Institute of Actuaries of Australia

History Repeating?

Can Insurers Face a Similar Problem to Asbestos Again?

Siddharth Parameswaran

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The Institute of Actuaries of Australia
Level 7 Challis House 4 Martin Place
Sydney NSW Australia 2000
Telephone: +61 2 9233 3466 Facsimile: +61 2 9233 3446
Email: insact@actuaries.asn.au Website: www.actuaries.asn.au

Background

At the time of writing, the workers' compensation market place in Western Australia had seen very vigorous price competition between insurers, with industry-wide discounting of 7.6%[1] on rates suggested by the Premium Rates Committee. During the same period, there had been a considerable increase in the number of claimants seeking compensation for asbestos related diseases on workers' compensation policies written 20 to 30 years ago[2].

The presence of latent claims on past policies would suggest that an actuary should at least consider the possibility of such claims eventuating in the future on business written today. Given the competitive market environment, and the industry's premium setting approach, such an allowance is very difficult to price in.

This paper sets out to see how insurance professionals address the issue of possible latent claims on current business. An anonymous survey was sent to actuaries and underwriters that deal with classes affected by latent claims asking them:

A) How they deal with latent claims,
B) Whether they think the industry's approach to latent claims is adequate and
C) What improvements they think are needed

Survey results were obtained from 23 actuaries and 6 underwriters, spread between 5 insurance companies and at least 4 consultancies and 2 reinsurers. All participants had dealings with classes likely to be affected by latent claims. This is quite likely to be a representative sample of industry-wide thinking on latent claims.

This paper documents the results of the survey, and assesses options for change. Appendix A has details of all responses and comments. Thanks must go to Elaine Yang, and Andrew Smith, both of whom helped greatly with the collation of the responses.

Given the publicity surrounding the cost of latent claims, due to the Jackson Inquiry into James Hardie's asbestos related liabilities, the insurance industry has a great opportunity to re-evaluate how it can best avoid making the mistakes of the past.

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[1] Premium Rates Committee of Western Australia Actuarial Assessment of the Recommended Premium Rates for 2004/2005.

[2] Based on statistics from the NSW Dust Diseases Tribunal on cases registered between 1994 and 2002.

IAAust Asbestos Working Group Discussion Paper

1 Objectives

The objectives of this paper are to:

- *Discuss how important latent claims are to the ongoing financial condition of a general insurance company.*
- *Assess whether there can be latent claims that manifest in the future on business written today.*
- *Discuss problems in pricing for latent claims.*
- *Create a summary of current actuarial and underwriter thinking on the industry's approach to latent claims, as described by industry practitioners.*
- *Stimulate discussion on improvements that can be made in the industry on the treatment of latent claims.*

This paper is not intended to be a detailed discussion of options for change, but is instead intended to be a starting point for reflection on the current approach adopted by the industry, and the validity of that approach.

2 Latent Claims

2.1 What are latent claims?

Latent claims for the purposes of this paper are defined as claims that have a very long lag between the incident or exposure leading to loss, and the reporting of the loss to the insurer.

Examples of these include claims where the cause of damage is:

– Mesothelioma, from occupation related exposures to asbestos fibres
– Gradual onset deafness, from occupational exposure to loud machinery
– Silicosis, from occupational exposures to silica dust, typically from construction activities
– Molestation, from sexual abuse of children or others to whom a duty of care was owed

2.2 Which classes of business are likely to be affected?

The main classes that are likely to be affected are those that cover a very large number of causes of loss, where the losses can manifest several years into the future, and where the loss can be reasonably attributed to the fault of the party indemnified. The likely candidates are:

- Workers' Compensation[3]: The policies typically indemnify employers from any injuries or diseases that their employees suffer as a result of going to work. Workers spend a large proportion of their lifetimes at work, sometimes with potentially hazardous exposures. Any latent diseases they may get can often be traced back to work related causes.
- Public and Products Liability: The policies typically provide indemnity to the insured party for any damage that they or that their products cause. The policies do not usually specify a list of perils, and hence they cover a wide range of claims, including possible latent causes.
- Professional Indemnity*: Theses policies provide indemnity to the insured for any damage that their services cause their customers. Sometimes the damage can take several years to become apparent. The latent losses from this are now mostly limited by writing the policies on a "claims made" basis that specifically attributes the loss to the period the claims are first reported to the insurer. Therefore, the latency from true cause may be long – but the insurer will only have to pay if they provided indemnity at the time of report.

2.3 Known vs. Unknown

Causes of latent claims that insurers are aware of today, may not be the ones that manifest in the future for exposures from current business. There is great uncertainty in predicting which causes may result in claim. This makes the cost of them very difficult to assess. Insurers typically respond to limit coverage of "known" causes of latent claims, through for example exclusions, or avoidance of risky segments.

[3] In this paper workers' compensation has been used interchangeably with employer's liability

3 How Important are Latent Claims?

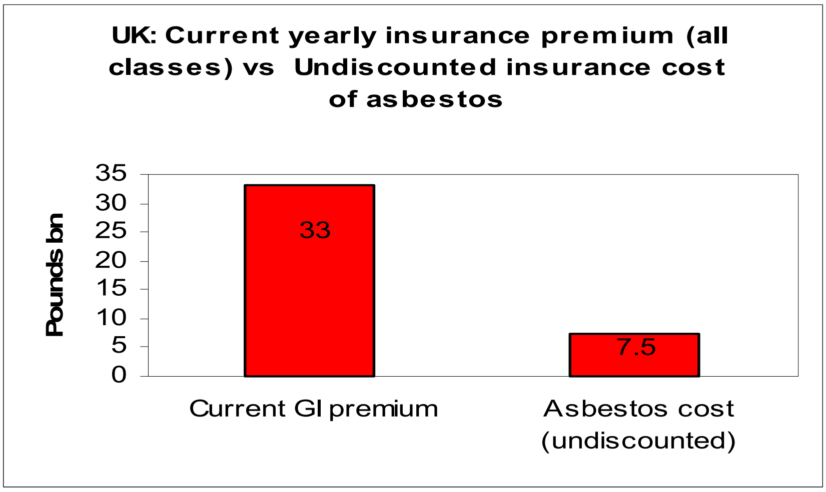
3.1 Approach

Two approaches have been taken to assess the importance of latent claims to the ongoing financial viability of an insurance company:

- Assess the cost of latent claims to the general insurance industry
- Ask industry practitioners' how important they think latent claims are to the ongoing financial condition of an insurance company

3.2 Cost to general insurance industry

Figures on the cost of latent claims are very difficult to get from anywhere in the world. The costs of these are usually hidden within the non-latent losses from various classes of business. Estimates of the cost of asbestos are available from the UK and US, and these have been used as a proxy to assess the costs of latent claims. It must be noted that these will understate the true cost latent claims, as it will ignore non-asbestos related causes. No public figures on the cost of asbestos to the insurance industry in Australia were available at the time of writing.

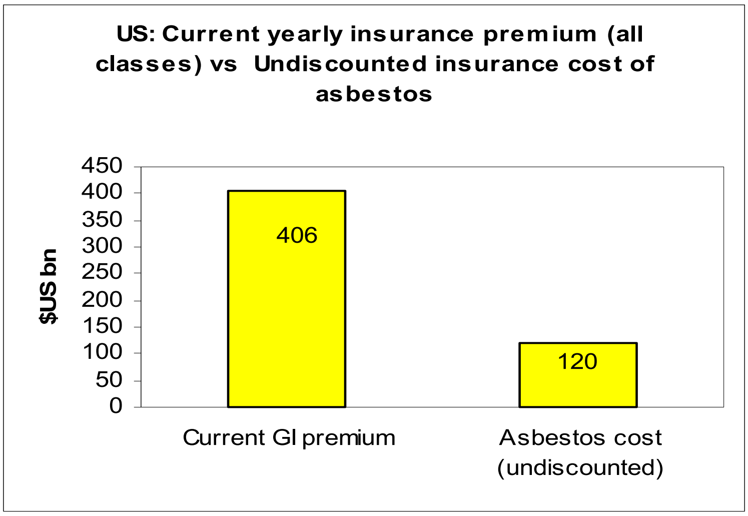


The graph above shows the estimated undiscounted ultimate cost[4] of asbestos related diseases to the UK insurance industry compared to the 2003 insurance industry net written premium[5] for all classes.

[4] UK Asbestos. The definitive guide.

