


2010 CAS Annual Meeting
C-15: Impact of Current Tort Environment on Asbestos Reserves
November 8, 2010

Jennifer L. Biggs, FCAS, MAAA

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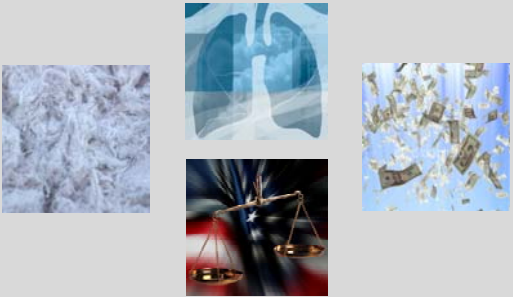
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Agenda

- Comparisons of U.S. P/C insurers' net ultimate loss and expense
 - Current estimates range from <\$65B to \$85B
 - AM Best reports that \$68.2B was recognized as of 12/31/2009
- Comparisons of the "universe" of asbestos loss and expense
 - Current estimates range from \$195B to \$275B
- Discussion of key considerations

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ASBESTOS LIABILITY ESTIMATES



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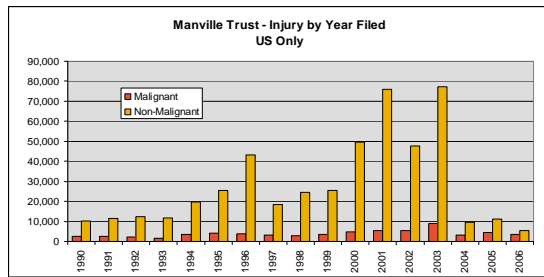
Some History Regarding Asbestos Loss and Expense Estimates – Various Nominal Estimates Were Published in 2001

- AM Best:
 - \$65B for US P/C insurers
- Milliman:
 - \$70B for US P/C insurers (range of \$65B-\$75B)
 - \$275B Total "Universe"
- Towers Watson (Tillinghast):
 - \$60B for US P/C insurers (range of \$55B-\$65B)
 - \$62B for non-US insurers
 - \$78B for defendants
 - \$200B Total "Universe"

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Subsequently, the Litigation Environment Changed

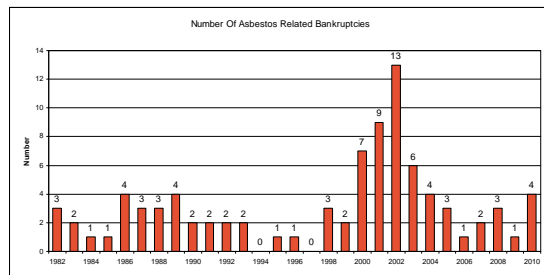


- Nonmalignant claims increased dramatically and have now declined
- The Manville Trust ended public disclosures of detailed data after 12/31/2006

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At Least 90 Companies Have Declared Bankruptcy Due to Asbestos



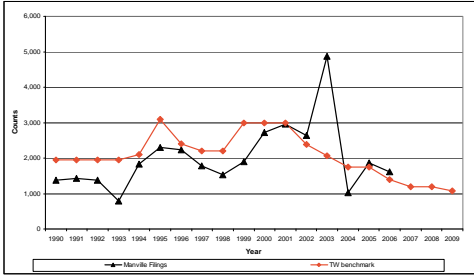
- The rate of annual bankruptcy filings decreased significantly in 2003+

