EMERSON, REID'S

INSURANCE OBSERVER

Volume 2, No. 3 | 10 Columbus Circle, New York, New York 10019 (212) 765-2103 | September, 1990

Products Liability Crisis Over—Rates To Plunge?

Many years back we enrolled in the Diploma In Risk and Insurance program at The College Of Insurance. Despite our distaste for school, we somehow found ourselves in class again, five days a week from eight-thirty in the morning until one in the afternoon, taking courses with titles such as Property Insurance, Casualty Insurance... If we had to sum up our feelings about the program in one word it would be this—DULL. We passed our time in the back row, lost in thought, struggling to keep our eyes from shutting.

One day a fellow student, a Nigerian risk manager, shared some information with us over a cup of coffee during a mid-morning break. We'd been discussing the huge sums that had been handed down in recent liability cases, when he said in utter amazement, "In my country, if a man is killed on the job, we give his wife $50 and a turkey."

We recalled that conversation while reading *The Quiet Revolution In Products Liability*, a study published by James A. Henderson, Jr. and Theodore Eisenberg, professors at Cornell Law School. Henderson and Eisenberg contend that in recent years there's been an abrupt judicial shift, and that the trends are now favoring defendants, not plaintiffs.

This is actually heady stuff, and what makes the thesis all the more interesting is that this judicial revolution has gone pretty much unnoticed. That's not surprising since most corporate planners tend to use only the recent painful past to extrapolate the future, thereby missing the big picture. (As 1989 loss reserve disclosures have shown, the insurance industry is still adding to reserves for the pre-1979 years, as well as the 1981-1985 period.)

To compile their data, the authors read summaries of thousands of judicial decisions from 1976 to 1988 and then did some statistical work. The results show a declining success rate for plaintiffs. Just as "the body of case law from the mid-1960s to the mid-1980s reflects an attitude, widely shared among judges, that our products liability system plays an important social insurance role in making America a safer, better place...", the authors found that "The revolution reflected in our data [from the early to mid-Eighties on] is not simply one of juries rebelling against the perceived excesses of the products liability system. The change...consists largely of courts articulating new law; it is a revolution primarily of lawmaking, not fact-finding."

Products Liability Commemorative Stamps

In 1977, judicial opinions favored the defendants just 44.3% of the time. By 1988 this figure had risen to 63.4%.

Hey Dude, Let's Party

Twenty-one life insurance companies had junk-bonds-to-statutory-net-worth ratios of 500% or more at the end of 1989.

If the authors' hypothesis is correct it probably has some profound implications for the insurance industry. For starters, products liability premiums may not be inadequate at current levels, and they could be headed even lower—not a pleasant thought for brokers working on commission.

Indeed, the crisis in medical malpractice has abated somewhat. Rates have been lowered, median medical malpractice awards have fallen, and insurers have released recent reserves. St. Paul, for example, released $251 million of reserves in 1989, thereby more than doubling their profit.

Nonetheless, most insurers are still underreserved, at least according to some pretty shrewd folks we know. This paints a seemingly puzzling picture. If things are getting better, why are they so bad? We think we have an idea. The insurance companies don't get bitten by the same dog twice; they get bitten by a different dog. We see a double whammy coming. There's a lot of reinsurance out there that will never be paid off, and there's a lot of new business being written at inadequate levels. We are also of the opinion that interest rates are headed north, the exact opposite of the direction you'd like them to head if you happen to own lots of longer term bonds, which the insurance industry does.

Naturally, one can interpret data any which way, and conclusions can differ materially. Just in case you aren't quite sure where we stand, we'll be blunt. The soft market ain't over yet.

♦

DBL Leader Offers Many Markets

We hate to brag, but we just had to get this off our chest. Emerson, Reid, well-known as the leading general agency specializing in New York DBL, has more than nineteen DBL markets available, twelve of which have Best's ratings of A of better. Since no insurance company comes through for you all the time, you can't afford to limit yourself to a handful of carriers. So give us a call.

♦

Earthquake—A Big One Could Bust The Insurance Business

Robert E. Litan has a bachelors degree in economics from the University of Pennsylvania, a law degree and a Ph.D from Yale, has served on the President's Council of Economic Advisors, written books, been a lawyer, and is currently a senior economist at the Brookings Institution. He is also the author of an address to the Insurance Information Institute entitled *Insurer Insolvency and Earthquake Insurance: Lessons From The Thrift Crisis,* which issues some blunt warnings.

Just as the thrift crisis grew in dimension because of neglect, faulty regulation, and the reluctance of both Congress and the healthy thrifts to speak out, so too could a solvency crisis develop in the insurance industry.