[5] http://www.abi.org.uk/Display/File/306/General_Data_-_Public.xls

The graph below shows the same figures for the US insurance industry[6].



The figures shown need to be interpreted with some skill:

- Firstly, the ultimate costs for asbestos related diseases are shown undiscounted. Given the average latency of about 30 years for the payments to be made, the effect of discounting can be quite significant (>50%), which would reduce the cost of the claims when discounted to the time of writing of the business.
- A second offsetting factor however is that the premium volumes shown are the current levels, not the premium when the policies causing exposure were written. It is likely that those premium volumes would be much less than current amounts.
- A third consideration is that the exposures for asbestos occurred over about 20 – 30 years – and so the costs need to compared with 20 – 30 year's premiums.
- A fourth consideration is that if the premiums volumes shown were for just those classes that contributed to the exposures (liability and employer's liability), the premium volumes would be much lower. In the UK for example, liability premiums (including employer's liability) only account for 13%[7] of total general insurance premium volumes.
- Asbestos costs are only a subset of the total cost of latent claims to the insurance industry.

It is clear from the graphs, taking all these considerations into account, that the costs of the asbestos related diseases are **not** insignificant. The estimates as shown are for 23% and 30% of total current premium volumes in the US and the UK. These would be much higher as well if expressed as percentage of the liability and workers' compensation premiums.

[6] Tillinghast estimate 2001. 60% of $200bn total undiscounted cost of compensation , http://www.insurance-canada.ca

[7] http://www.abi.org.uk/Display/File/306/General_Data_-_Public.xls

The figures cannot be classed as catastrophic by any means either. These costs are from 20 – 30 years exposures, and would only be a few percent of the yearly premium volumes.

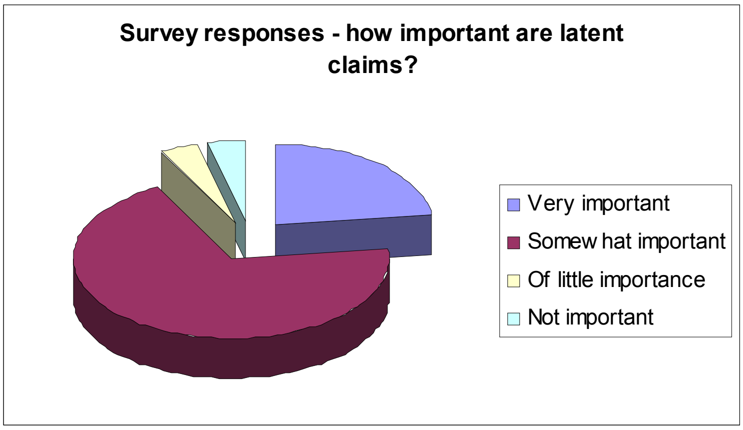
What is clear is that if adequate amounts are charged for the risks when the exposures are taken, it is not an impossibly large cost relative to the normal premium volume. If the liabilities are acknowledged in one big hit however, they can be a very large cost for the insurance industry to take.

3.3 Practitioners' views on the importance to the insurance industry

Survey participants were asked:

"How important an issue to the long term financial condition of a company do you think latent claims are?"

The graph below shows a summary of their responses.



It is clear the vast majority that that it was either "somewhat" or "very" important for the long term financial condition of a company. Amongst those that indicated that it was not an issue, one respondent said that latent claims were dwarfed by other areas of uncertainty facing an insurance company.

3.4 Summary of importance of latent claims

It is clear that how an insurance company deals with latent claims should be of some importance to the long term viability of the company.

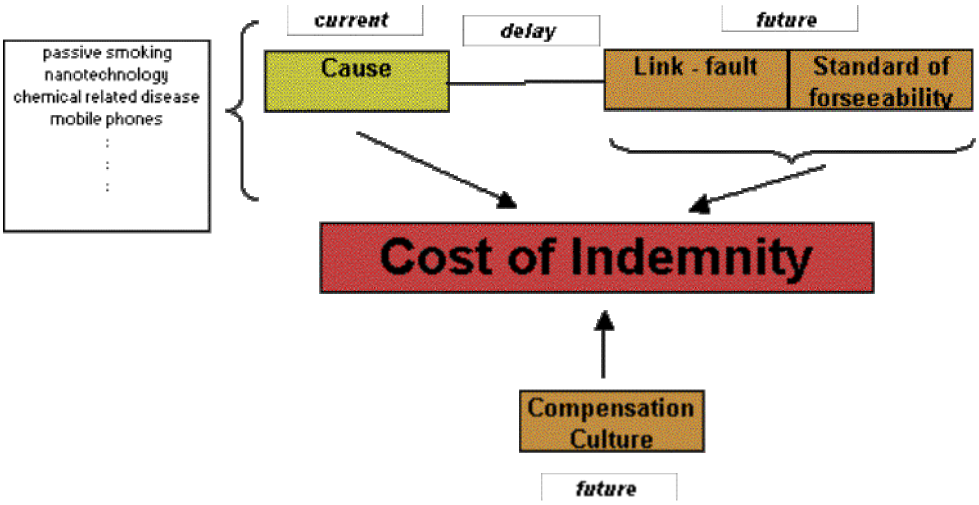
It is worthwhile pointing out that there are examples from overseas (such as Chester Street and Equitas), of insurance companies going into liquidation or run-off as a result of not adequately planning for the costs from latent claims. It is arguable that the same may have happened in Australia, had there not been some acquisitions which injected capital into certain companies.

4 Can Insurers Have Latent Claims on Current Business?

4.1 Factors affecting latent claims occurrence and cost:

In order to understand whether the insurance industry will get latent claims from current business, we need to understand the process by which we get the claims, and the determinants of that cost.

Most latent claims that affect insurers are compensated through an adversarial process: The legal principle that needs to be satisfied is the "Law of Negligence". The diagram below shows the process by which insurers end up with compensation liabilities for latent claims on business written today under this law, and the determinants of that cost. The explanations of the diagram follow below.



Cause:

What is needed firstly is a "cause" of harm today to the claimant that results in latent damage. As mentioned earlier, this could be from causes that are either known or unknown to the insurer. There are industry practitioners that try to prognosticate the next cause of latent claims. Many reinsurers provide seminars for their clients on such issues. Potential candidates on current business include:

- asbestos in developing countries, whose use is rapidly increasing as a cheap building material.
- passive smoking, for occupational exposures in pubs and clubs leading to lung cancer.
- mobile phones, where some studies have postulated a link between the phones and the incidence of cancer
- nanotechnology, where the impact on people of certain substances designed to work at a molecular level has not as yet been assessed.
- chemical related occupational exposures

It is worthwhile noting that as a society, our age profile is getting older, and the leading cause of death is cancers (malignant neoplasms).[8] This has been increasing in percentage terms over the past decade. Many cancer-related deaths are associated with long latencies from their underlying cause. This may mean that latent causes of claims will increase in the future.

Delay:

The symptoms of the loss must of course manifest some years after the cause for it to be a latent claim.

Legal Principles:

Once the damage has manifested, in order for there to be a case for compensation, the following two principles must be satisfied:

- Link fault: It is necessary for the damage to be able to be blamed on / linked with the insured, who must have had a "duty of care" to the victim.
- Standards of foreseeability: It is necessary for the victim to prove that the insured could reasonably have foreseen that their actions would cause harm.

It is worth noting that these will be determined in the distant *future*, many years after the "cause". This makes it a difficult area (especially for insurers) to know what links may be drawn between some cause of exposure and the harm caused, and the standards that will be used to decide foreseeability.

Standard of diagnosis and ability to link fault can change from an insurer's perspective. For example, Dr Allen Kraut from the University of Manitoba made a submission to the *Workplace Health and Safety Consultation in Manitoba* on occupational diseases and compensation. In that, he quotes studies that say "*between 4- 10 % of cancers in adults are thought to be work related*". Nowhere near that number are compensated as such at the present. If such numbers can successfully be linked back to occupation in the near future – there may be many more latent claims on workers' compensation policies.

Insurers are also one step removed from the process of controlling exposures. Therefore, even if the insureds are aware of risks and dangers (i.e. satisfy the principle of foreseeability), the people providing the indemnity – the insurers - may not appreciate them.

Compensation Culture:

A final determinant of the cost of latent claims to insurers is the *compensation culture* that exists when the claims manifest in the *future*. Not all injured victims currently seek compensation. The culture of seeking compensation at the time the injury manifests is critical in determining the cost. This can be many years from exposure, and hence can be difficult to predict. Arguably as a society we have become more litigious and have become more aware of access to compensation. It is also possible that the amount of compensation society and courts deem as adequate can change over time. Historically, these have usually increased, making estimation of the standards over a 20 to 30 year time horizon very difficult for insurers.

