



International Association for the
Study of Insurance Economics

Études et Dossiers

Extract from

Études et Dossiers No. 295

The 27th Liability Regimes Conference
“A European Perspective on
Global Developments”

27 – 29 October 2004
Rüschlikon Global Dialogue Centre, Zurich

April 2005

Working Paper Series of
The Geneva Association

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The Economic System as Catalyst for Evolving Liability Regimes

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Liability Regimes



The economic system as catalyst for evolving liability regimes

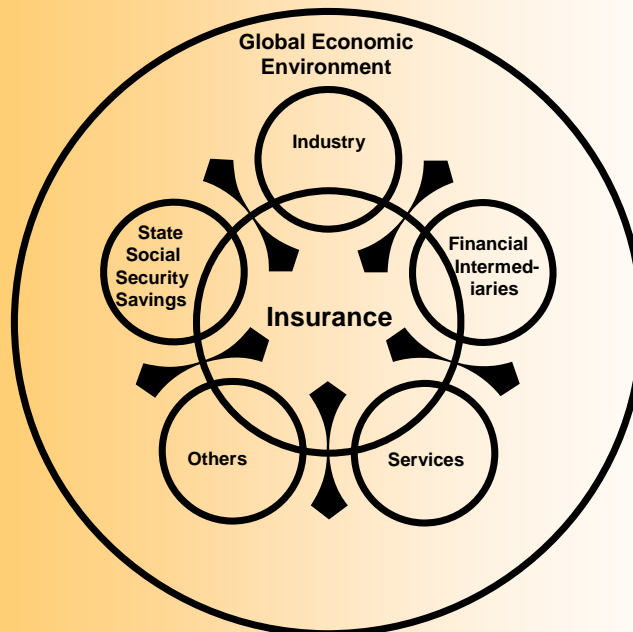
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The economic system as catalyst for evolving liability regimes

Overview of presentation

- The Geneva Association
- Introduction on "Why liability regimes?"
- The changing economic rationale
- The new legal production system
- Final reflections



Introduction on "Why liability regimes?"

- Relevant issue for the insurance industry
- Problems involved are of a strategic nature
- International/ global character of the question
- Challenges reside to a large degree in the precompetitive area
- Current limited knowledge and understanding in how the complex issue evolves
- And most importantly:
The industry can do something about it



Liability regimes – Problem identification

- Very dynamic development of claims since the 1980s in different liability areas
 - Increasing cost to insurers
 - Sometimes erratic and “emotional“ jury awards, esp. at the upper end of the scale
 - Difficulties in predicting future liabilities and therefore reserving requirements
- Plus:
- The insurance industry feels misunderstood in its role by society and exploited by lawyers



US-Trend in Liability: The bad news

- Perception of increasing number and size of claims
- Erratic, cost intensive and “emotional“ jury awards
- Surprise at the intensity of this development and consequently underreservation
- Very aggressive legal profession that is fully profits-driven
- Legal system that allows "venue shopping" and other techniques to maximize awards
- Development of the legal system through judges and juries



US-Trend in Liability: more bad news

The tort system has moved away from fault and reimbursement.
New routinely accepted principles:

- “Liability without fault“ (beyond the concept of implicit endangerment), e.g. asbestosis claims against unsuspecting buyers of properties
- “Damages without harm“, e.g. on financial markets through the concept of “fraud against the market“
- “Quantum of damages without reason“, e.g. based on contact with asbestos without further medical indication or pathological development

=> *"We are moving from a system of fault and recompense to one concerned chiefly with wealth distribution." (Rick Murray)*



US-Trend in Liability: ...but most importantly....

- Increasingly different environment in which economic agents display a changing set of expectations and priorities when interacting
- Fundamental change of the “legal production system”



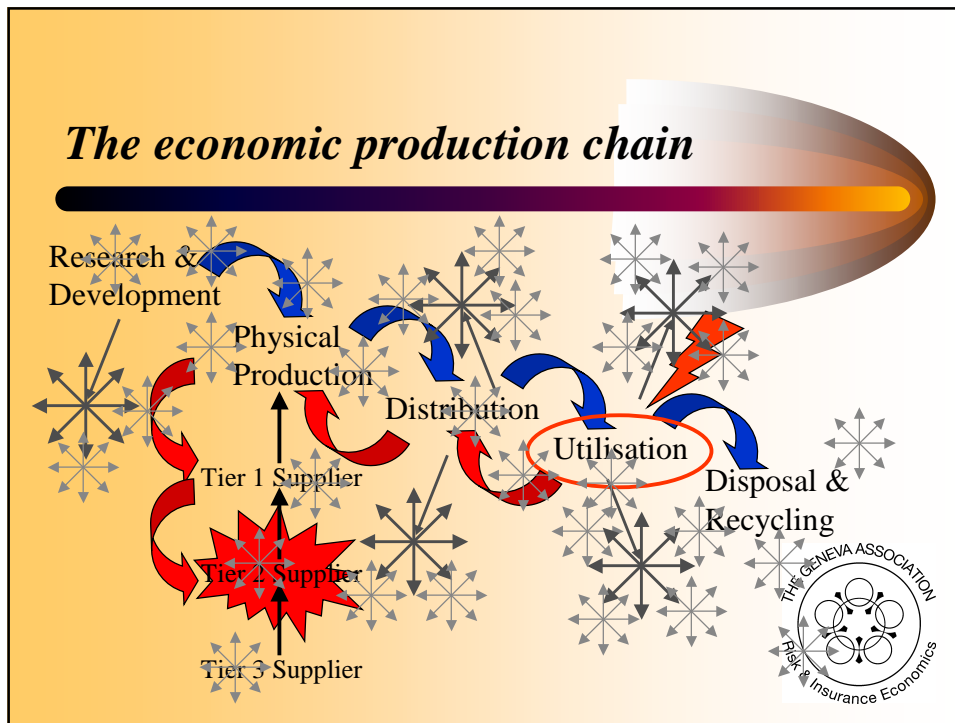
The new "legal production system"

