with price increases.

EXHIBIT F

6/20/85 Journal of Commerce

Study Analyzes Industry Woes

By JAMES NOLAN
Journal of Commerce Staff

NEW YORK — The property/casualty insurance industry's woeful financial state recalls a story from the old pushcart days along Delancey Street on New York's Lower East Side.

A merchant cut his prices sharply on ladies' boots and put up a huge charcoal lettered sign to tell the world.

Across the street, his competition cut prices lower, and said so with signs.

On the price war raged. Finally, the first entrepreneur posted a sign which declared: "Ladies' Boots. I sell below cost."

How can you do that, asked the competition? Sell below cost?

"I can sell below cost," the reply came, "because I buy below cost."

It was just this sort of a mindless price war which brought the property/casualty business to its present low and sorry state.

And no one knows it better than the industry itself. Witness a new study done by the Insurance Services Office and the National Association of Independent Insurers.

"The property/casualty industry must accept the major responsibility for its current financial condition," the study concluded. "But, the brutal price war of the last six years is over. The industry has finally realized that a business cannot indefinitely price its product below cost and expect to survive."

'The brutal price war of the last six years is over. The industry has finally realized that a business cannot indefinitely price its product below cost and expect to survive.'

The study, "1985, a Critical Year," pulls together a story that has been told piecemeal for the past 18 months.

It compares the industry in 1984 with back years, using all of the familiar ratios: rates of return, premiums compared to losses and expenses, combined ratios and the like.

In some cases, the economic data from the insurance industry has been plotted on graphs, laid over similar data from The Fortune 500 industrials and U.S. bond yields. In all cases since mid-1981 the insurance industry graph lines — reflecting profitability — turn down where others rise.

The sponsors want the 31-page document to "help the public and state insurance regulators understand why premium increases are needed to assure the future financial stability of the insurance industry."

Casting back to the origins of the price war, the study notes that "since 1979, while underwriting results have declined, the industry's net investment income has grown continuously.

"In an attempt to generate cash flow for investment, insurers competed aggresively for premium dollars, knocking prices more and more out of line with loss costs," the study said.

But it was poor management strategy. The $1.7 billion in annual investment income could not be stretched far enough to cover the $3 billion annual growth in underwriting lossesthe industry suffered.

Closer to home, the 10 percent climb in investment income of $1.6 billion in 1984 fell far short of the 60 percent increase in underwriting losses of $8 billion for that year.

Such a financial climate worries the industry on several scores.

First, industry actuaries are predicting that in the next few years, corporate America will find soon that it cannot insure all of its assets.

The conclusion flows from operating results for 1984. The study says that during the year, policyholder surplus fell by 3 percent to $63 billion.

The industry measures its ability to write property/casualty coverage by this surplus figure. "Indicating," the study said, "that capacity may not be sufficient to meet the insurance needs of an expanding U.S. economy."

Still a more urgent worry is the continued financial solvency of a substantial number of companies. The study said that the ratio tests ap[illegible] by the National Association of Insurance Commissioners and the A.M. Best Co. show that "the the number of financially impaired insurers has increased."

While the study did not total the number of such companies, in September of last year, the NAIC said that 319 of the 2,477 property/casualty insurers it keeps tabs on were in bad enough financial shape to require "immediate attention" by state insurance regulators.

The NAIC warning came after it had finished desk audits on the financial results filed by the companies in the spring.

Such audits are in various stages of completion at the moment.

RATHER HOT DISCUSSION ON CAPACITY

By LOIS J. LYONS

NEW YORK—Superintendent James P. Corcoran rolled up his sleeves, looked the industry in the eye and said, "There is no capacity crisis." Donald Kramer, president of Kramer Capital Consultants, took a similar stance, looked the superintendent in the eye and said, "There is a capacity shortage, and it is severe."

Mr. Corcoran, somewhat outnumbered in his opinion and certainly in his ideas of how to handle the situation, was also opposed by David B. Mathis, chairman, president and chief executive officer of Kemper Re, who said unequivocally that there is a "real capacity crisis that is likely to remain at least through 1987," and by Michell J. Cole, vice president and principal of Tillinghast, Nelson & Warren Inc., who hedged only a little, saying there is certainly a "restructuring of property casualty markets," which might not be a crisis but a "revolution."

James B. Stradtner, managing director of Alex Brown & Sons, investment bankers, never really joined the fray but, taking a third positon, said the problem is that capacity is never quite "in sync" with what the industry needs and that insurance companies have never been able to cope with excess or even adequate capacity. "Given the rope," he said, "they will succeed in hanging themselves," but he said he is optimistic about the future of the industry.

The speakers made up a panel discussing "New Capacity, New Players" at a seminar at the annual "I" Day meeting of the New York Chapter of the Society of CPCU. The panel was moderated by Joseph S. Diamond, executive editor of the National Underwriter Co.

Mr. Corcoran said he feels he has been patient with the industry, but is losing his patience. He said the legislators are "furious" and feel that the industry has "overplayed its hand."

Difficult position

"Now I'm in the difficult position of trying to make sure that we dont' get reactive legislation," he said.

But, he added, such legislation may come about, "and it is what the industry has created."

"When you talk about new players and new capacity," he said, "you are talking about an essential and permanent change in the way this industry does business. I don't agree that this is a cycle. I think it is a natural change."

He said the capacity shortfall the industry is experiencing now is the worst it's been in 50 years and "it's not going to be solved by the stock market investing new capital." He said, "We're not sure where that capital is going to go. We're concerned about the financial guarantee products that we're going to see. It might well attract new capital but is it going to go into lines of insurance that we think are essential for the marketplace?"

While adverse court decisions have contributed to the crisis, he said, if there had been adequate pricing of products over the last 10 years, the situation would not exist today.

He warned the industry that some of the new players and new capacity "might well not be what they want."

To ease the crisis in his jurisdiction, he said, he will look into granting greater underwriting authority to the state insurance fund; creating joint underwriting associations for coverages required to operate a business when such coverage is not available in the voluntary market; and encouraging self insurance pools and reciprocals.

He said life insurers do not appear to have a capacity problem at this time and perhaps they can be encouraged to form property casualty subsidiaries to fill the void.