[8] Australian Bureau of Statistics website

Summary:

The circumstances which led to large latent claims costs from past exposures could conceivably be met again in my opinion.

5 Pricing for Latent Claims

If insurers are covering the risk of latent claims on business they write today, they should theoretically allow for them in the prices they charge. The difficulties in doing this are outlined below.

5.1 Problems in analysis

Is the past a guide to the future?

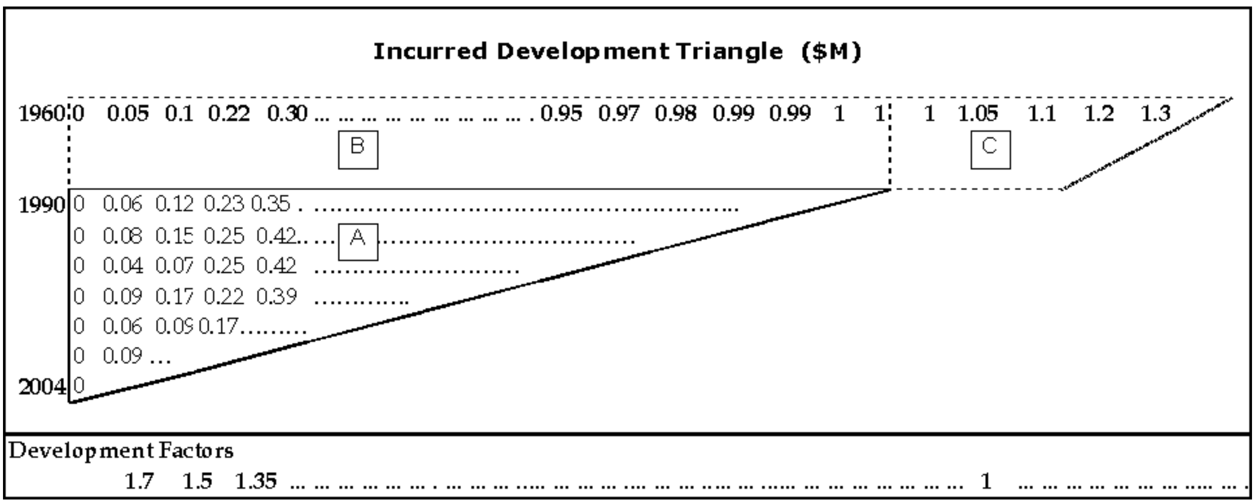
The past is arguably not a good guide to future costs when it comes to latent claims. For example:

- coverage and policy conditions change over time.
- there may be new / different causes of latent claims.
- Many factors that influence cost are in the *distant future*, and as such are not easy to estimate now. This includes factors such as -
    - future attitudes to compensation being different / stronger to current standards
    - court awards being more or less generous than current awards
    - standards of fault and foreseeability that are used by courts in the future may be different to current interpretations by courts.

Looking at past data alone therefore may not give a guide to the expected cost of latent claims on current business.

Technical difficulties

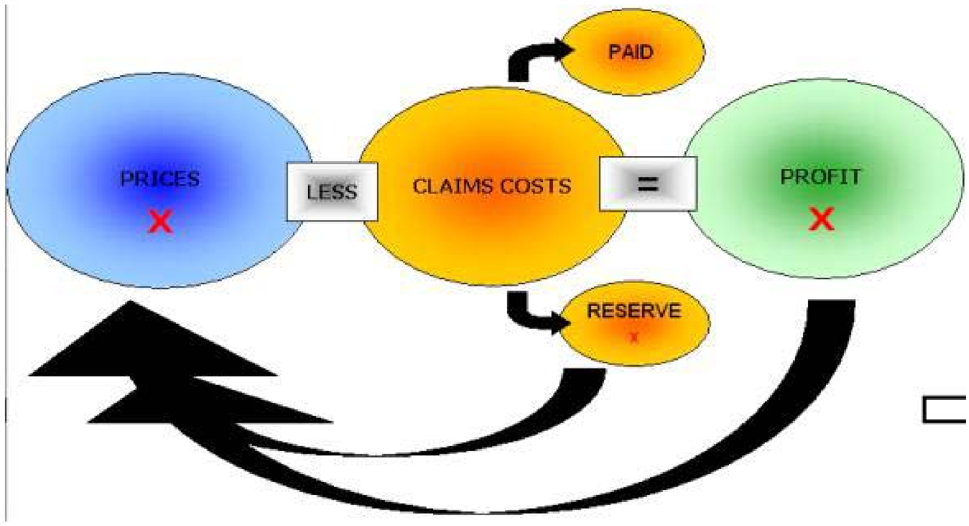
Using past data to estimate expected latent claims costs also poses some technical challenges. The diagram below illustrates this.



In most pricing exercises, the data that will be used is that in Section A – recent claims experience. Data from Section B may not be available in a computerised format, and is usually ignored. Data from Section C (latent claims development on old accident years) is usually segmented and treated as a separate class. If the latent claims data is excluded from claims development analysis of the entire class, the possibility of such development is being ignored.

Reserving problems feeding back into pricing

Another problem in pricing relates to the issue of reserving. In order to ensure the right feedback into pricing decisions, adequate reserves need to be held.



The diagram above illustrates this concept. If latent claims are initially priced for, reserves have to be set aside for them until they manifest. If they are not set aside, profit in early periods will be overstated, providing a message to society and management that prices are too high. Prices will drop, and the cost of latent claims will no longer be allowed for.

What is critical here is that the *central estimates* of the outstanding claims should contain the expected costs of the latent claims. Some survey respondents indicated that notional allowances were set aside in prudential margins for latent claims. From a pricing perspective this is inadequate in my view, as it is really only central estimates and historical paid that are considered by actuaries in determining an adequate price for new business.

5.2 Problems due to Market Pressures / Short Termism

For latent claims that insurers can foresee, a competitive market should theoretically allow participants to charge amounts for the risk covered. Most latent claims are difficult to predict however– and there would be a lot of complaints about charging for risks that may or may not be covered. In a competitive environment, loadings for latent claims that cannot be seen are the first thing likely to go in negotiations on price –unless everybody in the industry allows for it in a consistent way. Even if they are charged for, there will be difficult discussion on equity – who should bare the cost of paying for such uncertain claims?

Given the time horizons involved for latent claims to manifest, insurance industry participants today do not have as much of an incentive to adequately allow for latent claims as they do to allow for "normal" claims.

A final point worth making is that accounting standards do not of course allow for these to be funded on a pay as you go basis. Theoretically, insurers should be funding the cost of claims as they take on the risks.

5.3 Corollary – Are latent claims insurable?

Given the difficulties outlined above for pricing for latent claims, it begs the question if insurance companies should be covering them at all. In my view, latent claims fail two criteria of insurability[9]:

- "the frequency and magnitude must be assessable". As outlined above, there are many difficulties in determining the correct cost for latent claims.
- "the premium must be affordable". In a competitive market, it is something that is very difficult for individual insurers to justify the cost to customers.

[9] As taken from the "Actuarial Practice of General Insurance"

6 Current Practice and Thoughts on its Adequacy:

Shown below are results from the survey of industry actuaries and underwriters. Questions were asked to understand how the industry currently prices, reserves and otherwise deals with latent claims on current business, and what practitioners think of the current practices.

6.1 Survey responses on what industry practitioners do

Survey Responses: Do you consider latent claims in:	Yes	No
PRICING .	39%	61%
- across the board loadings	26%	74%
- loadings on high risk groups	9%	91%
RESERVING .	52%	48%
- explicit assumptions	26%	74%
- conservative assumptions	22%	78%
- prudential margins	22%	78%
TERMS .	50%	50%
BUSINESS SELECTION .	100%	0%

The pricing results shown are those from the 23 actuaries that responded. Most actuaries indicated that they did not allow for latent claims in their pricing recommendations. Those that did, mainly allowed for it through across the board loadings.

On the reserving side, about half the actuaries indicated that they allowed for it. There was an even spread between those that indicated that they allowed for it through explicit assumptions, through conservative assumptions and through reliance on prudential margins.