If such a situation is not already upon us (see graph on page 3) it no doubt will occur when a big earthquake strikes. (By the way, earthquakes aren't confined to California. In 1812, a giant quake struck Missouri with thirty times the force of the quake that hit San Francisco last October.) According to Litan, the "Big One" could kill thousands and cause more than $50 billion of property damage claims. This could lead regulators and insurance buyers to an unpleasant crossroads. Because insurance companies' capital would be severely impaired, the amount of insurance available going forward would be inadequate to meet the needs of the marketplace, assuming that insurance companies continued writing business at existing premium-to-surplus ratios.

This would be difficult and damaging, but Litan projects a worse scenario:

"An alternative outcome, which I personally believe is more likely, is that insurance regulators will not learn, or be permitted to learn, from the thrift crisis. Instead, precisely because they would fear a capacity "crunch" that would ensue if they strictly enforced existing minimum premium-to-surplus ratios...insurance regulators, either on their own initiative or in response to political pressure, would engage in the same kind of capital forbearance that thrift regulators practiced in the 1980's. In the process, regulators would then lay the groundwork for a subsequent, possibly even more devastating, financial "aftershock" than the initial depletion of capital that any major quake would trigger.

With the old capital rules no longer in force, while state guaranty funds continue to protect policyholders, many thinly capitalized insurers would no doubt attempt to roll the dice and gamble their way back to solvency. The thrift disaster teaches that many, if not most, of those gambles would fail."

In such a situation the state guaranty funds would be overwhelmed and the taxpayers would ultimately bear the burden of bailing out the insurance industry.

Litan sees a way out—the "Federal Earthquake Insurance and Reinsurance Act" (FEIRA). The Act would require property owners to purchase earthquake insurance if they have mortgages backed by a federal agency or issued by a federally insured institution. FEIRA would also provide federal reinsurance to insurance companies.

FEIRA has the backing of the insurance industry, and was introduced in Congress in April. But Litan worries that nothing will happen unless it gets some "grass roots" support.

With tax hikes in the coming years being almost a certainty, it seems unlikely that voters are going to be in favor of a hidden tax such as mandatory earthquake insurance—particularly since insurance companies are all for it.

That's too bad, because the alternative is going to be much worse.

♦

They Said It

On February 20, 1990 AmBase announced it was putting The Home Insurance Company up for sale. "AmBase took this action because it believes the Company's shares continue to be significantly undervalued. Our recent share price does not fairly represent the inherent values of the Company..." said highly-compensated Chairman, President and CEO George T. Scharffenberger. The stock was around $8 at the time.

—During the week of August 13 AmBase stock collapsed to $2 1/8 due to the disappointing price they will receive from the sale of The Home.

♦

Fire Fighting History On View

In the former Engine Co. 30 firehouse on Spring Street between Hudson and Varick, in a wide three floor structure across from an aging industrial building distinguished by a fading sign for Whitehead Metal Products, stands the three year old New York City Fire Museum. Inside resides one of the most comprehensive collections of fire fighting memorabilia around—engines, pumps, documents, badges, hoses, firemarks, extinguishers, and assorted apparatus.

Since the history of fire fighting in America is closely linked with the history of insurance, it is of interest to us. We recently spent part of a balmy afternoon at the museum, which prompted us to prepare this brief history:

America's first recorded fire took

EMERSON, REID'S
INSURANCE OBSERVER

David Schiff, Editor
Emerson, Reid's Insurance Observer is published periodically by Emerson, Reid & Company, Inc., the leading General Agent, Intermediary and Specialist in New York DBL. Subscriptions available upon request. Editorial and executive offices at 10 Columbus Circle, New York, N.Y. 10019. Telephone: (212) 765-2103.

place in Jamestown, Virginia in 1608. Captain John Smith wrote in his journal, "Most of our apparel, lodging, and private provision were destroyed." It was not until twenty-two years later though—in response to the destruction wreaked by chimney fires—that the first fire regulations were enacted, in Boston: "Noe man shall build his chimney with wood, nor cover his house with thatch." Sensible rule.

In 1648, during Peter Stuyvesant's administration as governor of New Amsterdam, the first organized fire fighting began with the appointment of four fire wardens. (Today, New York City has 11,000 uniformed firemen.)