"Otherwise," he said, "that void might well be filled by the banking industry. Banks have the resources available to write property/casualty insurance and the governor supports allowing banks to write all lines of insurance." He added that "banks would certainly add new players to the marketplace to write business currently being avoided or overpriced by the property casualty insurers."

He accused property/casualty insurers of "irresponsible behavior" and said that this behavior will possibly

Cont'd on Page 58

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serve as the "linchpin for enactment of those recommendations."

After this cycle is over, he said, "there won't be a return in the marketplace to business as usual." He said, "A lot of these companies will find themselves in a very difficult time reentering the market when things are 'good'."

Mr. Kramer said the current crisis is a "period of dislocation," caused by price changes but that capacity would return when returns on equity improve but for the present the industry is going to suffer.

He observed that in recent Congressional hearings on capacity, Consumerist Robert Hunter made headlines when he talked about the "conspiracy of the industry." But, Mr. Kramer said, "no one seemed to ask the question of Mr. Hunter of how the industry managed to conspire to lose $3.5 billion last year. That never made the press."

He said much of the problem today is a lack of capital. Some of the reasons for this, he said, are that it is no longer as easy to enter as it was in the past, citing such difficulties as needing a creditworthiness rating and admissibility. He added that foreign reinsurers will not fund letters of credit for IBNR (Incurred But Not Reported), that letters of credit are harder to obtain because banks have been burned by the recent failure of offshore insurance companies, that domestic companies are less willing to reinsure abroad and that Lloyd's has lost its retrocessional market.

"Someday," he said, "when returns on equity improve, there will be capacity back in this industry, but during this period of dislocation we're going to suffer through a period when reinsurance rates are going to escalate dramatically, as the premiums on which the reinsurers base their reinsurance go up and as the rates the reinsurers charge for the premiums go up. We're going to have a dramatic increase in reinsurance demand without necessarily an increase in reinsurance capacity until some form of profitability returns. When it does the capacity will be there."

Mr. Stradtner's view of capacity is somewhat different, though also somewhat more optimistic. "Capacity is fluid," he said, "always in motion, thus leading to an industry with overcapacity or under-capacity...never perfectly in sync with its needs."

Scenario is simple

Today, he said, the "scenario" is relatively simple. "Excess capacity produces underwriting losses. Underwriting losses drive out capacity. Property/casualty stock prices rise because institutional investors believe the time to buy the shares is when the earnings are at their lowest level. Higher stock prices enable insurance companies to sell securities to investors on very attractive terms. Prosperity returns, more capacity comes in. The additional capacity raised will bring back price competition, underwriting losses and a diminution of capacity."

EXHIBIT G

RAPID RETURN TO LACK OF PRICE DISCIPLINE SEEN

By ALFRED G. HAGGERTY

RENO, Nev.—"The property-casualty insurance industry today is in a stronger capital and surplus position than it has ever been in and it clearly has enough capital and surplus to meet the needs of the insurance industry today and in the near future," a specialist in insurance research said here.

Dr. Michael E. Hogue, president and managing director of Philadelphia Insurance Research Group, also predicted a quicker than expected return to "a period of a lack of price discipline" in his remarks to the annual convention of the National Association of Professional Insurance Agents.

Dr. Hogue said A.M. Best reported consolidated policyholder surplus of $64 billion as of Dec. 31, 1984, and then in a July 15, 1985, report indicated an adjusted surplus of $92 billion. Thus, he said, Best saw an equity in the balance sheet of $28 billion, which he said arises out of undervalued assets and overstated liabilities. He said it comes primarily from the unearned premium reserve for that portion already paid out in acquisition costs and from the estimate of the loss reserves on a discounted basis.

"In general, what that means," he said, "is that the property-casualty industry, if it were put into a runoff situation and assuming the reserves are accurate, when the period of runoff is completed, not only would there be $64 million in capital and surplus, but there would be another $28 billion left over."

Even assuming a reserve deficiency of as much as 20 percent, he said, after the period of runoff, the industry would have not only the $64 billion of reported surplus, but another $8 billion or $9 billion of undisclosed profits.

"It is for this reason," Dr. Hogue said, "that we believe the property and casualty insurance industry is overcapitalized; and that, frankly, is going to be a detriment, not an advantage."

He said his firm studied a group of seven companies representing about

PIA Convention Report

one-third of policyholder surplus and concluded that by the end of 1985 they would be writing at slightly over 1.25 to 1.4 times their surplus position.

"It's for that reason," he continued, "that we maintain that the industry does not have a capacity problem. It clearly does not have the same problem it had in 1974 and 1975, when at this time in the cycle we were at about 1.4 to 1.5 times surplus."

What it does indicate, he said, is that the insurance industry is not pleased with the profitability of the market and is unwilling to release the capacity in search of taking risk. "There lies our major concern," he said.

"When the profitability appears in the financial statements of the carriers, particularly in the regional and other small companies that have not had the extent of problems that many of the larger carriers have had, they will begin to release the surplus in anticipation of growth of market share."

Dr. Hogue said Chubb and Ohio Casualty recently released nine-month results showing that earnings per share have already doubled in 1985.

"It is our concern," he said, "that we're going to find a more rapid release of that surplus in search of market share than is otherwise being predicted relative to when the markets will turn. It is our belief that that is going to result again in a period of lack of price discipline.

"We believe that the requirement to allocate the surplus because of the necessity to leverage that surplus against returns to meet the target return on investments of many of these corporations, we will begin to start the process of market competitiveness."

He called it "gross mismanagement of a property-casualty insurance company to attempt to increase market share unless there are indicators available showing where the price and relative exposure are at any point in time. He said it has been his experience that there are few insurance companies in the U.S. market which are fully aware of the current price and exposure relationship in their portfolio on a recurring basis and, therefore, any move to begin to increase their prices is done so without an eye to what the effect is going to be on their financial statements or surplus.

"In other words," he said, "[illegible] expect to see the same effectiveness in dealing with excess capacity that took place coming out of the 1974 and 1975 pricing turns." ◆

This situation, he said, is in place today. only the length of the capacity cycle is open to debate.

Capacity, he said, is "innocent" or "dumb" but it can be gathered at just the times when it is needed most, but that insurance company management has never been able to cope with excess or even adequate capacity.