The questions on terms and conditions and business selection were asked to the underwriters. Only 50% of underwriters indicated that they used terms and conditions to limit their exposure to latent claims. Those that didn't however all worked in workers' compensation where limitations on coverage are not allowed. In liability classes, exclusions are used extensively to try and limit costs from latent claims.

Many respondents believe they control their exposures to latent claims through business selection. This is of course possible at the individual insurance company level. At the end of the day however, especially for statutory classes such as workers' compensation – everybody must have insurance – so somebody must be writing the risk!

Comments:

Outlined below are some interesting comments from the survey respondents. There is full list in Appendix A.

- *"As with catastrophe reinsurance, these liabilities will probably be financed in arrears by insurers".*[10]
- *"Latent by its very nature suggests an unknown exposure so there will always be insufficient data to accurately price such an exposure. Whilst allowance in pricing is made via the fact that there should be allowance in capital allocation and profit margins, some notional additional pricing may be allocated, but more likely to control through restrictive terms and conditions or business selection."*
- *"given the currently very competitive underwritten WC market, there is little scope to charge anything more than a trivial allowance"*

6.2 Survey responses on adequacy of current practices

Is the industry approach adequate for:			
	Yes	No	Not Sure
PRICING ?	4%	58%	38%
RESERVING ?*	29%	33%	38%

Has the industry learnt lessons from asbestos in:		
	Yes	No
PRICING .	36%	64%
RESERVING* .	55%	45%
TERMS .	82%	18%
BUSINESS SELECTION .	57%	43%

The above table shows combined responses from actuaries and underwriters. The questions on reserving were asked to actuaries only.

Very few respondents are willing to say that the current approach practiced in the industry is adequate for either pricing (4%) or reserving (29%).

The good news for the industry however is that most participants (82%) thought that the industry had learnt a lot from experiences with asbestos, with terms and conditions in particular being used to limit exposures. As mentioned earlier, reinsurers try and "predict" the next cause of latent claims.
In reserving and business selection as well, the majority that the industry had learnt something from asbestos experiences.

[10] This may not be a problem as long as markets have barriers to entry. Otherwise, new entrants would always have the ability to undercut established players that had emerging claims costs from latent liabilities. I would also argue that with asbestos, that other classes of business are paying for the cost of asbestos, not just those that contributed to the exposures.

Comments:

Outlined below are some interesting comments from the survey respondents.

- *“To a large extent the reaction of the industry has been retrospective. Only once the problem has been identified is a reaction made”*
- *“With pricing, ourselves (and other insurers from what we can gather) are establishing an emerging risks task force to explore issues and go beyond merely identifying an emerging risk but actually start to think about pricing implications. We presently have a list of some 40 risks including climate change, sexual abuse, genetically modified foods, mobile phones, EMF's that are being investigated for potential cost implications. Reserving remains a difficult and subjective area in respect of latent disease claims. This is likely to improve modestly with industry approaches and assumptions becoming more standard with the extra focus latent diseases will attract. Exclusions in the terms and conditions are the most commonly used method for managing unknown risks. Business selection is also the other method where concern over latent disease potential does lead us (sic) avoid some industries”*
- *“Industry generally responds to known latent exposures reasonably well by restricting terms and business selection, do not believe respond well to unknown latent exposures. However at a higher level short sighted focus on current year performance by senior management takes focus off future impact of such events”.*
- *“Not convinced that the industry's memory is very good or very long!”*

7 Are there alternatives to the current approach?

This section is not a detailed discussion of alternatives to the current practice. It is instead intended to cover a few initial options that could be considered for discussion with the view to reaching a more sustainable approach to dealing with latent claims.

7.1 Government coverage of latent claims

One alternative to the current approach is for insurers to decline coverage of latent claims by separating it from other types of claims. If society decided that there would still be need for a risk transfer mechanism to exist for the latent claims, governments would have to step in to fill the void.

Survey respondents were asked if they thought society was better served by insurance companies or governments covering latent claims. 28% indicated they thought insurers were a better option, 45% indicated that governments were better, and the rest did not express an opinion either way.

Advantages and Disadvantages of Government Involvement

Outlined below are some advantages of having latent claims covered by the government:

- From an insurance company shareholder's perspective if latent claims are not insurable risks, insurers should try to limit their exposure to them.
- From the claimant's perspective, governments will remain solvent and as such they will be guaranteed some compensation.
- Having the cost of latent claims reported to government will provide a pricing signal to society about whether the amounts paid as compensation are too high or too low. The cost would not be borne by one group (insurance sector) with deep pockets alone, where perhaps one generation of policy holders would subsidise another. If the levy to fund this is broad-based, there will be a natural lobbying group to make sure society is happy that an adequate but not too high an amount is being borne. Many determinants of cost latent claims are in the future, and by having government involvement provides a signal to society what the cost of compensation is.
- Governments have a lower cost of capital than the private sector, especially for something as risky as latent claims.
- Governments have very flexible funding alternatives. They can either fund upfront or pay as you go.

Some disadvantages of trying to have latent claims covered by government are outlined below:

- It is hard to get government buy-in of the need for state coverage. It can be very difficult to get in a climate where the government is trying to reduce its social security burden and involvement in the economy.

- Governments are inefficient at providing insurance??
- Deficits can build up, requiring cross subsidisation across generations (although arguably private insurers also do make losses that require cross subsidisation between different classes of business or generations of policyholders)
- There is scope for political interference that may distort adequate levels of compensation. It can be argued that courts are fairer at determining awards needed for compensation.

Fault or No Fault?

No fault compensation has some merits for latent claims, where the party at fault may be difficult to locate several years after causing the exposures that led to the damage. Of course, apart from this, legal costs may be able to be reduced by removing the requirement for proving fault. No fault compensation is easiest with government involvement in the scheme. Such arrangements of course only work well if the damaged party is an individual, rather than a corporate.

Funding

Government coverage would provide the opportunity for slightly different funding options. Decisions would have to be taken about how to collect money for paying for latent claims, including:

- Whether to fund directly through taxes, or to have a levy on insurance products
- Whether to pre-fund or have a pay as you go scheme

Examples from overseas

Germany is an example of a country where workers' compensation occupational latent diseases are funded separately from occupational accidents. The two levies on employers are determined and administered by different authorities.

In 2003 in the UK, the Association of British Insurers produced a submission to the Department of Work and Pensions' review of employers' liability insurance. In that, they requested the department to consider separating long tail occupational diseases from other claims. They make the following comments:

- "the problems of pricing premiums for unknown and unpredictable risks make employers' liability insurance unsustainable in its current form, particularly because of the extreme difficulties caused by long-term occupational diseases;"
- "insurers bear the risk of changes to the law or improved medical knowledge which can arise in the many years between the setting of the insurance premium and occupational diseases manifesting themselves and being held to be compensatable by the courts. It is impossible for this risk to be assessed and priced."
- "Because of the long period that can elapse between the time when a disease is caused at work and when a claim is made (sometimes up to 40 years), the UK courts are often faced with critical dilemmas. Society rightly wants compensation to be awarded. The courts can only do this if fault is established. But, once they have done this … their judgments create a

retrospective burden for insurers that could not have been paid for through insurance premiums."

7.2 Alternative Options for Insurer Coverage of Latent Claims

If liability is to remain with insurers, certain alternatives could be considered by the industry that would provide more certainty of the costs of the latent claims to insurers.

Modification of Coverage

Options for modifying coverage include:

- Declining coverage of latent claims through statutes of limitation, requiring claims to be reported within a specified period from the date of exposure. For classes such as workers' compensation it is not possible for insurers to do this currently, as the coverage they provide is determined by legislation. It is possible for liability policies, but would require some industry-wide approach to wordings so that it was clear to clients what was being covered. This may not be acceptable to society, as some claimants may not get any compensation if the party at fault no longer existed.
- Providing coverage for certain types of risks on a claims-made basis. This may not work well for workers' compensation without some modification, as claimants would not be able to claim from companies that were bankrupt, and therefore did not have insurance coverage. It would also mean that certain companies would face very high premiums when they started getting a flood of latent claims for past exposures.
-
- For liability classes, coverage could be provided on a named perils basis, which may limit losses from unknown latent claims.