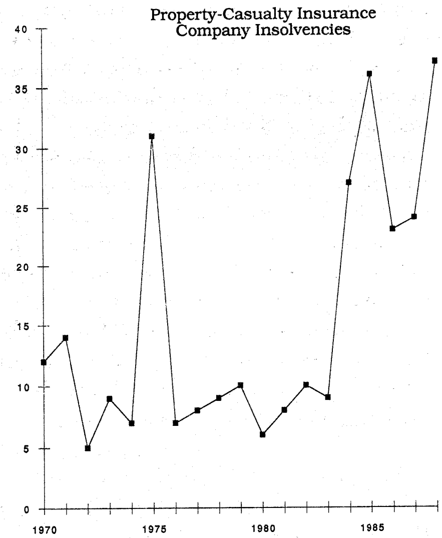
Fire fighting was simple and primitive back then, and bucket brigades were the order of the day until 1676, when the city of Boston brought the first "pumper" to America. This technological leap forward led to the formation of the first engine company in America.

The first volunteer fire company wasn't organized until 1736, when Philadelphia's Benjamin Franklin ("Never leave till to-morrow which you can do to-day.") set up the Union Fire Company. Sixteen years later he started the Philadelphia Contributorship, one of the earliest fire insurance companies. But the distinction of forming the first fire insurance company belongs to Jacob Motte of Charleston, South Carolina, who founded The Friendly Society for the Mutual Insuring at Houses Against Fire in 1736. Four years later a disastrous fire put the fledgling company out of business.

Following the British example, by the mid-1700's American insurance companies began issuing firemarks —lead emblems mounted on wooden shields—to mark property covered by insurance. These decorative and colorful emblems were phased out by the late nineteenth century, but are collectors items today.

Then, as now, being a volunteer fireman was a prestigious, club-like activity. George Washington, Thomas Jefferson, Paul Revere, Alexander Hamilton, Aaron Burr, and Benedict Arnold all served as volunteer firemen.

The industrial revolution brought about many changes in fire fighting.



Hand-drawn pumpers could now send out continuous streams of water instead of intermittent spurts. A new hose was designed to withstand greater pressure, and early protective gear, including the forerunner of today's fire hat, came into use.

By the 1850's, horse-drawn steam engines had replaced the old man-drawn and man-pumped engines. In New York City, seven story tall watch-towers were manned by fire wardens on the lookout for smoke or fire. Boston installed the first fire alarm box system.

New York City didn't organize its paid fire department until 1865, twenty years after The Great New York Fire of 1845 destroyed a large downtown area and brought about the failure of many New York insurance companies.

In those days firemen were paid $700 per year and got one day off a month. Department regulations prohibited, among other things, profane language. There were many firehouses because the horses that pulled the engines could only run at full gallop for a few blocks.

New York City began building its high pressure water supply system in 1903 and shortly thereafter bought its first motor-driven engines. By 1910 motorized equipment began replacing horse-drawn systems, and in 1922, Engine 205, the last of its kind, made its final run. The *F.D.N.Y. Centennial* commented:

"Thus ended a colorful and glamorous period...Nothing was more thrilling to the old New Yorker than the sight of three beautiful horses straining in the harness, at full gallop, as they pulled one of those magnificent steamers trailing a column of smoke from its highly polished stack. Old-timers knew it well, but alas the youngster of today can only see it in pictures, without ever really knowing the thrilling sound of the pounding clattering hoofs and clanging bells."

Fire fighting has changed much since the early days, but one element remains the same; it is hazardous, dangerous, dirty work. The smoke, heat, and flames take their toll. This city's fire fighters are aptly called "New York's Bravest"; 8,959 of them were injured on the job in 1987.

Today there are 32,000 fire departments in America, of which 31,000 are manned by volunteer fire fighters, whose ranks total approximately 1,500,000. We take our hat off to them.

The New York City Fire Museum is located at 278 Spring Street between Hudson and Varick. It is open Tuesdays through Saturdays from 10 to 4. The phone number is (212) 691-1303.

♦

America's Best-Known Fireman

"If you pick up a telephone receiver in this town you may, or may not, get a dial tone. If you get on a subway you may, or may not, get stuck in a tunnel for an hour. The wall socket in your apartment may, or may not, contain electricity. The city's air may, or may not, be killing you.The only real sure thing in this town is that the firemen come when you pull the handle on that red box."

So states Dennis Smith's *Report From Engine Co. 82*. This classic account of the busiest firehouse in the country is a gritty and compelling documentary of firemen working in the poverty-stricken, fire-ravaged South Bronx in the early 1970's; and the author was one of New York's Bravest when he penned this best-seller.

The success of *Report* changed Dennis Smith's life forever. He started Firehouse Magazine in 1975 (which he sold a year ago) but continued to work full-time as a fireman until 1980. In the intervening years he has written eight more books, including three novels and a children's book, and continues to work on a number of financial service projects involving the health and safety of fire fighters.

