Liability Underwriters Group Annual Conference 2006

Synopsis of a Lecture

Liability Underwriting and the Theory of Everything[1]

By

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Abstract – "occurrence " wordings do not provide a sustainable way of writing long tail exposures because the lag between setting premium and knowing the true cost of the risk prevents the price mechanism from charging the proper cost of the risk to the customer. Proposes research into the use of "claims made" wordings for such risks. Recommends legislation to put claims made underwriting on statutory footing and makes recommendations for progressing such matters.

It is about 20 years since I first encountered my first liability underwriter. As a relatively inexperienced young lawyer I was impressed and completely taken in by the self-confidence of someone and who apparently not only could predict what the law would be but also whether an accident would occur, who would be liable for it and better still even when the payment would have to be made.

My admiration was perhaps short-lived as I recall that by my very first presentation at the Liability Underwriters Group Annual Conference I was asking the perhaps naïve question of, why do you people write business knowing that it will ultimately make a loss? I have pursued an answer to that question ever since but somehow it evades me and contrary to all my expectations liability underwriting has not collapsed, not all have gone bankrupt and some of you still see it as a land of opportunity in which to make your fame and fortune.

[1] When I agreed to present a paper at this conference I was to have a 10 minute slot with two other presentations each giving different views on what changes the liability insurance community should address – ideas that may change the world. Can there really be such a shortage of ideas?

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My subject matter today has been addressed many times before at these conferences by people much more learned than I. Here is the list:[3]

1994 Phil bell "The problems of Insuring Legal Liabilities

1995 Michael Mendolowitz "Insurance Cover for the Long Tail and Unforeseeable"

1996 Paul Ceurvorst "The faults in Liability Wordings for long tail Exposures"

1997 Don Carey "Liability Wordings Exposed"

1998 Michael Gill "The Expansion of Liability and the Role of Insurance …"

2002 Mark Scoggins "Long tail, long term and long stop"

2003 Phil Bell "The Future for Employers Liability"

2005 Michael Lay "Claims Made and Occurrence" [4]

You might be forgiven for saying enough is enough - turn the record over!

Not that easy - how come we have a recurrent theme with the great and the good telling us we can't sensibly write long tail risks but we still keep doing it?

Ten years ago, to be exact on the 22nd September 1994, Phil Bell the senior liability underwriter of Royal & Sun Alliance presented a paper to this conference entitled "The Problems of Insuring Legal Liabilities".

It is perhaps instructive to commence with one of Phil's closing comments: -

> "*One thing is for sure, we will all be worrying about new problems in 5 or 10 years time – in addition to all the existing ones – as this is the nature of liability insurance. It never stays the same and if we are to have a buoyant and successful market, it is essential for underwriters to at least move with the times – preferably be ahead of the developments – so that our policy wordings and premiums are sensible and realistic.*"

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[3] Source IMC website

[4] Perhaps there should be added a further paper - Dr Peter Young – his 1999 paper "an Essay on Subjective Risk, Uncertainty and Managerial Decision Making" has a certain relationship to this subject.

The words *"preferably ahead of developments"* catch my eye. I am going to attempt to persuade you that this is in fact impossible.

I will seek to argue today that the underwriter using an ***occurrence***[5] wording for long tail business can never be ahead of the game, he will always be in a reactive position, he will always be behind the game. I think there are two principal reasons for that. First of all everyone else in the game is playing a short-term game often lasting no longer than five years, only the underwriter is playing the long-term game and that's because he doesn't realise that the other players have changed the rules.[6] My second reason is that the underwriter is the victim of his own complacency. Just look at the facts. You have next to no control over the amount of money you get in and someone else has total control over the amount of money you pay out.

At the root of this insurance business is the idea of fortuity. The chance that something will or will not happen, there is a similarity with gambling but how many gamblers would place a bet on a match where they had no idea how many players there might be, what the rules might be, or even how long it will go on for or for that matter how you actually define winning. Phil Bells 2003 paper gave an overview of the liability market between 1990 and 2000. In every year you made an underwriting loss. On that performance how can you ever think that you can be ahead of the game?

Is Liability Underwriting a story of success or failure?