He added that excess capacity did not completely disappear in 1984, it just diminished.

"Add to this," he said, "the new money raised through securities sales and you are well on the way to restoring excess capacity in the next two to three years. Remember, future earnings will be tax free, thanks to substantial tax loss carryforwards, and we have been blessed with reasonably good stock and bond markets."

Because of his optimism for the industry, he said, he hopes for a return to stable economics producing a typical cycle of three good years followed by three poor, but not devastating years.

"The industry," he said, "in my opinion, is prepared to live prosperously under this type of scenario."

Mr. Mathis discussed some of the ways the present capacity shortfall is different from previous ones such as a lack of an alternative market to Lloyds, the litigious atmosphere surrounding the U.S. casualty business, the withdrawal of the retrocession market, the shortage of underwriting talent, and the slowness of the positive impact on the bottom line of changes in price and terms.

Therefore, he said, he sees the following as a "likely scenario" for the industry: continued equity investor interest in experienced companies, on the assumption that the industry is on the road to recovery, but little interest in new ventures unless they are staffed with proven management, a sort of "back to basics" philosophy—emphasis on underwriting profit resulting in not only higher prices, but restricted contract terms; more net line underwriting for insurer and reinsurer alike; and a longer period of tight market conditions that has been typical of the past as companies not only improve the profit picture, but also make up for deficiencies of the past.

Mr. Cole said that while it is unclear whether the current situation is a crisis or a revolution in the way corporations, health care institutions, philanthropics and governmental entities buy insurance, "if the unavailability and unaffordability of insurance persists...it is my contention that one-third to nearly one-half of all commercial insurance premiums will be financed by non-traditional sources."

He said he predicts that by year-end, self-insurance will represent slightly more than one-third of all commercial insurance premiums which will increase by 44 percent to 50 percent by 1987, that self insurance will play an even more important role in this market than it did in the recovery of 1976-77 and "it may well revolutionize the way insurance is purchased."

He said, "The industry needs to heed the warning that this significant expansion of non-traditional capacity and determine how it can co-exist with these new players and capacity."

EXHIBIT I

Remarks to the Florida Senate Commerce Committee on Property and Liability Insurance
By Commissioner Bill Gunter

Mister Chairman and members of the Committee, over the past several months, we have seen some alarming developments in the insurance industry in Florida and across the United States, they include the rapid and significant increase in the cost of commercial property and liability insurance, and the reluctance or outright refusal of many insurance companies to assume certain kinds of property and liability risks.

In order to look at the problem first hand, I have held public meetings around the state. I have asked the business community to come forward with their experiences and ideas. The reaction has been gratifying and the testimony we gathered can serve as a valuable resource and standard against which to measure any proposed solutions to the problem.

Time after time the people told horror stories that left no doubt of the breadth and seriousness of the problem...like the Orlando man whose taxicab coverage went from $8,000 to $80,000...or the owner of a small Orlando garbage company who told me that coverage for his vehicles will increase more than a thousand percent this year. He said, and I quote, "This business will not survive under these tremendous cost increases."

There was the Fort Lauderdale day care center operator who saw her general liability premium go from $5,000 to nearly $15,000 in one year with additional exclusions in the policy, even though the center had no claims whatsoever during its three years of operation. A Dade county children's program director told us that at least 5,000 children are on their waiting list for care, while liability insurance for many child care facilities is being cancelled.

A north Miami Beach Condominium Association's insurance went from $21,000 in 1984 to more than $105,000 in 1985, on two days notice. A homestead C.P.A. said he may have to refuse to sit as a trustee on a self-insurance health trust because directors' and officers' liability coverage as of this date has not been obtained.

A Jacksonville dentist is paying a 300% premium increase from 1984 to 1985. He told us of others who are paying even more. An auto dealers association officer told us that some car dealers in the panhandle can't find garage liability coverage. He spoke of dealers receiving nonrenewal notices three or four days before their policies expired.

All over Florida we are hearing the same stories: people whose insurance is cancelled though they haven't had a single claim; small business people forced to sell out to larger firms because they can't afford insurance. They are telling us that when the state mandates coverage, it has the duty to see that coverage is available and affordable.

What's at stake here is not just the years of hard work it took small business men and women to put their businesses on a paying basis...but the jobs they provide, and the well-being of local economies. A vast number of Floridians are in a situation that is difficult for some and impossible for others.

For that reason, my department is drafting proposed legislation for the 1986 session to address these issues. I believe the need is clear, the only question is what other steps can be taken in the interim to ease the pain brought on by these cataclysmic changes. In the legislation, I think we need to address these points:

First, to get Florida policyholders off the rollercoaster ride of peaks and valleys in pricing. The insurance industry owes its business customers the kind of pricing stability so they can plan their expenditures, yet somehow the insurance industry has become addicted to a boom and bust, feast and famine approach to setting premiums.

Second, to make sure that the premiums charged bear a proper relation to the risks and losses experienced by the industry. I don't want to see the insurance industry playing catch-up on losses of previous years by demanding premiums that are completely out of line with current losses. I want premiums based on defensible loss experience, not on speculation.

Third, to put the control back into the consumers' hands, I'd like to see small insurance consumers get together and use their combined numbers to their advantage. Just as health care coalition members negotiate health care costs directly with hospitals to make sure their employee health benefits provide the best care for the dollar, they should also be able to use their collective purchasing strength to get the best deal in property and liability insurance.

Fourth, to find creative ways to increase the capital that is available for reinsurance. The investors that in normal times stand behind companies that write property and liability insurance have backed away from that market. I believe there is capital out there, willing and able to provide the back-up for the kinds of insurance that are too expensive and too hard to find at present.

The Miami-based Insurance Exchange of the America's can be an instrument to expand the reinsurance market in this state. I am convinced that additional expansion is entirely possible with the right kind of encouragement.

Finally, businesses need to perfect the art of risk management in Florida. We're used to thinking that if you manage to avoid losses, your insurance premiums will go down. Lately it seems that rule hasn't worked. We need to see that there are incentives for risk management, and that insurance consumers with low losses are preferred customers.

I believe the preceding five points pretty well describe the solution we want to find. I think that proper responses to most of them can be found in well-considered legislation.