Industry / APRA Mandated Approach in Allowing for Latent Claims

Options that could be considered include:

- Setting up a mutual company with industry capital specifically to fund latent claims. There would have to be a requirement or agreement that all participants in the market would reinsure their latent risks to the mutual company, and would be forced to pay premiums on new business that is in some way actuarially determined, to fund the latent losses. On an on-going basis, any shortfalls in past funding would be funded by the premiums on new business.[11]

[11] Of course, any liabilities incurred by insurance companies before the setting up of the mutual would have to be funded by themselves

- An industry-wide approach to pricing for latent diseases that is agreed and applied by all. There may be room to have standard wordings for coverage of latent claims, and for sharing of data to enable more data for pricing. For workers' compensation policies where rates are determined by government authorities, it may be necessary to convince statutory authorities of the necessity of allowing for latent claims.
- A similar agreement would be useful for reserving.[12]

7.3 Funding Principles

If options to try and fund for latent claims on an industry wide or government based approach are considered, the following criteria for assessing funding options may be useful.

- Sustainability: Any option shouldn't result in costs to one group at a particular point in time that are much too high for the benefits they receive.
- Clarity of Rules: Clarity for pricing, risk allocation and reserving, which types of claims (to avoid boundary disputes) will avoid disputes down the line. Rules for adjusting funds in light of experience, and for reserves to be set aside are essential.
- Polluter pays: This principle can be improved with incentives to limit latent diseases.

Simplicity: If the system of funding is too complex – there will be more room for argument, and more chances for the system to break down.

[12] There is a paper from the UK GIRO conference 2004 "Reserving for Unknown Liabilities" that deals with this very issue.

8 Other suggestions from the survey for changes

The following are general comments from the survey on changes needed.

- “The industry needs to make research and projections on latent costs available to all players to assist with adequate pricing. Also educate consumers, governments and industry groups as to these costs and how these exposures can be avoided. Lastly insurers need to hold these additional premiums as reserves to fund the latency as it emerges.”

- “Better gathering of data on latent claims, possible industry-wide sharing of data on such claims, improving monitoring of paid and outstanding amounts, monitoring of possible exposure to latent claims”

- “APRA forcing companies to declare their latent claims experience and provisions so that market can use all information to set appropriate provisions.” – and I would add for the insurers to be judged on those provisions.

- “Allow for some loading in prices in a more systematic way than currently - allow for it in reserves.”

- “The improvement would be to explicitly allow for unknown future latent risks. An industry discussion forum on these types of claims and agreement on how to deal with them would give some direction on how we as an industry can improve on allowance for latent claims. ”

9 Conclusion

It is apparent from the survey participation rate, and the content of the responses that practitioners believe that latent claims are an important issue for the insurance industry to address. It is also clear that many think that there is room for improvement on current practices. Given the current publicity surrounding latent claims, and the current healthy state of the industry, it is an opportune time to address the issue.

10 References & Useful Additional Reading

10.1 National Workers'Compensation and Occupational Health and Safety Frameworks – Productivity Commission Inquiry Report, No7; Mike Woods , Judith Sloan, Gary Johns; The Productivity Commission; 16 March 2004

10.2 Submission # 9, Brief to the Workplace Health and Safety ConsultationTask Force; Allen Kraut MD FRCPC Associate ProfessorDepartments of Community Health Sciences And Internal Medicine, University of Manitoba; November 28, 2001

10.3 Response of The Association of British Insurers to The Department of Work and Pensions Review of Employers' Liability Insurance; The Association of British Insurers; February 2003

10.4 Rating Systems. An internationa1 comparison of workers' compensation insurance systems; Munich Re Group; 2002

10.5 Reserving for Unknown Liabilities; Philip Archer-Lock (Chairman), David Bishop, Peter Clark, Colin Czapiewski, Richard Stock, Peter Taylor, Helen Wilkinson; GIRO; 2004

10.6 Occupational Diseases. How are they covered under workers' compensation systems?; Corporate Underwriting Global Clients Workers' Compensation Unit; Munich Re Group; 2002

10.7 The Cost of Compensation Culture – Jonathan Broughton, Brian Gravelsons, Colm Hensman, James Rakow, Julian Lowe (Chairman), Mark Malone, Grant Mitchell, Shreyas Shah; GIRO ; 2004

10.8 UK Asbestos. The definitive guide; Brian Gravelsons, Wendy Hawes, Sylwia Jakubowski, Anthony Kent, Julian Lowe (Chairman), Andy Macnair, Darren Michaels, Anita Morton, David Sanders, Philip Towell, Andy Whiting, James Widdows, Anthony Williams; GIRO; 2004

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10.10 Asbestos. The Perfect Storm; Michael E Angelina; November 11 2002;

10.11 Actuarial Practice of General Insurance; Hart, Buchanan and Howe; Institute of Actuaries of Australia; 1996.

11 Acknowledgement and Thanks

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John Boden, QBE
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Bill Konstantinidis, QBE

12 Appendix A – Summary of Survey

Survey on Latent Claims:

History Repeating?

This survey was carried out by Siddharth Parameswaran and Elaine Yang of QBE Insurance Australia. The results of the survey were collected for use in a presentation on latent claims[1] to the Institute of Actuaries of Australia's Accident Compensation Seminar on the 29th November 2004. It's aim is to help with understanding how the insurance industry currently deals with latent claims, and to ascertain whether participants in the industry believe the current approach is adequate.

The survey was sent to senior practitioners in the industry who have involvement with underwriting, pricing or reserving of classes that might be affected by latent claims. The results were collected by a "third party" to ensure anonymity, the purpose being to encourage more candid responses. Results were received from underwriters and actuaries from at least 4 insurers, 2 reinsurers and 3 consultancies.

A very big thank you must go to Andrew Smith of PricewaterhouseCoopers who very kindly put a lot of hard work into collating the responses for us. A big thank you also to all the respondents, many of whom took time to give detailed commentary on what they see as critical issues in the treatment of latent claims.

A summary of the results can be seen in the following pages.

Siddharth Parameswaran

Elaine Yang

[1] Claims with a very long lag between exposure to the cause of the claim and the time of report of the claim. Typically, this would be for periods greater than 15 years. This can make it difficult to estimate the number, size or source of the claims.

Overall Summary

The issue of latent claims is seen by most of the industry participants as being important to the long term financial condition of an insurance company. 93% of respondents indicated that the issue was either *somewhat important* or *very important*. Those that didn't said that latent claims were a very small part of the overall exposures of a company, and were swamped by other uncertainty.

Who did we survey?

We received responses from 6 underwriters and 23 actuaries. This included responses from at least 4 insurance companies, 3 consultancies and 2 reinsurers. The vast majority of the respondents indicated that they worked with long tail lines (mainly *employers' liability* and *public / products liability*). Actuaries that worked for a reinsurer were asked a slightly different questionnaire. Due to a low response rate for them however, their results were grouped with those for insurers.

What is the current treatment of latent claims like in the industry?

A clear majority of actuaries (61%) did **not** allow for the possibility of latent claims in the prices they set. Those that did mainly allowed for it through *across-the-board loadings*. 83% of underwriters however, indicated that they did allow for latent diseases in their pricing decisions. This suggests that perhaps on an individual risk basis notional allowances may be made for latent claims, but that there are few allowances for it at a portfolio level.

48% of actuaries indicated thavt they did **not** allow for latent claims in reserving current lines of businesses. Those that did said they did it through either conservative assumptions, explicit allowances and/or prudential margins. This figure of 48% may include some distortion of the intent of the question. Some participants indicated in their comments that they allowed adequately for dust disease liabilities (from the 1980's and prior), whereas the question was intended to see if they allowed for latent claims on current business.

50% of underwriters indicated that they minimised their exposure to latent claims through restrictive terms and conditions. Those that did not appeared to be working in employers' liability where it is impossible legally to have restrictive terms. All underwriters believed their selection criteria of risks would minimise the cost of latent claims. This perhaps is unlikely to hold true at an industry wide level for employers' liability - as a statutory class, every employer must be insured and the entire market cannot avoid taking on business that might be exposed to latent claims.

Is the current treatment of latent claims in the industry adequate?

Most (83%) underwriters did not think that the industry allowed adequately for latent claims in business written today, with one saying that he / she was unsure as it may have been done at a portfolio level. Actuaries were generally either unsure or did not believe that the industry's approach to latent claims were adequate in pricing (95%) or reserving (71%).

Looking forward – what does the industry think the effects and causes of latent claims will be?