I was fascinated by a book, which was published earlier this year by Dr Paul Ormerod, a distinguished economist. The book is entitled "Why Most Things Fail" and subtitled "Evolution, Extinction & Economics".[7]

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[5] Essentially I mean by this injury sustained or disease caused during the period of insurance. See further "Liability Policy Wordings and Cover " by Peter Madge. Buckley Press Reprinted 1981.

[6] The underwriter thinks the game is about his business, its not, he is the only one that does not realise it but he has become part of the social security system. As far as the other players are concerned his job is to fund the type of social security system that modern "liability" has become.

[7] Published by Faber & Faber ISBN 0-571-25032-6

In our world we are used to most things working most of the time. Ormerod's basic proposition stands that comfortable proposition on its head. He argues that failure is a perfectly natural state of affairs. He opens his book with these words: -

> "*Failure is all around us. Failure is pervasive. Failure is everywhere, across time across place and across different aspects of life 99.99% of all biological species that have ever existed are now extinct.*"

He points out that "From biological species to companies, to government policies there appears to be an Iron Law of Failure, which is extremely difficult to break". He says that the precise mathematical relationship which describes the link between the frequency and size of the extinction of companies, for example, is virtually identical to that which describes the extinction of biological species in the fossil record only the timescales differ. Any comparison between Dinosaurs and the ABI is entirely unintentional!

There is one easy to identify characteristic that defines the moment just before an enterprise fails - it runs out of money! You can see this is not going to be an intellectually challenging lecture. It's that simple. You run out of money for basically two reasons. You either do not get enough in or you pay too much going out.

Dr. Ormerod points out that-

> *"Choosing the price of a product is a challenging and difficult decision for companies. If a firm makes a big enough mistake on this, or even persists with perhaps a relatively minor mistake for a sufficiently long period it will fail."*

What if an entire industry under prices a product for decades at a time?

Ormerod offers a controversial insight into why some things work and others fail. Part of that insight is recognition of the massive role that uncertainty plays in the final outcome.

I mention Ormerod's work because I and others have for the past 20 years or so felt that the failure of liability underwriting was just around the corner, like doomsday you know you should put it in your diary but you do not know when.

But put all this gloom to one side, we are still here, ten years ago Phil Bell ended his talk with these words: -

> "*My view is that because of all of the change and uncertainty, it is the most complex and interesting class of business to be associated with. Let us all work together to make it successful.*"

Phil Bell's concepts of "uncertainty" and "working together" have some parallels in Paul Ormerod's view of life. He argues that uncertainty is the driving force of evolution. Similarly, he argues that contrary to the conventional thinking of all out competition between individuals some degree of cooperation can often be discerned in those examples of things that do not fail.

My personal attention span for cutting edge economics particularly when combined with ideas of biological evolution does not extend beyond five minutes, so it is perhaps time for a diversion; a diversion however on a similar theme. When I am not being curious about liability underwriters my great passion is sailing. This summer I cruised to the Channel Islands just off the coast of France. Crossing the English Channel in a small boat is small beer by the standards of today when heroes such as Ellen MacArthur are whizzing round the globe single-handed at lightning speed encountering and overcoming treacherous conditions. However, 65 miles across the busiest shipping lane in the world is always, for me, something of a personal adventure. Nowadays we know precisely where we are because of GPS. Before that we used some reasonably simple mathematics. However, the variables which affect a small boat making such a passage are both well known and relatively limited.

Unfortunately, there is nothing similar to GPS for liability underwriters. Your basic skill set is derived from property underwriting, you look backwards at your history and say it is likely that there will be this many losses costing this much each year. But when you start trying to predict liability over the course of a policy that may take 30 years to close off none of these tools actually work. Fire insurers don't give you 30 years cover for a single premium, what they insure is a 12 month period of time.

In liability there are simply too many variables. They range from politics to science. When Unions are powerful the law changes to reflect that power for example by pushing at limitation periods. Advances in Science - I single out "low dose toxicology" in particular can now link a disease to an exposure in a way that could have not been imagined a decade ago. In turn that impacts the "causation" component of the liability equation. Discoveries in genetics have an equally important impact. In short when you write a liability risk on an occurrence policy you take on the whole burden of change across a vast spectrum of areas that can affect what you finally have to pay.

Your financial position at any given point in time depends upon the adequacy of your reserving and a wide spectrum other factors over which you have even less control such as the rate of investment income.