I'm sure you remember the problems we had a few years ago in workers' compensation, and before that in automobile insurance. In both of those areas appropriate legislation was enacted and although insurance costs are rising in nearly all areas, rates in auto and workers' compensation have been substantially more stable than the lines outside the authority of the Department of Insurance.

More recently, we have the example of hospital costs which had been rising at a frightening rate for more than a decade. In 1979, the Florida legislature established a Hospital Cost Containment Board and in 1984, granted it the power to reject dangerously inflationary hospital budgets. In the first year since that second step, we cut rising costs by well over half, so legislation is a tool we have used successfully in the past.

their employee health benefits provide the best care for the dollar, they should also be able to use their collective purchasing strength to get the best deal in property and liability insurance.

Fourth, to find creative ways to increase the capital that is available for reinsurance. The investors that in normal times stand behind companies that write property and liability insurance have backed away from that market. I believe there is capital out there, willing and able to provide the back-up for the kinds of insurance that are too expensive and too hard to find at present.

The Miami-based Insurance Exchange of the America's can be an instrument to expand the reinsurance market in this state. I am convinced that additional expansion is entirely possible with the right kind of encouragement.

Finally, businesses need to perfect the art of risk management in Florida. We're used to thinking that if you manage to avoid losses, your insurance premiums will go down. Lately it seems that rule hasn't worked. We need to see that there are incentives for risk management, and that insurance consumers with low losses are preferred customers.

I believe the preceding five points pretty well describe the solution we want to find. I think that proper responses to most of them can be found in well-considered legislation.

I'm sure you remember the problems we had a few years ago in workers' compensation, and before that in automobile insurance. In both of those areas appropriate legislation was enacted and although insurance costs are rising in nearly all areas, rates in auto and workers' compensation have been substantially more stable than the lines outside the authority of the Department of Insurance.

More recently, we have the example of hospital costs which had been rising at a frightening rate for more than a decade. In 1979, the Florida legislature established a Hospital Cost Containment Board and in 1984, granted it the power to reject dangerously inflationary hospital budgets. In the first year since that second step, we cut rising costs by well over half, so legislation is a tool we have used successfully in the past.

Some companies like Eastern airlines have taken the route of self-insurance. It normally takes a big company to make self-insurance work, but if a number of smaller companies band together and create a large pool, that approach can also work for them. If we are to expand the parameters for allowing this approach -- for instance to professional-like engineers, architects and accountants -- then we must revise our eligibility rules.

This option is a real possibility -- especially for risks like professional liability, day care and commercial fishing boat coverage, that are hard to place -- and for "main street" commercial insurance consumers, whose rates are out of sight. So self-insurance is also a tool that we can use.

I firmly believe Florida can take steps to attract more capacity. Through incentives, we can promote the establishment of a state of Florida reinsurance facility that will make reinsurance more available for Florida risks. This facility could provide reinsurance to both commercial and self-insurers. So expanding reinsurance capacity is also a tool.

Preventing losses is one of the most effective actions we can take to reduce insurance industry costs. From time-to-time, strings of disasters around the world, from air crashes, to child abuse, to chemical leaks, to lost satellites in space, raise insurance costs of all of us. On the other hand, risk management close to home is a positive response to the current crisis.

It sometimes happens that companies do not reap the rewards of good risk management until after the fact...in some cases not at all. It may be that we need to establish incentives -- possibly tax incentives -- to encourage business and industry to practice good risk management. So risk management is also one of our tools.

I am glad to say there is one thing we have already done that I believe will be of great value to those who feel that they have nowhere to turn for affordable insurance coverage. This is the market assistance plan passed by the legislature during the last session. I believe that in supporting that legislation, you in the Senate showed a vision that is now beginning to yield its reward.

The Market Assistance Plan (MAP), as we call it, is a clearinghouse for hard-to-get insurance coverage. Commercial insurance consumers or their agents call MAP when they can't find insurance. MAP shops all the available markets to place that risk at the best possible price. The most attractive feature of the plan is that it is entirely funded and staffed by the industry. I want to add they have been very cooperative in working with us to set it up.

The draft proposals that we are putting together today will constitute a major step toward helping Floridians deal with what I perceive to be a serious threat to business and professional people across the country.

Our proposals will be ready in 30 days. In the meantime, my staff and I stand ready to help and provide information to you as needed. If any questions are raised by the material before you or anything that I have said, I will be glad to answer them now.

Thank you.

sidewalks and a real property area.

c. there are two separately designated areas which impose liability for dangerous conditions of certain items such as traffic controls, street lights, water, gas and electrical systems, and;

d. the remaining two areas have little practical effect and very little meaningful application as they provide for liability dealing with personal property of another which is mishandled or lost by a political subdivision and the care and control of certain animals, and;

The Act not only limits potential recovery to the enumerated areas, but creates a more stringent burden of proof for the victim. Where the action is for recovery of dangerous conditions pertaining to streets, sidewalks, traffic controls, street lights or utility systems, the victim, in order to recover, has to establish not merely that the political subdivision had notice of the dangerous condition before the incident, but also that there was sufficient equipment and man-power available in view of other needs that the situation could have been corrected. Frankly, this provision has the effect of granting virtually complete discretion to a political subdivision as to when it would even decide to correct a known danger under its control and maintenance.

Because of the grant of immunity, the following are examples of the types of actions which cannot be brought or claimed against a political subdivision:

a. Negligent use of firearms or weapons such as by police, jail personnel or a school district security force, and;

b. Negligent supervision of school classes, shop classes, sporting or coaching activities, and swimming pools, such as negligent life-guarding, and;

c. Actions arising out of overzealous police actions such as injuries arising out of arrests or "police brutality" cases.

d. Negligent use or supervision of machinery and power tools such as in vocational departments of school systems;

e. Inspections of real and personal property such as the negligent issuing of occupancy or building permits in violation of various codes;

f. Actions for medical malpractice such as arising out of a county owned hospital.

It should also be noted that there is not a reasonable federal equivalent cause of action to provide for recovery for some of the immunity areas. Although federal civil right actions certainly exist, the standards for recovery and burden of proof are far different from the ordinary common law standards for personal injury actions and, under recent decision, require more than a showing of mere negligence in order to impose liability.