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Lung Cancer Claim Filings

- General increase through early 2000s, then marked decline

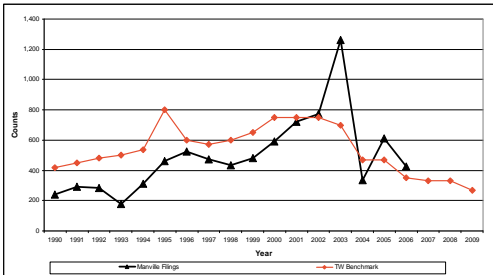


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Other Cancers Claim Filings

- As with lung cancer, marked drop in new claim filings in recent years

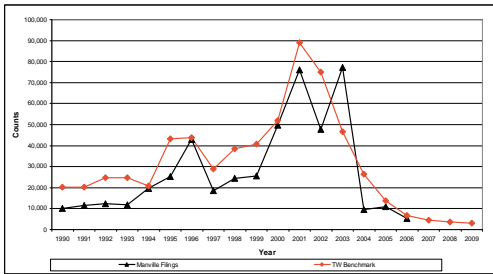


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Nonmalignant Claim Filings

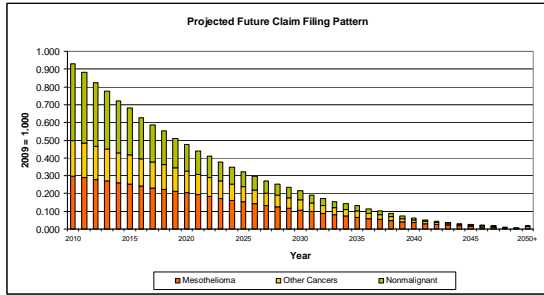
- New filings have fallen to a fraction of prior levels



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Towers Watson's Projections of Future Claim Filings



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Claim Payment Rates

- Payment Rates = Ultimate # Closed With Pay / # Filed
- Payment rates vary:
 - By defendant company
 - Products and defenses
 - Philosophy (e.g., use of matrix agreements)
 - By jurisdiction
 - By plaintiff firm
 - Over time

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Average Mesothelioma Indemnity Claim Values

- Average plaintiff awards have increased, but <1% of cases go trial
 - 2007: 30 verdicts, 15 defense, average of 21 pltf awards = \$5.5M
 - 2008: 45 verdicts, 20 defense, average of 27 pltf awards = \$5.1M
 - 2009: 30 verdicts, 9 defense, average of 23 pltf awards = \$5.6M
 - 2010: 10 verdicts, 6 defense, average of 4 pltf awards = \$6.1M
 - 2007+: 11 pltf verdicts >\$10M
- Although verdicts influence settlements, average settlement values are significantly lower
- Average claim values and trends for individual defendants vary and are influenced by:
 - Disease, jurisdiction and law firm
 - Defendant defenses and use of matrix agreements

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**Average Mesothelioma Indemnity Claim Values
Major Difference in Assumptions**

- Bates White assumes bankruptcy trust payments will partially replace payments currently made by solvent defendants
- This offset is not occurring in the current litigation environment

- Background:
 - Numerous bankruptcies filed 2000-2002
 - Bankruptcy stay on claims removed significant source of claimant compensation
 - Plaintiffs increased demands against solvent defendants and sued more defendants
 - Several trusts finally approved; significant funds became available 2007-2010
 - Solvent defendants seek collateral source offsets
 - Bankruptcy trusts are controlled by the plaintiffs' bar and information regarding trust payments to individual claimants typically is not disclosed

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**Significant efforts are currently being exerted to achieve "transparency,"
but this is not the state of the current litigation environment**

- Insights on defendants' views:
 - Peripheral defendants were not responsible for the claimants injury (at least not to the extent of the major bankrupted companies) and should not be required to pay the bankrupted companies' shares of claimant compensation
 - See U.S. Representative Lamar Smith's April 2010 letter to the GAO requesting investigation of secrecy in the asbestos bankruptcy trusts
- Insights on plaintiffs' views:
 - Pre-bankruptcy settlements were never as high as they should have been
 - Exposure attributable to peripheral defendants has now been proven
 - It's not double-dipping – all defendants contributing to exposure should pay
 - Why should solvent defendants get a windfall from bankruptcy offsets?

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**Significant efforts are currently being exerted to achieve "transparency,"
but this is not the state of the current litigation environment**

- High level summary of status:
 - ALEC model bill (disclosure/offset) has not been adopted in any state
 - LA and OH failed
 - WV compromised with CMO; not where the meso claims are
 - The majority of meso claims are filed in states that are viewed by lobbyists as unlikely to adopt offset reforms in the near term (CA, IL, NY)
- So, realistically, how quickly can the situation improve?
 - Several experts leading the efforts for transparency individually stated that it will be at least 10 years before there is real change
 - Legislation is hard to pass
 - How can you get offset in settlement negotiations without supporting legislation or CMOs?

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Trend in Average Indemnity Values

- Industry data shows that average mesothelioma whole claim values have exhibited positive trend, increasing over the last decade
- Selection of a long term trend rate is appropriate
 - Long term medical components of the CPI exceed 4%
 - Long term wage component of the CPI exceeds 3% (lower in 2008-2009)
- Claimant aging reduces claim values
 - Towers Watson offsets its inflationary trend to reflect claimant aging specifically tied to projections of future claim filings by age group
- Towers Watson uses combined annual trend of 2%
- Bates White assumes equivalent of trend of 0% in future average tort-based meso indemnity values, reflecting composite effect of inflation, claimant aging and increased trust offsets

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Defense Costs

- Claim based projections can be distorted due to changes over time in:
 - Disease mix
 - Use of matrix settlement agreements
 - Defense strategies
- Projections often based on defense-to-indemnity ratios, which also can vary significantly over time

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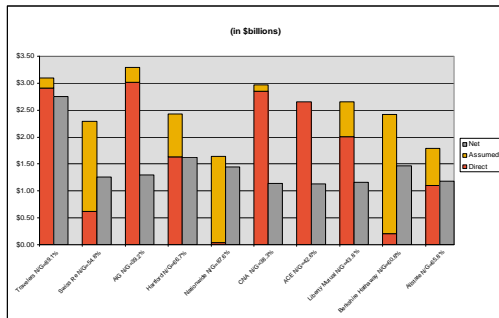
Key Considerations in Evaluating an Individual Insurer's Asbestos Liabilities

- Rules regarding allocation of losses to coverage vary by jurisdiction
 - Definition of Occurrence
 - Pro Rata vs. All Sums
- Several court decisions have expanded coverage
 - All sums allocation
 - Nonproducts claims
- Interpretation of individual policies is often subject to dispute
 - Limits for non-annual coverage
 - Interpretation of SIRs / deductibles
 - Wording of exclusions
 - Treatment of expense
- Also need to consider cessions and reinsurance collectibility

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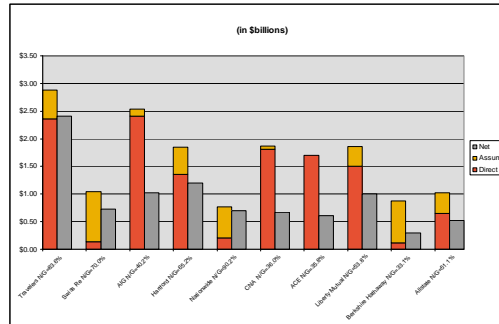
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**Comparison of Net-to-Gross Ratios by Insurer
Asbestos Reserves as of 12/31/2009**



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**Comparison of Net-to-Gross Ratios by Insurer
Calendar Year Asbestos Payments 2005-2009**



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From "Universe" to U.S. P/C Net Insured Basis

- Towers Watson's approach and results of allocating its 2001 "universe" to U.S. P/C insurers' coverage is provided in the appendix
- Milliman explains that while its "universe" of asbestos costs remains at \$275B, its estimate of the ultimate portion relating to U.S. P/C insurers, net of reinsurance increased from \$70B in 2001 to \$85B today due to coverage expansion:
 - Nonproducts (premises/operations) exposure was assumed to be insignificant in 2001
 - The significant shift in defendants involved lead to the availability of more insurance limits
- Bates White - presumably its <\$65B net ultimate estimate is significantly influenced by assumptions relating to trust offsets to tort settlement values

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Industry Outlook

- Future focus will be on mesothelioma claims
 - New claims include take-home exposure and contract workers (premises exposure)
 - Expenses (at least per claim) may increase
- Bankruptcy trust money will influence filing levels
 - Advertising
 - Cancer and nonmalignant claims are especially elastic with recruitment activities
 - Resurgence of nonmalignant claims against solvent defendants appears unlikely
- While the pendulum has swung more toward defendants ...
 - Volatile economy and new public mood may affect litigiousness
 - Insurers/defendants fighting against rollback of tort reforms
 - Also pursuing transparency in claim process, but not yet achieved
- Risk transfer deals may increase

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Guidance from Actuarial Standard of Practice 43 Property/Casualty Unpaid Claim Estimates

- The actuary should
 - Identify the intended purpose of the unpaid claim estimate (e.g., financial reporting)
 - Identify the intended measure of the unpaid claim estimate:
 - "Actuarial Central Estimate" represents an expected value over the range of reasonably possible outcomes
 - Use assumptions that have no known significant bias to underestimation or overestimation of the identified measure
 - Consider the sensitivity of the unpaid claim estimates to reasonable alternative assumptions
 - Consider relevant external conditions that are generally known that are likely to have a material effect on the analysis
 - Consider whether there have been significant changes in conditions that are likely to be insufficiently reflected in experience data or assumptions

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Statutory Accounting Guidelines for Insurer Liabilities

- SSAP 55 requires us of "Management's Best Estimate"
 - By line and in aggregate
 - If no point in the range is better (more probable), use the midpoint
- SSAP 65 requires undiscounted estimates
 - With the exception of fixed and reasonably determinable payments (e.g., workers compensation tabular discount) or explicit permission of a state insurance department
 - Unlike for some defendants that provide discounted liability estimates in their SEC Form 10-Ks, insurer reserves are typically held on a nominal basis

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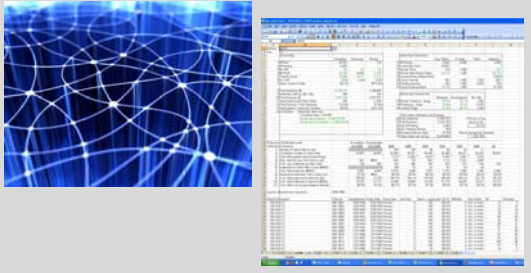
Conclusions

- U.S. P/C insurers' net recognized asbestos liabilities are likely to continue increasing for the next few years
- Various experts can be expected to have differences of opinion regarding assumptions used to estimate asbestos liabilities
 - Data availability / interpretation
 - Disease incidence, claim filing patterns and payment rates
 - Average indemnity claim values and trend rates as well as defense costs
 - Appropriate insurance / reinsurance allocation
- However, estimates based on highly judgmental assumptions regarding the future course of the litigation environment are speculative
 - "Transparency" has not been achieved
 - Experts leading the lobbying crusade do not expect to see meaningful change in the near term (10 years)

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APPENDIX: 2001 \$200B "UNIVERSE" METHODOLOGY



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Towers Watson (fka Tillinghast) 2001 Estimate of Ultimate Asbestos Personal Injury Claim Costs

- Tillinghast estimated ultimate loss & expense relating to U.S. exposure will be \$200 billion
- Two approaches:

Top-Down

- ◆ Focused on total awards to plaintiffs
- ◆ Estimated # future filings by disease
- ◆ Estimated indemnity cost and trended by disease
- ◆ Loaded for expense

- ◆ Focused on amounts paid by defendants
- ◆ Assigned defendants to tier
- ◆ Estimated # future filings, indemnity, and expense by tier
- ◆ Allocated ultimates to year and compared to insurance coverage

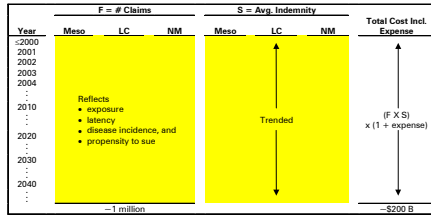
Bottom-Up

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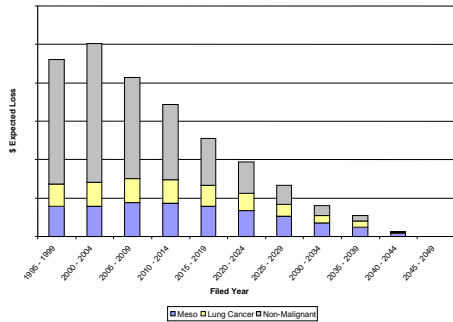
2001 Estimation of Ultimate Loss and Expense – Top Down