Before I had GPS I navigated by a technique called "the circle of uncertainty". Essentially this consists of accepting that you will never know precisely where you are but instead navigating a theoretical circle where the probable errors in the vessel's position are translated into a kind of guard zone which is then navigated around a particular hazard. That was only possible because of the existence of good charts, tide tables, accurate time and the compass. In essence reliable information from which rational deductions could be derived by mathematics.

Unfortunately, there is no similar technique for liability underwriters indeed, in my view there are very many factors which make "cautious reserving" a very difficult thing to deliver. It took scandals such as the collapse of the Independent to make regulators wise up to just how important the reserving task was. Since then we have seen regulators bring forth a variety of initiatives such as CP190[8], individual capital requirements ("ICAS") and compulsory increases in solvency margins. These measures have seen some weaker underwriters leave the market. Whether they are sufficient in themselves to correct what I believe is a *structural* tendency to under price and under reserve remains to be seen. The claims director is after all being pushed by his Board to release reserves so as to take profit – a topic on which Neville White was due to present to you in his slice of this afternoon's presentation. Similarly, just as you are being squeezed on one side by the FSA who are demanding a greater capital margin so you are also being pushed by the Treasury who are very much in favour of declaring a quick profit as therein lies a quick tax payment. And while this is happening the Judges are spending all your money as if comes from a bottomless pit and you have neither control nor even influence. Indeed I have a mental picture of an occurrence wording as some sort of judicial credit card where the Judge spends your money on his "social justice" purchases and you settle the bill. But as the bill sometimes does not arrive for 20 years or more, it can often present some surprises.

In Phil Bell's original paper he rightly drew attention to the spectre of industrial disease claims. He correctly identified the steady trend in both frequency and severity of disease claims, which had risen steadily since the early 1970s, and I believe it is fair to say that they continue on that trend. He cited deafness, VWF, chest diseases and upper limb disorders as the most pressing problems and looked ahead to correctly predict the increase in relatively new industrial diseases such as stress and passive smoking. He rightly observed that while you need to charge realistic premiums now to allow for the risks that you are actually running liability underwriters need to be attuned to emerging liabilities which may in the future have

[8] FSA Consultation Paper 190 "Enhanced capital requirements and individual capital assessments for non-life insurers" July 2003.

to be paid out of exactly the same premium pool and for which no allowance could have been made in the rating data.

I agree entirely with Philip's prudent warnings but while I find myself in agreement with his diagnosis I do not necessarily agree with his proposals for a cure. I ask, is it not now *obvious* from our experience that there is something so fundamentally wrong with the "product" that you offer that it is not simply a failure to ask for the right price.

Consider this perhaps there is *no right price*. Perhaps the product is so misconceived that it defies the ability of the market to actually allocate the right price to it. I think you might already know that. I think you might already know why - its simple and its obvious. Liability insurance is one of the very few products whose cost of production is not known, with reasonable certainty, until twenty or more years after it is sold. So obvious is this that we accept such "*mega uncertainty*" as a normal state of affairs.

Although it did not feature in Phil's paper to us in 1994, his thinking subsequently inspired the ABI suggestion that industrial disease claims should be taken out of conventional underwriting and ceded to a kind of "pool" arrangement. That idea was developed in his 2003 paper on the future of employer's liability. I do not know if that idea found much favour with the government. I can say that it didn't come to fruition. It seems to have fallen from the agenda. The last thing I heard from the ABI they seemed to be concentrating their efforts on vilifying plaintiff personal injury lawyers with some remarkable "research" which suggests that claimants who don't have lawyers get paid more than those who do[9].

Anyone who thinks that misconceived and naïve "research" such as this would ever assist in winning a now long overdue debate with government needs to think again.

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[9] Law Society Gazette 13th July 2006

Just two years after Phil's original paper the 1996 LUG conference received a paper from Paul Ceurvorst the casualty underwriter of the Cologne Re. His title was "The Faults in Liability Wordings for Long-Tail Exposures". Paul's essential diagnosis was the same as that of Phil Bell – the problem was disease and of course that means that the nature of the problem is long tail exposure as most "accidents" occur during the policy period. Paul's analysis was that at the heart of the problem was the occurrence wording. I don't think that conclusion can be seriously challenged but we have done nothing to solve the problem. In common with Phil Bell he observed that the fact that premium is charged for a policy period against which claims might not be brought for 20 or 30 years.[10] It is worth recalling Paul's exact words.