Damages

Under the Pennsylvania statute, even in those cases where a claim is permitted and the claim can be proved, the innocent victim is limited in the items and amounts which can be recovered. The negligent or liable political subdivision receives the full benefit of any private insurance which was available to the innocent victim meaning that in those instances where private insurance paid property damage, medical bills or work loss, no claim or recovery for those items can be made against the polictical subdivision. General damages in the form of pain, suffering, disfigurement and inconvenience can be had only where there are at least $1,500.00 in medical or dental expenses and there is a permanent injury. These provisions would permit no recovery in a case where, for example, an innocent victim with medical insurance sustained thousands of dollars of medical expenses and severe injuries but made a recovery without a permanent injury.

Finally, there is a cap or ceiling of $500,000.00 placed on all claims, regardless of the number of victims involved, arising out of any one occurrence. Hence, where one incident, accident or ocurrence results in catastrophic injuries or death of a number of persons, the political subdivision can be held to pay only a maximum of $500,000.00 for all victims.

Miscellaneous

This statute contains certain other roadblocks for the claimant. There is a six-month statute of limitations provision which requires that a victim provide a certain form of written notice to the political subdivision of his intention to file a claim. Should that action not be taken, suit would be barred even if filed within the otherwise applicable general limitation period. Additionally, the statute prohibits the entry of "pre-judgment interest" against a political subdivision. This constitutes yet another privilege in that all other wrongdoers in Pennsylvania lawsuits for personal injury, death and property damage can be held liable for "delay damages" should they fail to make a proper offer of settlement and force the victim to try his case in court.

Conclusion

Pennsylvania's "closed-end" immunity statute totally abolishes a substantial number of meaningful claims for death or injuries sustained by innocent persons, victimized by negligence. It further makes proof of liability more difficult even in the areas where claim can be made dramatically restricts the recovery of damages.

EXHIBIT K

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October 22, 1985

Express Mail

William A. K. Titelman, Esquire
Pennsylvania Trial Lawyers
Legislative Counsel
240 North Third Street
P.O. Box 413
Harrisburg, PA 17103

Dear Mr. Titelman:

I was hoping to be able to clear my schedule so that I could be with you on Wednesday, October 23, 1985, to testify before the Senate Banking and Insurance Committee, especially since that Committee is chaired by Senator Holl, who is from Lansdale.

Unfortunately, my schedule does not permit me to be in Harrisburg. However, I would like to report to you and the Committee that my firm represents seven municipal subdivisions in Montgomery County.

We have experienced no increase in claims or litigation involving these Political Subdivisions in the last several years, which we find to be surprising, in light of the fact that our clients have experienced difficulties in obtaining liability insurance and the commissioners and employees have experienced difficulty in obtaining errors and omission insurance.

Our experience verifies the conclusion reported in the New York Times of Sunday, October 20, 1985, which indicated that claims experience is not what influenced the insurance market at the present time, just as the passage of the Political Subdivision Tort Claims Act did not result in reduced insurance premiums.

Very truly yours,
HAMBURG, RUBIN, MULLIN & MAXWELL

By ______________________
Edward Rubin

ER/mdd

EXHIBIT L

BEST'S INSURANCE MANAGEMENT REPORTS

Supplement To Financial News

September 9, 1985

A.M. Best Company
Oldwick, N.J. 08858
201-439-2200

Financial News | Washington Review | Perspectives | On-Line Reports

Quarterly Earnings Per Share Rise Again

With many investors evidently reading recent industry results as a sign indicating smoother sailing ahead, the stocks on Best's Insurance Index were up overall more than 25% for the second quarter of 1985 when compared with the corresponding quarter of the previous year. This composite gain, the best in more than seven years, follows first-quarter gains of 16%. For the first time in more than three years, all four components of Best's Stock Index showed per-share earnings gains for the quarter.

Life/Health Stocks Continue Three-Year E.P.S. Trend

The life/health index posted the smallest of the quarterly gains, up 8.1%. Buoyed by year-end news of renewed premium growth among life/health companies, particularly in the annuities and universal life fields, life/health stocks have demonstrated a steady if not spectacular popularity with investors, recording gains in 10 of the last 11 quarters. The lone exception was the fourth quarter of 1984, which reflected some write-offs not related to the new tax law that several companies chose to make in the quarter of the tax reserve adjustment.

The second quarter was close to a carbon copy of the first for the life/health index, with three times as many stocks advancing as declining. Large gains were not quite as numerous—10 stocks achieved double-digit increases as opposed to 13 in the preceding period.

Jefferson National Life led in second-quarter earnings growth, up nearly 66%. Other top performers were Torchmark Corp. and Monumental Corp. Six stocks had declines in earnings per share, the largest of which were those of Northwestern National Life and Equitable of Iowa, off 37% and 34%, respectively.

Property/Casualty Index Posts First E.P.S. Gain in Eight Quarters

In the second quarter of 1985, property/casualty stocks on Best's Index staged a turnaround in the longstanding downward direction of operating earnings per share, even though there were slightly more decliners than gainers. Property/casualty stocks posted an overall gain of 13.6% when compared with the previous corresponding quarter.

In the first half of 1985, property/casualty stocks on Best's Index have advanced 30%, investor excitement being generated by a reasonable consensus that the longest industry down-cycle in history has finally turned, albeit by a small margin. They were rewarded, on average, by advances twice the size as those reaped by the general stock market.

The largest calculable percentage gain for the quarter was by Hartford Steam Boiler, with an earnings-per-share increase in excess of 156%. Another strong performer was SAFECO Corp., with a gain of almost 51%. Two stocks—Kemper Corp. and St. Paul Companies—followed up a quarterly operating loss in last year's second quarter with a gain in the current time period.

During the second quarter, Mission Insurance's already considerable per-share operating loss plunged still lower. The losses of Fremont General Corp. and Orion Capital Corp. went further into the red, and USF&G recorded a small loss in the second quarter of 1985 after a 60-cent gain a year earlier.

Multiple Lines Stocks Achieve 60% Gain

Among the multiple lines stocks on Best's Index, only one—Travelers Corp.—posted a small decline in earnings per share in the second quarter. CNA Financial Corp. flirted with doubling its per-share earnings and Aetna Life & Casualty actually did so. CIGNA Corp. pulled its previous second quarter earnings out of the red. Overall, the multiple lines index was up 60.7% over the comparable quarter, setting a seven-year record.