As expected, all respondents suggested that the classes most likely to be affected in the future by latent claims were *Employers' Liability and Public / Products Liability.* Underwriters suggested the causes most likely to lead to future latent claims were:

- Chemical and environmental exposures
- Electromagnetic exposures
- Medical treatment/genetic manipulation

Suggested improvements on how insurers should treat latent claims include:

- more research, discussion, data gathering, modelling, education
- fund reserves through additional premiums
- change wordings/coverage
- lobbying for codification of awards rather than common law based awards

Some interesting comments

- "Competitive pressures would result in insufficient allowance in pricing for latent claims"

- "Current reserving practices do not allow for specific or general latency, particularly of new injury or disease types. Any additional premium collected to fund these latent exposures is therefore immediately released to profits rather than to reserves."

- "The industry needs to make research and projections on latent costs available to all players to assist with adequate pricing. Also educate consumers, governments and industry groups as to these costs and how these exposures can be avoided. Lastly insurers need to hold these additional premiums as reserves to fund the latency as it emerges."

- "Latent claims exposure is a very small proportion of the exposure which is swamped by other areas of uncertainty in pricing and reserving models. Theoretically the emergence of latent claims in historical data would already be driving the increased profits required from businesses prone to latent claims exposures."

- "Industry generally responds to known latent exposures reasonably well by restricting terms and business selection, do not believe respond well to unknown latent exposures. However at a higher level short sighted focus on current year performance by senior management takes focus off future impact of such events."

- “Theoretically, insurers can compensate for latent claims, but the (correctly priced) cost would be prohibitive due to the uncertainty. Ultimately, insurers can't guarantee they'll still be around to pay those latent claims in 15+ years time.”

- “Current industry pricing will not have any real allowance for significant future latent claims exposure. Whether this is adequate really depends on the ability of the industry to recoup any future latent claim losses from either the government, or from future generations of insurance customers..”

- “There may be a role for govt and insurers to openly share or plan for these exposures. There may be an opportunity to build community reserves similar to the earthquake funds built up in New Zealand over the last few decades.”

- “How does one price for an unforeseeable and unquantifiable peril? “

- If exposure is foreseeable (I would suggest that any on-going exposure to asbestos e.g., from renovators, is foreseeable), the companies creating that exposure and their insurers should be responsible for the cost of any claims that emerge). Not sure how you draw the line between the foreseeable and unforeseeable! When did the asbestos related problems become foreseeable? 1965? 1970? 1980? I think it was well before 1990!

Attachment 1

Summary of Survey Responses

Summary of Results

How important an issue to the long-term financial condition of a company do you think latent claims on business written today are? (Question 1 on the underwriters and actuaries survey)

	Underwriters	Actuaries
Very important	33%	17%
Somewhat important	67%	74%
Of Little Importance		4%
Not important		4%

Comments:

Underwriters

a) Important to the extent that those latent claim exposures are not fully identified and either avoided; reduced or managed; and or priced for in today's contracts. It is also important to identify the cost of the exposures and provide specific or general reserves to fund these future claims. Some jurisdictions through legislation or administrative practice transfer latent exposures to the current rather than past insurers. Current reserving practices do not allow for specific or general latency, particularly of new injury or disease types. Any additional premium collected to fund these latent exposures is therefore immediately released to profits rather than to reserves.

b) Latent exposures are a factor of business and should be allowed for in allocation of capital and setting of profit margins.

c) In the local environment we have seen the effects of Asbestos in society and when you look overseas to some of the troubles of say Royal & Sun a few years ago and the effect on their share price (although other events at the time also would have contributed) it is easy to see where our underwriting today could effect our company in the future. Of several possible "bogey - men" out there though which one if any will eventually manifest itself as a latent disease and in the short term how do you justify a building a reserve now for any one of them in particular. How do I as an underwriter convince a client any possible latent disease is a pricing factor now and I wish to charge them for it? Forgetting the fact I work for an Underwriter if I were a shareholder today would I necessarily care about 10 or more years from now. I might not own a share in an Insurer in the future, why should profit or dividends be kept from me now in aid a future shareholder?

Actuaries

a) The duration is so long that companies can adjust their reserves in regards to the new information from emerging experience. If they get it wrong there is time to correct it, in that payments are very uncertain and won't be made for many years. It goes without question that any known emerging exposures must of course be taken up fully in reserving.

b) As we have seen with asbestos, the emergence of latent claims can have both political and financial implications for companies and insurers. I therefore think companies should be considering the possibilities of latent disease in today's decision making processes

c) As with catastrophe reinsurance, these liabilities will probably be financed in arrears by insurers.

d) Exclusions should keep many of these costs at bay.

e) In many cases, having a diversified portfolio means that an insurer can often trade through periods of funding for latent claims. They represent a material impact on profitability rather than the balance sheet, which has remained strong for many insurers. This is not to say that future latent claims won't be of greater materiality, although underwriting standards and terms and conditions evolve very quickly to respond to prevent or exclude potential latent claims. Hence, although I'm quite worried about latent claim potential, I think it will only have a 'somewhat important' impact on the financial condition of insurers.

f) Theoretically important, as we should be providing fully now for future latent claims, but since their size and nature is totally unquantifiable, the outcome will probably be we will provide for them out of future income not current income, as we are for asbestos

g) There is potential for a 'non threatening' future latent claim scenario to emerge. I believe that a 'threatening' latent claims scenario has some chance of eventuating, but a somewhat remote chance and very difficult to quantify in any robust way.

Which classes of business do you work with? (Question 2 on the underwriters and actuaries survey)

	Underwriters	Actuaries
All		14%
CTP		8%
Employers' Liability	42%	27%
Public and products	29%	32%
Professional Indemnity	29%	8%
Short Tail		11%

When selling policies, do you consider the issue of possible latent claims emerging from business you write today? (Question 3 on the underwriters survey)

Yes 100%
No 0%

Comments:

a) Considerations include future latency as well as "past" latency exposures. Some jurisdictions force late onset injuries and diseases on to the current rather than past insurers.

b) Some potential latent exposures are known, however there will be other latent exposures that are unknown. At an individual risk level it is impossible to consider the unknown latent exposures.

c) Avoid some occupational activities (limited).

d) Yes, we are conscious of dust diseases in mining, carcinogenic substances in manufacturing and processing as well as passive smoking. But usually only consider it on larger accounts industries where it is obvious. There could be whole industries underwritten on a small employer basis where the penny has not dropped.

A) Do you attempt to minimise the costs of these through restrictive terms and conditions?:

Yes 50%
No 50%

B) Do you attempt to minimise the cost of these through business selection?:

Yes 100%
No 0%

C) Do you attempt to allow for the cost of these through pricing?:

Yes 83%
No 17%

Comments:

For A)

a) Workers' compensation legislation does not allow restrictions which diminish a workers access to statutory entitlements.

b) If the latent exposure is known, may minimise costs by restricting terms and conditions, excluding coverage, sub-limiting exposure or setting higher deductibles.

c) Our policy form is legislated.

For B)

a) Burners on risky policies, risk surveys, use of fac to remove some risk, get staff with experience looking at risky industries, endorsements.

b) If the latent exposure is known, may decline to accept business for certain occupations that have a potential high exposure to the latent claim.

For C)

a) Pricing, or increased pricing is used as a selection tool forcing the risk with latent exposure to the market and hopefully another insurer. Any penalty pricing is purely punitive and doesn't really reflect the expected cost of latency as predicting those costs and their timing is outside most underwriters abilities as research or cost indicators are not available.

b) Latent by its very nature suggests an unknown exposure so there will always be insufficient data to accurately price such an exposure. Whilst allowance in pricing is made via the fact that there should be allowance in capital allocation and profit margins, some notional additional pricing may be allocated, but more likely to control through restrictive terms and conditions or business selection.

c) Part of portfolio pricing.

d) Attempt is the key word here, what will the market allow to price the risk at? It is easier to control the exposure through selecting against the risk and not issuing cover to start with than gamble on "what is the right price for a latent risk"

In the classes of business you work with, do you address the issue of possible latent claims in business you write today in: (Question 3 on the actuaries survey)

A) Pricing? Yes 39% No 61%

If yes, is this through:

(i) across-the-board loadings? Yes 26% No 74%

(ii) loadings for perceived high risk groups? Yes 9% No 91%

(iii) other?

Comments:

a) Identifying the exposure and directing the underwriter to load for it.
b) conservatism in assumptions relative to historically available data.
c) Part of reason for high profit loadings on liability business.
d) Broadly. Usually no allowance for material "new" sources.

e) given the currently very competitive underwritten WC market, there is little scope to charge anything more than a trivial allowance

B)	***Reserving?***	Yes 52% No 48%

If yes, is this through:

(i) an explicit allowance for latent claims?	Yes 26% No 74%
(ii) conservatism in assumptions?	Yes 22% No 78%
(iii) an allowance in prudential margins?	Yes 22% No 78%
(iv) other?	