> "*One solution to the 'occurrence' problem is without doubt the 'claims made' trigger, but achieving it may require an effort that makes Indiana Jones' search for the Holy Grail seem like a stroll in the park!*
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> "*The claims made wording is the Claire Short of insurance clauses: very straightforward and effective but not much liked by its peers. It has had a rough time of things particularly since 1990 when the French Supreme court declared it void, … Thereafter followed anti claims made judgements in Belgium, Spain and, for different reasons Australia and the US.*"

Paul's paper provides a very well argued analysis of the debate between occurrence and claims made wordings and he courageously argues that claims made has advantages to both insurer and insured. I perhaps felt that he went a little too far when he said: -

> "*The Professional Indemnity market in the UK is a good example of how a claims made form can provide capacity to meet the needs of most insureds and is proof that the perceived disadvantages of claims made are clearly not an issue.*"

[10] It is more precise to say that in the first period of its exposure it pays accident" type exposures and then perhaps 20 or 30 years later it is called upon to pay "disease" type exposures.

I respectfully beg to differ. The claims made trigger at least in its present state is not by any means a *fully* acceptable answer. Don Carey in his 1997 paper "Liability Wordings Exposed" took a similar view. He said:

> *"I accept the comment made elsewhere that the claims made approach does not provide the panacea that we might all have hoped for. In theory it overcomes the main objection to the losses occurring approach - it introduces a certainty of when the policy is triggered. It also appears to overcome the problem of the "tail" inherent in losses occurring policies and arguably it benefits the Assured because it provides today's indemnity limits for today's claims."*

My views on the topic were set out in some length in a lecture I provided for the Insurance Institute of London at Lloyd's a couple of years ago[11] where I sought to identify the very real problems associated with the use of a claims made both in professional indemnity and in my view in all forms of liability insurance. I have not undergone a road to Damascus conversion. While there is a lot that is wrong with claims made, lets face the reality it might be the *only* alternative open to you. Michael Lay in his 2005 paper looked at the "Occurrence Reported" trigger sometimes known as the Bermuda form. He sought to explain the concept of "integrated occurrence"

While I accept that there is much work to be done on alternative triggers, what I think the question comes down to is this - should the product be a one off premium payment or should it be a recurring premium providing cover for a fixed but renewable period of time. In my analysis this is the important distinction between occurrence type wordings and claims made type wordings as far as the ability to collect sufficient premium is concerned.

The inability of the occurrence wording to adequately deliver realistic income to service the long tail nature of the commitment being given ultimately leads to losses

[11] Claims Made Products …" download at www. fisherscoggins.com

and losses lead to insolvency. Prominent insolvencies in the insurance industry have ultimately brought about regulatory intervention. Surprisingly, this regulatory interest has apparently never seen the connection between solvency and the occurrence product.

Only this month the ABI were speaking enthusiastically about ICAS -

> *" Firms believe ICAS has helped to embed a risk-based approach to calculating how much capital firms need. As a result, customers are being properly protected without prices being driven up, which would result if firms were being required to hold unnecessary capital".* [12]

I think that is code for "Phew thank God that is over".

The FSA anticipate that the result of ICAS being implemented is that underwriters will hold sufficient capital *" to mitigate their risks to an agreed level of confidence of survival - a level typically defined as 99.5% confidence of remaining solvent over 1 year or in other words, to have sufficient capital to survive a 1 -in- 200 year adverse event."*

So everything in the garden is hunky dory. I think not! For some liability accounts ICAS I am told required capital increases to be injected ranging between 30 and 300%. Pure speculation this may be - I know of no published figures. However, that in many cases further capital has had to be found does I think underline that we have a basic and *structural* problem with the "occurrence" product.

You will be familiar with CP190.[13] A lesser-known document is the Woodrow Wyatt 2003 Report to the FSA " Calibration of the General Insurance Risk Based Capital Model". If you ever find you can't sleep this is what you need. Now given that all of

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[12] Chase Cooper Regulatory News

the papers I have highlighted above scream at you that long tail exposures are "the" problem when written on "occurrence" wordings you might expect to find some discussion of this issue in that Report. Surprisingly not that I could find.