- Solutions looking for cases and not vice-versa
= new legal Taylorism
- Aggressive marketing of lawyers and their firms
- Reinvestment of past awards into new fields of activity
- Aggressive and intensive political lobbying

Hence the descriptions:

"Lawyers are predators" and
"Sharks with brains"





- ### *Paradigms of the new service economy: Technological aspects*
- Customers and business partners expect:
 - More service (maintenance intensity ↑, leasing arrangements ↑, usage coupled with service ↑, etc.)
 - Higher quality of goods and better services
 - Performance over time instead of pure delivery of goods
 - Outsourcing and globalisation make value-producing chains longer and more international
 - Technological advances make them more complex
 - The importance of the quality cascade is fully understood
 - Business relationships are more contract reliant
 - Everybody is more willing to sue
-

Paradigms of the new service economy: Social aspects

- Ethical aspects of conducting business become increasingly important:
 - It is no longer enough to be technically correct but one has to be regarded as ethically correct (honest, fair)
- Socially responsible behaviour is the key, transparency its tool:
 - Responsibility is no longer linked to the pure business risk
 - Social responsibility has become a new source of liability
- Social affinity to legal procedures is on the increase – everybody is more willing to sue
 - More informed and proactive customers and their specialist organisations
 - Easier access to the legal system (incl. legal insurance!)
 - Tools to reduce the risk (cost) of the claimant in case of a lost case



Paradigms of the new service economy: Legal aspects

- Business-to-business and business-to-customer relationships are more and more contract reliant
- Guarantees and "promises" are inherent parts of business relations
- Increase in consumer protectionism (incl. extension of guarantees etc.)
- Better documentation of business processes (esp. through email) facilitates lawsuits
- Win-loss balance for claimants and their lawyers (esp. through claims aggregation) entice more lawsuits
- Use of instruments beyond the purely legal find their ways into processes – "mediatisation" and "emotionalisation" of legal cases



The liability environment Some critical reflections

- The legal certainty trade-off will always yield fertile ground for lawsuits:
 - Precision versus generalisation
- More insurance contributes to more lawsuits:
 - Legal framing of relations
 - Moral hazard to sue and adverse selection of litigious insureds
 - Creation of "deep pockets"
- The ultimate defense of business: limited liability
 - High gearing and low asset base prevent lawsuits by making them pointless against the firm



Why worry in Europe?

- Pervasive US influences in the legal sphere
 - Transmission of significant tort activity around the world is fostered by a combination of exported US principal interacting with the domestic jurisprudence of individual countries.
 - Replication of the economic drivers of the US liability system in Europe:
 - use of claims aggregation techniques under domestic law
 - acceptance of highly leveraged rewards for claimant's counsels
 - tolerance of courts and political systems for behaviour modification in the legal profession
 - The need (and incentive) for US lawyers to expand into new growth markets.



Why worry in Europe?

- Pervasive US influences in the economic sphere:
 - Spread of the new business model with stronger customer centricism
 - Service orientation of customers
 - Increasing customer rights
 - Longer guarantees (*cf. new EU legislation*)
 - More producer responsibilities



Let's worry in Europe!

- The necessary preconditions for a liability explosion in the legal sphere are increasingly in place
- The social and economic environments are gradually shifting towards a more liability-prone system
- Still existing cultural obstacles could be weakened and finally be removed over time
- So:
 - The prospective gains for the legal profession are great.
 - the insurance industry has, as of yet, not enough protected itself from these developments...
...and consequently....
 - the loss potential for insurers is enormous.



Liability regimes and the insurance industry

- Growing markets are good for business
 - Markets with no or too little volatility and (no or too little uncertainty) are not good for insurance
 - Changes in the legal system and practice are not totally exogenous to a country and can be predicted over time
- => Necessary strategy: “Manageability of risks”
(the aim is to guarantee the control of the downside)
- Key problems:
 - Fear of killer risks for insurance that were not predicted (predictable) and do not allow enough time for a controlled exit
 - Extent of the time lag (“the time lag is the killer”)



Challenges for the insurance industry

- Better understand the legal developments in the US and possible transfer mechanisms to other regions (direct or indirect)
- Immunize operations against high/excessive volatilities
- Reduce the temporal lags in insurance portfolios
- Better align the interests of insured and insurance
- Formulate exit strategies as hedge against exploding claims developments
- Intensify the co-operation with the different pillars of the legal system
- Overcome the public misperception that insurance payouts do not generate costs to society