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



2001 Estimation of Ultimate Loss and Expense

Tillinghast Projection of Asbestos Related Ultimate Losses



2001 Estimation of Ultimate Loss and Expense – Bottom Up

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

The Types of Asbestos Defendants

Tier 1: Manufacturer/producers in litigation since inception

- Will use all available insurance coverage

Tier 2: Became involved shortly after Tier 1 companies

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

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

- Lesser exposure due to encapsulated products or limited distribution

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

2001 Estimation of Ultimate Loss and Expense – Bottom Up

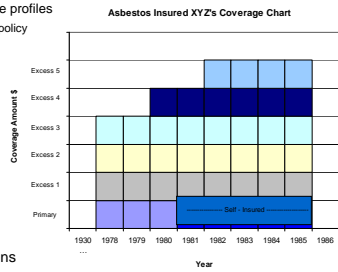
- Projected future filings for each defendant
 - implies ~60 defendants per plaintiff case
- Projected future severities by defendant
 - implies average ultimate severities of \$1,873 to \$5,550 – vary by tier
 - Averages include dismissals
- Projected future expenses (defense costs) by defendant
 - Implies average ultimate expense loads of 20% to 116% – vary by tier.
 - Reflects a reduction in expenses for Tier 3-Low defendants over a five year period.
- Ground-up ultimate loss and expense for each defendant = Filings x Trended Indemnity Severities x (1 + expense)
- Allocated ground-up ultimate indemnity and expense to year
 - Compare to average defendant coverage profiles

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Estimation of Ultimate Loss and Expense – Bottom Up

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

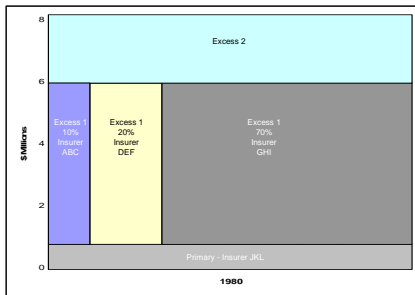


- Consider reinsurance cessions

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More Detailed Coverage Description of Excess 1 Layer in 1980



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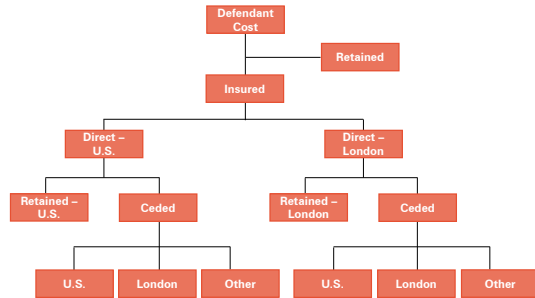
Comparison of Loss Allocated to 1980 to Available Coverage of Insurer ABC

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

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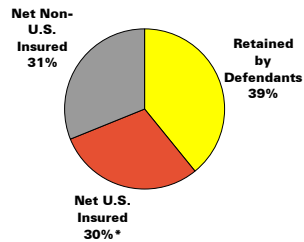
2001 Allocation of Ultimate Loss and Expense of \$200 Billion Among Multiple Payers



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



*\$60 billion mid-point of \$55 - \$65 billion range of the "2001 Universe" of net liabilities to the U.S. P/C market.

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Costs through 2000 were substantial, but told only part of the story

- According to RAND, estimated total costs of resolving asbestos claims through 2000: \$54 B
 - U.S. insurers \$22B
 - Non-U.S. insurers \$8-\$12B
 - Defendants \$20-\$24B
- Corresponding Tillinghast unpaid estimates at 12/31/2000:
 - U.S. insurers \$38B = \$60B - \$22B
 - Non-U.S. insurers \$52B = \$62B - \$10B
 - Defendants \$56B = \$78B - \$22B

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2001–2003 Era Quotes from Colleagues and Clients

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

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