Brokers and Agents Enjoy Impressive Earnings Gains

The brokers and agents component of Best's Index was up 50% for the quarter and more than 300% for the first six months of 1985. However, this percentage gain derives from comparison with very low prior year figures, particularly in the case of Alexander & Alexander, whose second quarter 1984 earnings per share was eight cents, and Marsh & McLennan, which recorded operating earnings of only two cents per share in the first six months of 1984 due to losses sustained from unauthorized investment activities.

N.B. [illegible] share figures, where [illegible] common and equivalent shares [illegible] issues are outstanding, even though [illegible] dilutive for some or all time periods [illegible] tained from using the common share [illegible] Capital Corp. and Alexander & Alexander are [illegible] due to lack of complete data. Data shown [illegible] from reported operating earnings [illegible] subsidiaries and affiliates and [illegible] the time period covered [illegible]

LYNDEN INCORPORATED

670 W. Fireweed, Suite 239
Anchorage, Alaska 99503
(907) 279-7501

January 23, 1986

Fred Zharoff, Senator
Pouch V (MS 3100)
Juneau, Alaska 99811

Subject: Lynden Incorporated support for Insurance and Tort Reform

Dear Senator Zharoff:

The Alaska Trucking Industry is confronting a crisis which is "Life-or-Death" for many operators. The already slim operating margins that the industry has had to adjust to over the last few years has now become non-existant with insurance premiums raising anywhere from 100 percent to 600 percent.

Lynden, with a history of successful operations that extends over 75 years, contracted over 30 insurance companies to underwrite our insurance needs for 1986. Only two of these 30 companies expressed any interest at all, and only then if the premiums were substantially escalated. As a matter of fact, our 1986 insurance premiums are 2.8 times our 1985 premiums. Further deterioration of the insurance supply will mean Lynden and others will be unable to buy insurance and will consequently be out of business.

If action is not taken to effect a reduction of these premiums, all Alaska trucking operations, large or small, will be faced with the decision of either continuing operations at a loss or bankruptcy.

Lynden requests your support for Tort Reform as shown on the attached Coalition Agenda, as well as any insurance industry reforms that may be necessary.

Tort Reform must clearly include provision for a sliding scale for contingent fees so that the injured parties receive a larger proportion of the fees than the attorneys that represent them.

Insurance industry reforms include mandatory cancellation clauses requiring 60 days notice of Intent to Cancel a liability insurance

LYNDEN INCORPORATED

policy. Additionally, we support full disclosure of insurance data wherein insurance companies servicing policies in Alaska implicitly agree to accept the provision of full disclosure of taxes, settlements, costs, defense attorneys, commissions and overhead.

The disclosures must be of sufficient detail so that the appropriate state authorities can verify accuracy.

In summary, Lynden cannot overemphasize the importance of taking action on insurance and Tort Reform issues. The problem is immediate, serious, and if not dealt with, will have serious consequences for the trucking industry as well as the total economy of the State of Alaska.

Very truly yours,

LYNDEN INCORPORATED

Jim Jansen

Jim Jansen
President

JJ:am

Attachment

cc: All Legislators

THE CITIZENS COALITION FOR TORT REFORM
PROPOSES THESE
IMPROVEMENTS TO ALASKA LAWS

--TORT REFORM--

--- Limit non-economic (paid and suffering) awards to $250,000.

--- Structure periodic payments in cases where the award exceeds $50,000.

--- Set a sliding scale for contingent fees that encourages early resolution of claims while providing fair compensation for attorneys while reserving a larger proportion of the award or settlement for the injured party.

--- Require those filing liability complaints to affirm that they believe all claims are true.

--- Require courts to direct damage payments proportionate to a defendant's degree of fault.

--- Instruct juries to itemize award verdicts.

--- Allow juries to know about insurance or other benefits paid to victims of negligence. .

--- Require that punitaive damages (which punish defendants for negligence beyond their liability for actual damages) are paid to the State of Alaska, that is, to the whole society

--- In instances of wrongful death, allow for death benefits only to spouses, children or other current economic dependents

-- Require that a lawsuit be filed within two years of the date of the act or omission on which the complaint is based.

-- Encourage settlements that avoid costly trials.

A COMPREHENSIVE SOLUTION TO:
* PROTECT VICTIMS
* LIMIT COSTS TO CONSUMERS
* RE-INTRODUCE FAIRNESS TO ALL PARTIES

--TORT REFORM---

Medical Insurance Exchange of California
Medical Underwriters of California Attorney-in-Fact

FEB 5 1986

January 28, 1986

TO: MIEC Board of Governors
MUC Board of Directors

FROM: Ron Neupauer

RE: Insurance Industry Results - Medical Malpractice

The enclosed article and five year chart from the January, 1986 issue of Best's Review tells the story of what lies behind the recent rate increases and market restrictions for primary, excess and reinsurance coverages in medical malpractice.

Malpractice insurance represents only 1.8% of property/casualty premiums but is responsible for 5.6% of the underwriting losses. Although premiums increased by 43% ($700 million) between 1984 and 1985, the malpractice line still produced a combined ratio of 158.2% in 1985, an improvement of just 2%. The five year ratio is also terrible: 152%. No wonder the management of most commercial carriers has again decided it is just not worth bothering with malpractice insurance, given its relatively small overall premium volume and its very unpredictable but historically adverse underwriting results. Even counting the substantial investment income generated because of lengthy delays between the occurrence of losses and their eventual payment, ultimate payouts are so large and increasing so rapidly that high investment income no longer helps.

A compounded average annual investment return of 9% over four years would yield about $1.20 on 85% of original written premiums. This would then produce operating losses of $.38 for every dollar of malpractice premium written industrywide during 1985. Losses of this magnitude cannot be tolerated for very long.

While the rest of the property/casualty insurance industry may very well recover from the recent down cycle within the next 24 months, medical malpractice seems likely to remain a problem for a longer period of time.

We think the problem can best be solved through careful professional management by well-funded and well-operated doctor-owned carriers which have a permanent stake in the business and have both the incentive and the resources to handle its unique problems better than the commercial insurance industry. Evidence of this is apparent in the operating ratios of some doctor-owned companies, including MIEC, which were 20-50 percentage lower than the industry totals. Even with the best management and utilization of funds, the professional liability insurance industry needs tort reform if it is to survive.

RN/ka/27JAN06/corll

cc: Dave Wille t
Jim King
Tom Hermes
John Griffiths

6250 CLAREMONT AVENUE • OAKLAND • CALIFORNIA 94618-1324 • TELEPHONE (415) 428-9411 • FROM OUTSIDE CALIFORNIA (800) 227-4527

MEDICAL MALPRACTICE

At the top of the list of high combined ratios is the line of medical malpractice. This line's pure loss ratio stayed at 112 for 1985, but the combined ratio was down almost three points, to 159, due to a slight improvement in the loss adjustment expense ratio and a more than two-point improvement in the underwriting expense ratio. Ratios aside, the underwriting loss increased 30%, from $1.1 billion to $1.4 billion.

Medical malpractice gained 43% in net premiums written in 1985 and 34% in premiums earned. Written 61% by stock companies, 21% by mutuals and 18% by reciprocals, medical malpractice had results in terms of combined ratios that were comparable for the three sectors, but stock companies had markedly higher underwriting expense ratios and lower loss ratios than the others.

In only one year since its critical nature earned it a separate line in the annual statement in 1975 has medical malpractice turned in an underwriting profit. That was 1977. Since then, total underwriting losses have mounted annually. Although medical malpractice represents only 1.8% of property/casualty premiums written (and 5.6% of underwriting losses), the attention that has turned to the line because of public interest has made it a focal point of attention by regulators and legislators. Resultant experiments in search of a solution to the medical malpractice problem may or may not produce models to be followed by other lines. Claims-made policies, limits on pain and suffering awards, and arbitration of claims all have potential for broader application.

Medical Malpractice

Year	Net Premiums Written $000	Loss & LAE Ratio %	Und. Expense Ratio %	Combined Ratio Before Divs. %	Combined Ratio After Divs. %	Statutory Und. Gain or Loss After Divs. $000
Stock Companies						
1981	723 032	119 23	20 15	139 39	139 66	-284,781
1982	814 368	122 79	20 58	143 37	143 52	-346 589
1983	893 529	121 03	20 63	141 66	141 73	-364 141
1984	1,084.151	137 04	19 68	156 72	156 67	-583.552
1985*	1,550.000	141 20	17 20	158 40	158 40	-829.010
5 Yrs	5,065.080	130 29	19 30	149 60	149 66	-2,408.073
Mutual Companies						
1981	319 164	128 70	7 14	135 84	138 78	-118,123
1982	350 279	155 52	7.74	163 26	167 07	-224,351
1983	352.866	153.34	8.55	151 89	165 15	-232,388
1984	350 569	167 08	10 13	177.20	180 03	-269,628
1985*	540.000	151 00	7 20	158 20	160 90	-291,270
5 Yrs	1,912.878	151 26	8.07	159 63	162 72	-1.135,760
Reciprocals						
1981	[illegible]	114 84	10 25	125 10	130 42	-80.512
1982	[illegible]	139 57	11.21	150 78	154 13	-140.814
1983	317.849	139 62	12.21	151 83	155 68	-167,224
1984	353.630	145 41	11 17	156 58	159 16	-223 420
1985*	465.000	147 20	10 00	157 20	159 70	-282.580
5 Yrs	1.754 466	139 39	10 90	150 29	153 60	-894.[illegible]
Total Industry						
1981	1,336.281	120 62	14 87	135 49	137 39	-483.416
1982	1,488.349	133 82	15 52	149.35	150 97	-711,754
1983	1,564,244	132 35	16 19	148.55	150.11	-763,753
1984	1,788.550	144 76	16 12	160 88	161 98	-1,076.600
1985*	2,555.000	144 43	13 78	158 20	159 27	-1,402.860
5 Yrs	8,732.424	136 82	15 15	151.97	153 36	-4,438.383

*Estimated

WALL STREET JOURNAL
TUESDAY 2/4/86

REVIEW & OUTLOOK

Torts Control

G.D. Searle announced Friday that it is taking its intrauterine birth-control devices off the market because the cost of defending the products in personal-injury cases has become prohibitive. Its Copper-7 was the most commonly used device among the 2.3 million women who use IUDs. The weight of medical evidence, including a recent report by the FDA, says that the devices are safe. Claims that the devices have injured women have been tried in 10 courts, with eight victories for Searle.

After settling more than 450 cases—for what the company says was less than the cost "to keep a file warm in some lawyer's office"—Searle is faced with the prospect of defending some 300 more suits claiming that the IUD causes pelvic inflammatory diseases, including sterility. In the latest trial, no damages were awarded, but the defense cost Searle more than $1 million. Annual sales of the IUD bring in $11 million; Searle says this simply doesn't warrant the legal expenses, so it is discontinuing the product.

The decision leaves only one IUD available in the U.S., a hormone-releasing device that has a small market share. A recent study by Planned Parenthood recommended the Copper-7 devices for most women; a group spokesman expressed "dismay" that the Searle IUDs will not be available.

Plaintiffs' lawyers and activist judges can claim another victory in the tort wars. The rest of us can view this as still more evidence that the torts system has gone berserk.

The problem is that enough class-action, contingency-fee lawyers have tried enough cases in enough jurisdictions to get some judges to revoke the common law. The traditional rule was that there would be no liability if the product was made using state-of-the-art knowledge; it was unreasonable to expect anything more. Activist judges, however, have expanded the notion of liability to reach into the "deep pockets" of defendants, often corporations, even when there is no fault. For example, a court in Maryland held a gun manufacturer liable because one of its guns was used to shoot the plaintiff.

Plaintiff lawyers get rich practicing a form of greenmail on defendants—they threaten that if there's no settlement, the defendant will spend millions on lawyers. If there is a trial, to award damages even if there was no fault. Rand Corp.'s Institute for Civil Justice estimates that when contingency-fee cases are won, two-thirds of the damage award goes to lawyers and only one-third goes to the plaintiffs. The large class-action suits give nickels and dimes to the injured, but make millionaires of the lawyers. So the incentive for the plaintiff's bar is to pick the most widely used products and most sympathetic injured clients.

What could be better than mothers and prospective mothers? The class-action lawyers were encouraged, of course, by the way their colleagues cashed in on the unhappy history of the Dalkon Shield, which A.H. Robins took off the market in 1974 when medical opinion concluded it was dangerous. So they took on Copper-7 as well, despite the weight of medical opinion.

Nor is this the first time a safe drug has been forced out of the market. Merrill Dow felt forced to drop Bendectin, a remedy for morning sickness used by 33 million women from the time it was developed in 1956 until 1983. The FDA approved its use and Merrill Dow lost no cases in court, but the company removed the product and created a $120 million settlement fund rather than face some 700 cases claiming that the anti-nausea drug caused birth defects.

This is becoming a major problem for society. One result is such legal uncertainty that liability insurance is no longer even available in scores of industries, from midwifery to day-care centers. Lloyds has pulled out of the litigious U.S. market. This judicial activism also discourages risky ventures by entrepreneurs, creating a huge hidden cost to the technological society. Who will bother to develop the next generation of birth-control methods if new devices cannot be sold profitably under today's tort laws?

The situation also is bringing disrepute on the legal system. Somehow the incentives in the system have to be changed. Our favorite proposals include limiting contingency fees and damages, as California has already done, having the loser pay both sides' legal and court costs, charging user fees for courts and strictly limiting class actions. But even more than these procedural reforms, what's needed is for judges and the bar to return to the ancient wisdom of the

Medical Insurance Exchange of California
Medical Underwriters of California Attorney-in-Fact

February 4, 1986

The Honolulu Advertiser
ATTN: John Griffin
Editorial Page Editor
P.O. Box 3110
Honolulu, HI 96802

Dear Sir:

Your editorial of January 31, entitled "Liability Insurance - Time to Reform It", is as clear and succinct a statement of the problem as we've seen.

This kind of public understanding and legislative action will improve the situation. We are sending copies of your editorial to the other states where we insure doctors, where reform efforts are being made, and to our reinsurers in London. They will welcome it.

Yours very truly,

William K. Scheuber
President
Medical Underwriters of California

WKS/ka/04FEB01/cor11

The Honolulu Advertiser

Established July 2, 1856

Thurston Twigg-Smith *President and Publisher*
George Chaplin *Editor*
Buck Buchwach *Executive Editor*
John Griffin *Editorial Page Editor*
Mike Middlesworth *Managing Editor*
Gerry Keir *City Editor*

RECEIVED M.I.E.C FEB 3 1986

Friday, January 31, 1986

UNDERWRITING

Liability insurance

Time to reform it

Among the state Legislature's top priorities this year should be reform of our outmoded liability insurance system.

Legislators have a special opportunity to come to terms with some of the inequities and excesses of rules that often penalize taxpayers and subvert the laws' intent.

A GROWING number of lawsuits and higher liability awards have led to skyrocketing insurance premiums. What's worse, some "high-risk" individuals, firms and governments — from doctors, bars and child care centers to municipal agencies — can't find insurance. That situation is clearly intolerable.

A number of areas deserve special and immediate attention. First, the state should change the "deep pocket" rule whereby a government or company that is found marginally at fault can be required to pay an entire judgment simply because other defendants can't pay.

A fairer system would be to make defendants pay only that percentage of damages for which they have been found at fault.

Second, there should be a cap on the amount of damages awarded. In California, there's a $250,000 limit for non-economic damages (such as pain and suffering) over and above what an injured party needs for out-of-pocket expenses, future medical care and wage losses.

RELATED TO this should be a cap on attorneys' fees. One good suggestion calls for a maximum 35 percent for recovered damages up to $100,000, 25 percent between $100,000 and $200,000 and 10 percent of damages over $200,000.

Such a sliding scale may help curb some of the demeaning "ambulance chasing" by plaintiff attorneys, whose advocacy of victim's rights often appears overshadowed by financial gain.

Third, legislators should look hard at limiting "punitive" damages, which are often awarded to punish a defendant and to deter similar future behavior.

Complementing these proposed changes will be a worthwhile program, announced this week by Hawaii Chief Justice Herman Lum, requiring most personal injury lawsuits to be handled through arbitration. In theory, the program should reduce costs for plaintiffs and defendants and reduce the caseload of the overburdened court system.

THE UNITED States is the most litigious society in the world. To be sure, victims deserve prompt and just compensation. But too often suits are filed merely to try to squeeze — either in court or through out-of-court settlements — astronomical damages out of companies, individuals and municipalities.

Directly or indirectly, Hawaii residents pay for these suits. It's time for legislators to restore fairness and balance to our liability insurance system.

LAW OFFICES
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BERNARD P. KELLY
PAUL COSSMAN

December 12, 1985

Senator Fred F. Zharoff
P.O. Box 405
Kodiak, Alaska 99615

RE: INSURANCE CRISIS

Dear Senator Zharoff:

I am enclosing herewith a copy of the omnibus reinsurance bill that was discussed by J. Robert Hunter, the President of National Insurance Consumers Organization, on Friday, December 6, 1985, at the Captain Cook Hotel at our meeting.

This omnibus proposal could be adapted to state law. We have enlisted the support of Avrum Gross, former Attorney General, to aid us in any efforts directed toward legislative drafting. We believe that this omnibus reinsurance proposal could constitute a safety net for reinsurance and for insurance itself for such needy businesses as daycare centers and the smaller cities which are having trouble with insurance, as well as other aggrieved insureds. We believe such a proposal, to the extent of state involvement, could make the state profit if it were properly priced. For help in this effort, we would need to enlist the aid of an actuary, such as Mr. Hunter. We believe the State Department of Insurance should be armed with such an individual, anyway, and some of our proposals would be greater degree of factual reporting by the insurance companies and a rate-making procedure that could be honestly evaluated based upon the data submitted by insurers, such as details of their investment income, combined premium and investment income, together with their proposed rate increases when they propose them.

We would be willing to help in the drafting of such legislation. We favor more reporting by the insurance companies. In fact, we believe that the problem here is insurance reform, not tort reform. We believe that our state needs a property casualty actuary capable of rate analysis for decisions in rate-making cases and capable of auditing and