<u>Comments:</u>

a) Some or all of the above according to the situation
b) At present, asbestos is the only latent claim explicitly modelled and a provision established. We constantly monitor portfolio for the emergence of other latent claims and have usually made an appropriate allowance within the valuation (for example, sexual abuse claims).
c) only really an implicit allowance through conservative valuation tail factors and/or prudential margins.
d) (ii) above is a very blunt tool for reserving and generally does not work well.

C)	***Advice on terms and conditions?***	Yes 43% No 57%
D)	***Advice on business selection?***	Yes 35% No 65%
E)	***Other areas?***	

<u>Comments:</u>

a) The allowance made for latent claims is generally insufficient due to the considerable uncertainty involved and lack of data, even after some of these claims start coming to light.
b) I do make suggestions - but latent claims may not always be the most important thing on people's minds.
c) Latent claims are only a small proportion of the ultimate claims cost except for obvious areas of potential exposure.
d) Terms and conditions are more important than pricing for these type of costs. These are not generally set by the actuary.
e) A minor factor in capital management.

Do you believe the industry adequately allows for latent claims in business written today? (Question 4 on the underwriters survey)

Yes	17%
No	83%

Comments:

a) Employers liability market is restricted by regulators. They do not allow for it to be priced for.

b) The approach is to avoid it, ignore it but not to price it

c) Don't believe the industry clearly understands the financial impact of latent claims or makes adequate allowance for in profit margins.

d) I say yes and no, the risk could be identified at high management and actuarial level but I doubt the underwriter coal face thinks too hard about it.

Has the industry learnt lessons and changed its practices as a result of emerging claims experience of latent claims (from past exposures), in any of the following areas? (Question 5 on the underwriters survey and Question 6 on the actuaries survey)

	Underwriters	Actuaries
A) Pricing	Yes 33%	Yes 36%
B) Terms and conditions	Yes 83%	Yes 82%
C) Business selection	Yes 100%	Yes 45%
D) Reserving		Yes 55%
E) Other		

Comments:

Underwriters

a) Industry accepts that there are a lot of unknowns

b) Industry generally responds to known latent exposures reasonably well by restricting terms and business selection, do not believe respond well to unknown latent exposures. However at a higher level short sighted focus on current year performance by senior management takes focus off future impact of such events.

c) We only recognise the latency when it emerges, it is too late then. It is hard to select and price business on "a hunch, or gut feel" that may or may not occur.

Actuaries

a) Market pressure would prevent any attempts to allow of potential latent claims.

b) The industry reacts to the emerging scientific data that would point to latent claims. As the data emerges exclusions are inserted into contracts and certain classes are avoided. This has always been the way.

c) The industry is definitely more cautious.

d) To a large extent the reaction of the industry has been retrospective. Only once the problem has been identified is a reaction made

e) Legislation. Examples of Terms and conditions include ACOD clauses (dust and diseases) with progressive exclusions on asbestos claims and culminating in today's total exclusion.

f) Not convinced that the industry's memory is very good or very long!

g) Terms and conditions are the key. Question whether liability will always have this problem due to the open-ended definitions used.

h) Industry is more informed than it was 20 years ago. Especially reinsurers who attempt to "predict" future sources of latent claims

i) With pricing, ourselves (and other insurers from what we can gather) are establishing an emerging risks task force to explore issues and go beyond merely identifying an emerging risk but actually start to think about pricing implications. We presently have a list of some 40 risks including climate change, sexual abuse, genetically modified foods, mobile phones, EMF's that are being investigated for potential cost implications. Reserving remains a difficult and subjective area in respect of latent disease claims. This is likely to improve modestly with industry approaches and assumptions becoming more standard with the extra focus latent diseases will attract. Exclusions in the terms and conditions are the most commonly used method for managing unknown risks. Business selection is also the other method where concern over latent disease potential does lead us avoid some industries

j) Capital requirements - While there is little change at the individual class level, overall capital requirements meant that insurers are required to have the strength to withstand the unknown as well as the expected.

k) I think that reserving practice has certainly improved in recent years.

l) lessons partially learnt on reserving but not on pricing. unsure about (C) through (E)

Are there any improvements that you think insurers should make in their treatment of latent claims? (Question 6 on the underwriters survey and Question 7 on the actuaries survey)

Comments:

a) Codifying claims management so that wastage reduces.

b) Documenting exposure for latent claims - more formalised.

c) The industry needs to make research and projections on latent costs available to all players to assist with adequate pricing. Also educate consumers, governments and industry groups as to these costs and how these exposures can be avoided. Lastly insurers need to hold these additional premiums as reserves to fund the latency as it emerges.

d) Yes. Research, proactive thinking and modelling.

e) Better gathering of data on latent claims, possible industry-wide sharing of data on such claims, improving monitoring of paid and outstanding amounts, monitoring of possible exposure to latent claims

f) Allow for some loading in prices in a more systematic way than currently - allow for it in reserves.

g) They should lobby the government to put in legislation to deal with latent claims specifically and exclude them from the terms and conditions (e.g. statute of limitation).

h) APRA forcing companies to declare their latent claims experience and provisions so that market can use all information to set appropriate provisions.

i) Move to liability coverage on a 'named perils' basis.

j) Greater consideration of the implications of existing underwriting decisions on the future results of the organisation. Customer segmentation could highlight risks that may have a higher potential for latent claims and these could be monitored. Eg employers liability - an insurer insuring high volumes of the sales sector could monitor for mobile phone claims.

k) No. As they are latent, no one has any real idea of likelihood of the impact or the actual cost.

l) Be aware that it will probably happen in some area that was not thought possible previously.

m) The improvement would be to explicitly allow for unknown future latent risks. An industry discussion forum on these types of claims and agreement on how to deal with them would give some direction on how we as an industry can improve on allowance for latent claims.

n) An explicit allowance should be made. It will be a guess but at least it is something to work from.

o) Poor at identifying and handling asbestos

p) Some sharing of data might assist pricing and reserving

q) Not sure that insurers are sufficiently tapped in to latest research regarding the emergence of new types of latent claims. Early recognition is important to control via business selection and terms and conditions

r) Yes - better understanding of exposure.

s) An explicit allowance in reserving would be a theoretical improvement, but its size is only going to be guesswork

t) Industry needs to consider more fully the implication of future latent claims exposure in its pricing.

u) claim identification, data collection and exposure recognition

What do you think the next 2 major causes of latent claims will be? (Question 7 on the underwriters survey)

<u>Comments:</u>

a) chemically related - farming, mobile phone related, passive smoking
b) Chemical and environmental exposures. Electromagnetic exposures
c) Silica and toxic mould
d) Financial services/building industry,
e) medical treatment/genetic manipulation GMOs
f) EMF or something out of mobile phones and electrical equipment.

Do you think society is better served by insurance companies covering latent claims, or governments covering latent claims? (Question 8 on the underwriters and actuaries survey)

	Underwriters	Actuaries
Insurers	33%	26%
Government	33%	48%
Both/blank	33%	26%

Comment:

Insurers

a) Government is not experienced in managing such exposures, although has an important role to play in managing through OHS and QA. Insurers are in the business of accepting such risk and in the current legislative regime should have adequate capital protection to manage such risk.

b) Government funding will usually result in a tax on society as a whole.

c) I think it depends to some extent. If the total cost to society is too high, it becomes the governments responsibility. Also, the financing mechanism of insurers (i.e. in arrears) leads to the automatic payment for the cost by society.

d) If exposure is foreseeable (I would suggest that any on-going exposure to asbestos e.g., from renovators, is foreseeable), the companies creating that exposure and their insurers should be responsible for the cost of any claims that emerge). Not sure how you draw the line between the foreseeable and unforeseeable! When did the asbestos related problems become foreseeable? 1965? 1970? 1980? I think it was well before 1990!

e) There is a role for government if liabilities are created retrospectively by courts.

f) Generally insurers. But government scheme may be appropriate for catastrophic scenario - asbestos claims would fit in to this category

g) To rely on government to pick up the pieces seems an abrogation of responsibility of the private sector

Government

a) Government in some form will hopefully be around long after an Insurer has merged, been bought, sold and then liquidated sometime in the next twenty to fifty years. The cost is then also truly bourn by all society and no affected person will be left without some form of help. NOT COMPENSATION, JUST HELP.