So I acknowledge that much attention has been paid to solvency but with respect to the great and the good the real difficult question in general liability insurance – namely the correct trigger, has remained unanswered for more than 20 years and I see no sign of an answer on the horizon.

It was a single word that destroyed much of Lloyds "Asbestos" it has not gone away. All this talk of solvency has in my submission missed an obvious point - the principal cause of insolvency in insurance is the same as in any other business - that is failure to make a real profit.

It was not asbestos that brought so much destruction to Lloyds it was insufficient premium to allow it to pay for asbestos. Many might reply stupid underwriters - they should have charged the correct premium. Build in a sufficient "circle of uncertainty" to steer you through the bad times.

I submit that the occurrence wording could never have generated enough premium income to fund long tail exposures such as asbestos. Bear with me for just a little classical economics. The father of modern economics was Alfred Marshall who believed that the unseen hand of competition and the interaction of supply and demand would always lead to the optimum allocation of resources. That view underlies most of modern regulatory policy throughout the Western World.

Is it true of liability insurance written on an occurrence wording?

I am not convinced that it is. The market does not always work for all products. A very famous economist, Nicholas Kaldor observed that for some agricultural products the market often failed to deliver equilibrium[14]. Supply and demand never matched and the price was constantly unstable. The phenomenon is sometimes called the "cobweb theory" because when the interaction of supply and demand is plotted over time on a graph it looks like a spiders web. I will not bore you with the details but at the heart of this is a mismatch between the supplier's anticipation of what demand conditions will be in the future and what actually occurs.

It arises from a lack of information or to put it another way "uncertainty". Not knowing the real cost of your product seems to me a similar kind of uncertainty. I am not suggesting that the occurrence based liability wording works in this way I simply use it as evidence that we must not assume that the market does always work in every circumstance. But I do think there is a very large question mark over how a market can work when the supplier will not know the cost of his product for twenty or thirty years. Arguably if the market mechanism did work for this type of product I would not be giving this talk and you would not be listening.

Time to add a little bit more amateur economics. Economic theory says that a producer will keep on producing his product or service until his marginal cost is equal to the price he can achieve. That means he will keep on supplying while there is a profit to be made.[15]

Now the serious point - it is one of the fundamental assumptions of economics that there is a certain level of information circulating between the buyers and the sellers. That simply cannot happen when you write a 20 or thirty-year claims exposure. All you are likely to get is a common level of ignorance about the future.

I suggest that dealing in *risk* is one thing but dealing in *ignorance* is another.

[14] His work studied the inelegantly named "pig cycle" in US farming – Economica 1935
[15] This translates to the well known maxim "set price equal to marginal cost"

Lets take that a little further. Lets imagine a liability underwriter- I am going to call him "Giles" - a member of LUG he attended lots of IMC conferences and listened to lots of lawyers moaning on about dreadful judges and the cases they have lost. He reasons this, there is a pattern somewhere - in the future during the currency of my claims exposure there will be something like a new asbestos - I do not know what it is but I have this "feeling in me water!" Giles is basically a man of the land and he trusts his instincts. The following day at the box a broker offers a liability risk on an occurrence wording. Giles says I want 300% more premium as "I have a feeling in me water" about this. Broker says - he has gone barking! - and goes next door where the cover is written for a groat. The moral of the story is that you can't know the unknowable and even if you think you do unless both other sellers and at least to some extent also buyers have a similar "feeling in their water" the price will not move.

My conclusion - you can never be ahead of the game and even if you are it will not make a difference until in effect what you know or fear becomes common knowledge.

I submit that you cannot have any rational reason to believe that you can properly price a liability risk on an occurrence-based wording. What you do is price the risk correctly according to the market *at that time*. The whole essence of the long tail problem is that the normal mechanism of the market cannot deal with a commodity where the cost of production cannot be reasonably accurately forecasted at the time of setting the price. I once thought that there might be an answer to be found at the "expenditure" end of the equation. If only Judges understood the underwriters difficulty somehow it would sort itself out. Others including Phil Bell thought that "risk management" might be part of the answer. I no longer share those views. Don't expect society to change its views of justice simply because you have chosen the wrong policy trigger.

Some little time ago I thought that this issue, might be suitable for a PhD thesis. Unfortunately, it is a not a thesis that will ever be written by me as I have been seduced by a new yacht and at least in my head I have plans for more adventurous wanderings than just across to the Channel Islands. It might however be worthwhile sharing with you the provisional conclusions that I did reach.

First of all I confirm that the nature of the problem is the long tail. Long tails in themselves are not an insuperable problem. Life insurance has a long tail but it makes money. The problem is that we cannot price for the long tail and customers who share our understandable ignorance about the future cannot justify paying what the correct price would be for the same reason, namely lack of information about the future. But is it the *wrong price* or the *wrong product*?

Why on earth given the history, do we think *occurrence* is the right product? Well I submit we have known for a long time that it is the wrong product, both for the underwriter and for the customer.

Phil Bell rightly drew attention to the fact that our concept of liability has changed fundamentally over time. In the 1950s strict liability was a rarity. The idea of retrospective strict liability would not dare be mentioned but both have come to pass. In my view the most significant change was the Employers' Liability (Compulsory Insurance) Act 1969. This changed the fundamental relationship between the underwriter and the State. By making Employers' Liability Insurance compulsory a social policy was being expounded, its purpose was to see that injured workers were compensated. The same policy now in my submission extends to the whole spectrum of liability law. Some call it the "Compensation Culture". One lesson that can be taken from this is that any progress towards a solution is bound to fail unless it achieves the objective of being able to pay the claims that rightly or wrongly society has come to expect to be paid.

So I suggest that the answer is not in seeking to avoid paying claims as we have so often done. I suggest this has been at a huge cost to the industries reputation[16] that we now need to refurbish if we are to engineer a way out of this difficulty.

Accordingly, whatever the answer maybe it is not going to be cutting adrift a large raft of claims which are not going to be paid. The policy of an all pervasive "Nanny State" is ingrained in our post-war values. If the industry thinks not paying claims be they for disease or whatever is a long-term strategy it needs to think again. It has long been my view that inadequate underwriting has been the fuel which has driven claims departments into taking steps which have on occasion been condemned by the judges, have propelled the movement towards regulation, and equally importantly, have tarnished the industry's image and therefore its influence in the very important debate that it needs to have with the public and with government. (Out of respect I will not mention making stupid decisions such as letting Fairchild ever get to court!)

It is my view that the answer to the problem identified by Phil Bell and later by Paul Ceurvorst to name but two, lies not in reducing the number of claims that we pay but by increasing the funds available to pay those claims by collecting more realistic and fair levels of premium. To do that, I suggest it is obvious that you need to retreat from the *occurrence* wording as soon as possible.

Towards a Solution

As I have just said the key to moving liability underwriting particularly Employers' Liability underwriting to a more sustainable future is not to wring your hands and say, we must be absolved from having to pay these claims because they are too expensive or there are too many of them or we could not price for them or whatever. The occurrence wording was designed by underwriters. The Employers'

[16] For an insightful account of how the industry looks from the outside see "Policies and Perceptions of Insurance law in the Twenty First Century" by Prof Malcolm Clarke Oxford University Press 2005

Liability (Compulsory Insurance) Act did not specify any particular kind of underwriting trigger, although I accept that if anyone were now to start offering to write Employers' Liability on a claims made form without first winning the approval of government an amendment to the regulations so as to make it absolutely clear that the policy had to be on an occurrence basis would in my view be highly likely.[17]

The way to move forward is therefore to build an alliance of reason with academics, with regulators and with government and perhaps dare I say it, even with the Unions. It must be shown *by evidence* that the purpose of reform is not to leave deserving claimants without recompense but on the contrary to secure a sustainable funding mechanism so that their interests are in fact better protected.

It would also be naïve and damage the industry's credibility to pretend that ultimately a reform system would not cost more. Of course it would, but stakeholders will accept that, if it is shown that the present method of funding through an occurrence wording creates an unacceptable risk of creating just another financial services black hole.

In my view, the path for reform is to find a way in which the industry can pay those claims that society wants it to pay, but to do so on a sustainable basis by raising an adequate level of premium income. The only method that I can see that will achieve this is claims made.

Claims made has acquired a reputation as being "claims not paid" that is what you must remove. Don Carey in my view was absolutely on the point in his 1997 lecture when he said:

> "So if we as an industry, decide that we cannot sensibly cost or reserve for claims which might develop some 20 years after the policy was issued, then it might make sense to offer an alternative product, but the alternative product

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[17] In the course of my research I did hear anecdotal evidence of an EL policy that was in fact written on a claims made basis. I have not been able to confirm that evidence.

has got to work for the customer as well as for us, and has to come with some guarantee of stability.

If claims made is to become that alternative product it needs to be fair, predictable and above all reliable. If you think that you can write a claims made policy that allows you to impose an exclusion at the first sign of trouble, don't bother just continue doing what you are doing and hope that Paul Ormerods theory of economics and extinction is wrong. If you want to move from where you are you need to demonstrate that you can be trusted to operate claims made in a way that is acceptable to the wider community. Don't even expect to start with a presumption of innocence!

Now I regret there is a further complication - the Competition Commission. The essence of Competition law is that you must not make collective decisions that influence the market. So how do you bring about change? I suggest you ask them.

I think we need to start a constructive debate with Government, Regulators and Customers. To be taken seriously there is a need to analyse the factors that would make any move away from occurrence work for them not just for us. They all need to be convinced, (even claimants lawyer's!) as without their active support you cannot expect to make progress.

In my view there is a need for an Act of Parliament to regulate claims made underwriting. There are many cases some of which I have been involved in where underwriters have been seen to pass the parcel between themselves with the hapless insured in the middle and the ultimate beneficiary of the claim watching from the sidelines. A proper code to set out the rules for claims made business would remove a great deal of uncertainty and mistrust. An inherent and necessary part of such a code would be restrictions on some forms of exclusions. The industry could of course always take the view that it should play no part in drafting the laws which should govern it – why should Turkeys vote for Christmas you might say - or it could take the initiative and perhaps commission some academics to bring forth such a draft law.

It also needs to do some economic modelling to show that claims made can provide a solution to long tail liability. There is some serious economics to be done here, the government and the public are clever enough to realise that at the end of the day the expansion of the tort system and the availability of compensation for a wider range of injuries and improved levels of compensation must be paid for somehow.

It is my belief that a well-argued economic case which uses the data from the past to demonstrate that the market cannot deal with long-term liabilities using an occurrence wording would do a lot to convince Government and other stakeholders that you are an industry that can innovate solutions that solve real practical problems.

What the economic model has to show is that by movement away from a single one-off premium payment for an occurrence policy towards a claims made product where the premium gathered in over time can be more closely adjusted to meet the needs of claims payments and can provide a stable market where cover is available at predictable prices without either excessive profiteering or imprudent underwriting.

At the same time the industry should consider the mechanisms by which such a change could be made. Again, that is a topic for further study but one possible solution which I think has many advantages is to get agreement that going forward all occurrence wording should have a "sunset clause" so that if a claim had not matured within say six years of the occurrence wording incepting, then that claim will not fall to be paid by that policy. But to redress the balance there must be an option to purchase a claims made runoff policy at the end of that six years, perhaps on an annual basis but possibly also for a longer period whereby in return for further premiums those claims which would be excluded by the sunset clause would be covered on a claims made basis. Before I am attacked with lots of questions aimed to show the difficulties involved in such an idea, please reflect for a moment, even an imperfect solution might be better than more of the same.

If you do not like my suggestion put your energy into finding one of your own. What I think so many papers at LUG shows is that the problem needs a solution and so far we get nil points for progress.

Underlying all of these proposals is recognition that in order to make progress the industry will have to win the hearts and minds of the stakeholders in this equation. A starting point would be to convince the FSA. There was a time when the FSA knew so little about insurance that they were open and receptive to new ideas. I hope that opportunity has not been lost.

In the longer term if it can be demonstrated that claims made can be used as a "top up" tool to deal with long tail claims after the expiration of the sunset clause that I propose for existing occurrence wording, then it seems to me that there is no reason at all why a regulated form of claims made should not completely replace the existing occurrence type of EL wording. I see no reason why in other non-compulsory classes faster progress cannot be made.

All of what I said is of course entirely theoretical. Even worse, what value can there be in a lawyer talking about economics? I expect in ten years time someone will give a similar lecture addressing this problem again. Perhaps in the meantime all the problems identified in liability underwriting by the likes of Phil Bell, Paul Ceurvorst, and Don Carey will have painlessly worked there way through the system. And there again perhaps the cow did really jump over the moon!

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