We recently visited Dennis at his east side apartment not far from the tenement in which he grew up. He is a pensive man, thoughtful and soft-spoken. If Hollywood were casting a movie about firemen, they probably wouldn't choose him. With his sensitive, almost sad face, and average physique, he doesn't look like a man who's put his life on the line fighting thousands of fires. But he is.

He lives alone these days, surrounded by stacks of art books, drawings, and paintings. Art is one of Dennis's great passions—he's chairman of the board of The New York Academy of Art and a collector of Old Master drawings. In fact, his home looks more like that of an art historian than a businessman, fireman, or writer.

In a corner of the living room we noticed a glass breakfront with a fire alarm box inside and four fireman's hats on top.

Dennis was wearing jeans and a blue work shirt—although he is often seen in black tie at various political and social events—and he spoke frankly. "Sometimes I miss the excitement of being out in the streets," he said of his days as a fireman. "The commotion, not knowing what's going to be there. We went out forty times a day. People in the South Bronx saw the firemen more than the cops."

There are many aspects that he doesn't miss though: the false alarms, the violence, the poverty, and the paramilitary discipline of the fire department. ("You need discipline—if you questioned an order someone could die—but I didn't like it.")

Once a year he gets together over lunch with the old Engine Co. 82 crowd, many of whom live outside the city, now. "We all came out of the same demographic mold; Irish, Italian, working-class Catholics." He talked of camaraderie, of the problem of arson, and of the extraordinary acts of violence that seem to pervade New York.

"I always thought I could be a writer," Dennis told us. We sometimes wonder how he found time. He had five kids and was working on a Ph.D in communications while he was a fire fighter. "It wasn't hard," he explained, making it sound easy.

Dennis showed us a drawing he was working on. It was a row of old buildings just north of the South Street Seaport, with the Brooklyn Bridge looming large in the background. It is a view that we have always loved.

It was getting late in the afternoon. Dennis was heading to Queens to visit his mother. We were planning to go for a leisurely jog in the park. We shook hands and took our leave. On our way home we looked at *Steely Blue*, Dennis' most recent book. He had inscribed it to us. It read, simply: "To my friends...with best wishes,".

Thanks Dennis.

♦

If You Can't Beat Them....

On July 7, Emerson, Reid's president David Schiff penned a column for the Insurance Advocate discussing a problem most insurance companies have had and will continue to have—making a decent profit. The cause of this problem is simple. The insurance industry is overcapitalized, even though many individual companies are undercapitalized.

"Things have to get terrible to be good," Schiff noted, before making a modest proposal. He suggested that insurance companies liquidate or sell out. *To whom? you might ask.* Why would anyone want to pay a premium price to enter a lousy business? Like the fate of the dinosaurs, that is one of the mysteries of the world. Still, there seems to be no dearth of buyers.

Shortly after Schiff's article appeared, Fund American announced the sale—at what looked like a very hefty price—of Fireman's Fund to Allianz AG.

Is this the beginning of a trend?

♦

Enriched DBL For Small Groups —You Asked For It

Many of you have asked about enriched DBL for groups with less than fifty lives. That's not surprising, since there's an increased demand from insureds for programs with higher-than-statutory limits.

We just want to let you know that we've got several markets available for this difficult to get coverage, and that the programs are quite attractive.

♦

New Jersey TDB—Kiss the State Fund Goodbye

Unlike New York, where most of the DBL is written with private insurance carriers, most of the TDB (Temporary Disability Benefits Law) in New Jersey is written through the State Fund, which (obviously) doesn't pay any commissions. That's crazy! Emerson, Reid has a number of very competitive markets that are actively seeking TDB.

In case you need a refresher in TDB, here it is: The law requires employers in New Jersey to provide Short Term Disability benefits to their eligible employees who are unable to work because of an off-the-job injury or sickness.

The benefit is 66⅔% of the average weekly wage to a maximum of $261 per week. Rates are a percentage of the first $13,900 of annual wages per person.

Benefits begin on the eighth day of disability and there is a twenty-six week duration. If an employee is disabled for three consecutive weeks following the waiting period benefits are retroactive to the first day of disability.

A significant lead time is generally needed to write TDB because there's a decent amount of paperwork involved. Since TDB policies are generally effective January 1, it's important to get started on this as soon as possible.

♦

Long Term Disability for Small Groups—Finally

Emerson, Reid has an excellent LTD program available for groups with two to nine employees. Give Mark Wintjen a call right away to learn more about this.

♦

Travel Accident

We do so much DBL business that our clients sometimes forget we can do a great job with Travel Accident. That's too bad—for us and for them. So from now on, think of Emerson, Reid for all your Travel Accident accounts. Give us a call and we'll take care of you.

♦