b) The catastrophic nature of the latent claims and the long latent period mean that there is no guarantee the insurance companies which issue the policies would be around or have the ability to pay for it. The nature of latent claims is too uncertain for actuaries to price for accurately.

c) I believe a national personal injury scheme for all injury classes be set up. The cost ultimately ends up on society anyway through increase insurance under the current system and in social security when insurance payouts prove inadequate in the long term.

d) Theoretically, insurers can compensate for latent claims, but the (correctly priced) cost would be prohibitive due to the uncertainty. Ultimately, insurers can't guarantee they'll still be around to pay those latent claims in 15+ years time.

e) The problem with latent claims is that insurers write contracts without knowledge of the potential problems that may emerge many decades into the future. If a latent disease does emerge then the financial implications could be negligible or disastrous. How does one price for an unforeseeable and unquantifiable peril?

f) Insurance companies are even more short-term focused than governments. Any form of long term compensation is better dealt with by statutory bodies because the private sector will only want to pay out as little as possible. The weight of shareholders is typically far higher than the weight of needy claimants (as James Hardie have proven).

g) Latent claim costs can never be effectively insured as the estimate of cost is not able to be easily made prior to the event

h) the length of latency means that insurers are seldom around to pay up, while governments are.

i) Logical for government to cover risks which are not insurable given the inability to forecast these to any degree. Practically, government will not be keen to take on these risks.

j) either provided the approach is well considered and properly funded

Both

a) There may be a role for govt and insurers to openly share or plan for these exposures. There may be an opportunity to build community reserves similar to the earthquake funds built up in New Zealand over the last few decades.

b) Insurers with assistance from government. It is very difficult for insurers to estimate with accuracy extent of these claims in pricing and reserving (if no claims experience is present). Funding (via premiums) for these types of claims is sometimes done post event, which suggests some form of government assistance is required if insurance industry solvency, viability and sustainability is to be maintained. Although, it does introduce issues of inter generational equity and unfairness in terms of user pays concept. Insurers/reinsurers should allow for these claims in risk premium estimates, although the uncertainty from source of latent claims and their extent makes it difficult to estimate and justify to the cedants, the public, ATO, etc….

c) No preference - arguments for each.

d) I feel that latent diseases by their nature suffer from extreme uncertainty that makes it difficult and even undesirable to attempt to project today. The industry would be well served by having an agreement with the government to have the power to declare certain diseases as a 'latent disease' and establish a separate process for handling the claims and funding them. Insurers would be required to make a contribution from existing provisions based on an agreed approach (or as prescribed by the government) and a levy structure imposed to fund shortfall.

e) No opinion. Either can work

Which classes of business do you think might be affected by latent diseases? (Question 4 on the actuaries survey)

Employer's Liability	100%
Public and Products Liability	100%

All participants picked both classes of business.

Do you believe the industry's approach to (a) pricing and (b) reserving for latent claims in business written today is adequate? (Question 5 on the actuaries survey)

A) Pricing	Yes 4%	No 48%	Unsure 48%
B) Reserving	Yes 29%	No 33%	Unsure 38%

Comments:

Pricing

a) Competitive pressures would result in insufficient allowance in pricing for latent claims

b) An actuary can only set rates and reserves on what is considered likely. Latent claims exposure is a very small proportion of the exposure which is swamped by other areas of uncertainty in pricing and reserving models. Theoretically the emergence of latent claims in historical data would already be driving the increased profits required from businesses prone to latent claims exposures.

c) Not particularly familiar with how the insurance industry is dealing with this issue in respect of current exposures - if it was me, I'd try to exclude it!

d) Probably addressed more in underwriting and policy conditions than by pricing.

Reserving

a) Latent claims would probably be allowed for in the catastrophe loading, but it is hard to determine what is an adequate allowance since we don't know what it is yet.

b) This seems to be the case from the latent claims that have emerged on old business e.g. asbestos related reserves. Although, for current business it is very difficult to ascertain what future latent claims will arise, and attempt, based on nil data, to quantify some reasonable assumption on their occurrence, claims frequency and average claim size.

c) We do the best we can with the data available but virtually by definition the data are not sufficient to enable reliable estimation, so the answer is "it depends what you mean by 'adequate'".

d) Risk margins are the appropriate way of reserving for these type of issues. You can't do much more as by definition these types of risks are not quantifiable.

e) From a fully-funded perspective, the answer is clearly No. The reason why I am also Not Sure is that I am coming more to view that some problems, such as asbestos, are best funded on a pay-as-you-go basis. This is because: (a) at best, loadings for latent claims will be arbitrary; and (b) the eligibility and access to compensation occurs at 'future' standards, which can also only be arbitrarily forecast.

e) I suspect it is not even addressed. Most claims runoffs only go for a max of 20 years so latent claims are completely ignored unless explicitly allowed for.

f) Current industry pricing will not have any real allowance for significant future latent claims exposure. Whether this is adequate really depends on the ability of the industry to recoup any future latent claim losses from either the government, or from future generations of insurance customers. Reserving adequacy now seems reasonable given the current knowledge about latent claims, however there is an obvious and not insignificant chance that current reserves will be inadequate.

g) reserving techniques improving rapidly.

Underwriters Survey on Latent Claims

1 How important an issue to the long-term financial condition of a company do you think latent claims on business *written today* are?

Very important ☐ Somewhat important ☐ Of little importance ☐ Not important ☐

Comment / Explain:

2 Which classes of business do you work with? (APRA classes)?

Response:

3 When selling policies, do you consider the issue of possible latent claims emerging from business you write *today*?

Yes ☐ No ☐

Comment:

- Do you attempt to minimise the costs of these through restrictive terms and conditions?:

Yes ☐ No ☐

Comment / Explain:

- Do you attempt to minimise the cost of these through business selection?:

Yes ☐ No ☐

Comment / Explain:

- Do you attempt to allow for the cost of these through pricing?:

Yes ☐ No ☐

Comment / Explain:

4 Do you believe the industry adequately allows for latent claims in business *written today*?

Yes ☐ No ☐

Comment / Explain:

5 Has the industry learnt lessons and changed its practices as a result of emerging claims experience of latent claims (from past exposures), in any of the following areas?

(a) Pricing ☐

(b) Terms and conditions☐

(c) Business selection☐

(d) Other (please specify): Response:

Comment / Explain:

6 Are there any improvements that you think insurers should make in their treatment of latent claims?

Response:

7 What do you think the next 2 major causes of latent claims will be?

Response:

8 Do you think society is better served by insurance companies covering latent claims, or governments covering latent claims?

Insurers☐ Government☐

Comment:

Attachment 3

Actuaries Survey on Latent Claims

1 How important an issue to the long-term financial condition of a company do you think latent claims on business *written today* are?

Very important ☐ Somewhat important ☐ Of little importance ☐ Not important ☐

Comment:

2 Which classes of business do you work with? (pick two max)

Response:

3 In the classes of business you work with, do you address the issue of possible latent claims in business you *write today* in:

(a) Pricing? ☐

If yes, is this through:

(i) across-the-board loadings? ☐

(ii) loadings for perceived high risk groups? ☐

(iii) other? Response:

(b) Reserving? ☐

If yes, is this through:

(i) an explicit allowance for latent claims? ☐

(ii) conservatism in assumptions (relative to historical trends)? ☐

(iii) an implicit/explicit allowance in prudential margins? ☐

(iv) other? Response:

(c) Advice on terms and conditions? ☐

(d) Advice on business selection? ☐

(e) Other areas (please specify)? Response:

Comments:

4 Which classes of business do you think might be affected by latent diseases? (max 2 classes)

Response:

5 Do you believe the *industry's* approach to (a) pricing and (b) reserving for latent claims in business *written today* is adequate?

(a) Pricing

Yes ☐ No ☐ Not Sure ☐

(a) Reserving

Yes ☐ No ☐ Not Sure ☐

Comment:

6 Has the industry learnt lessons and changed its practices as a result of emerging claims experience of latent claims (from past exposures), in any of the following areas?

(a) Pricing ☐

(b) Reserving ☐

(c) Terms and conditions ☐

(d) Business selection ☐

(e) Other? (please specify) Response:

Comment / Explain:

7 Are there any improvements that you think insurers should make in their treatment of latent claims?

Response:

8 Do you think society is better served by either insurance companies or governments compensating for latent claims?

Insurers☐ Government☐

Comment / Explain: