

Can FAIR bring finality?



The prospects for a revived FAIR Act would appear to be brighter under a second Bush term. But can the proposed fund bring finality for insurers? **Graham Jackson**, member of the steering committee of IntAP, assesses its likely impact

The concept of a trust fund to provide financial resources for social welfare is a common one adopted by the governments of developed countries. Usually, there is a tax imposed on the industry concerned and in return the government assumes responsibility for all or part of the ongoing liability. Responsibility for the liability may formerly have rested with that industry but if that liability cannot adequately be discharged, or there is a perceived inequity, the government may well step in.

In the US, compensation for individuals injured through the use of asbestos is clearly a situation where the industries concerned, including their insurers, cannot fully meet the claims that have arisen and the system by which these are settled can truly be described as inequitable. Victims condemned to a slow and painful death through mesothelioma are not, as one might expect, 'fast tracked', whereas individuals exposed to asbestos but not suffering any adverse health effects are placed equally in line for payments. Along

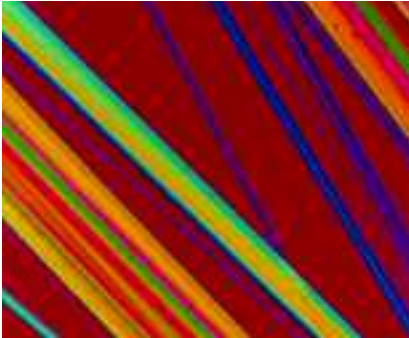
the way, plaintiff law firms win substantial fees. In 2002 a study by the Rand Association estimated that asbestos claimants received only 43 cents for every dollar spent on litigation, with the rest going to lawyers and on other transactional costs.

Fund proposal

The fund proposed under The Fairness in Asbestos Injury Resolution Act of 2003 (S.1125), a bill 'to create a fair and efficient system to resolve claims of victims for bodily injury caused by asbestos exposure', differs

from a classic trust fund in one significant respect: the US Government does not intend to assume any liability but rather to create an environment where the truly sick receive timely compensation and less of the available dollars are frittered away in legal expense.

The FAIR Act failed to become law in President Bush's last administration but following the November 2004 elections and subsequent Republican gains in the Senate there is now cause for optimism that the Act may now become reality, under the direction of Senator Arlen Specter, present chairman of the Senate judiciary committee. Even if this repeat attempt fails, the seriousness of the problem has now attained such a



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profile that US asbestos reform of some kind is inevitable. Nevertheless, the future debate is likely to be highly partisan and some Democratic support will still be needed for the FAIR Act, or its successor, to become law.

Asbestos court

The 2003 FAIR Act would have created a United States Court of Asbestos Claims and an Asbestos Claims Resolution Fund, intended to be the sole remedy for asbestos bodily injury claims in the US. The size of the fund, originally proposed at \$90 billion had been negotiated up to \$140 billion by February of 2004. Insurers and reinsurers would contribute \$46 billion over 27 years. Absent any agreement between these risk carriers as to how they would share this burden, a levy upon those with a past record of

having paid in excess of \$1 million in asbestos claims would be calculated and enforced through an Asbestos Insurers Commission of five Presidential appointees.

When debated in the previous administration, the \$140 billion appeared to be in the 'ball park' of acceptability to both industry and its insurers on the one hand and the unions, on behalf of the claimants, on the other. However, a significant factor in the insurance industry later withdrawing its support was the lack of 'finality' in the proposals.

With no safety net provided by the US government, the most obvious threat to finality is that \$140 billion proves insufficient and the hat is passed around again. Given that the actuarial profession has been unable to demonstrate that any of its previous predictions for asbestos' ultimate cost have been sufficiently accurate, there are reasonable grounds for scepticism. Judge Edward Becker, a former chief of the 3rd US Circuit Court of Appeals in Philadelphia, who was co-opted by the Act's sponsors to mediate between the industry/union factions, recently said the parties are going to have to accept some uncertainty:

'We will never solve [the question of how numerous and how expensive future asbestos claims will be]. We just have to make some informed predictions.' Written into the latest version of the Act is the proviso that valid asbestos claims would revert to the tort system in the event the fund is exhausted and claims remain unpaid after 300 days. Although Judge Becker's pragmatism is laudable, 'uncertainty', in return for handing over all their asbestos reserves, is not a welcome prospect for insurers.

Black lung fund

The last occasion when the US Government attempted to deal with industrial disease by trust fund legislation was not encouraging and indeed, discomfiting parallels may

be drawn between their approach to funding black lung (pneumoconiosis caused by the inhalation of coal dust) claims and that proposed in the FAIR Act for asbestos victims.

In 1978 the Black Lung Disability Trust Fund was created with the purpose of compensating affected miners when no responsible mine operator could be assigned the liability. This is a characteristic shared with asbestos claims, where, through latency, the injuries are difficult to assign to a particular asbestos product. Based upon the tonnage of coal mined, the mining industry was levied an excise tax to provide for the trust fund. However, as of April 2004, the fund's liabilities exceeded assets by \$8.2 billion. Unless there is fundamental reform, the Black Lung Fund is expected to be in debt to the tune of \$50.3 billion by 2040 (Source: US Department of Labor).

Where did it all go wrong and can any lessons be learned? Clearly, those responsible for estimating the volume of non-assignable black lung claims failed to hit the mark, or come anywhere near it. (Another worrying similarity with asbestos). By 1981, in just three years, Congress had already voted to double the excise tax in an attempt to keep up with the fund's requirements.

Another accused in the black lung debacle is organised labour. Just before he left office in 2001, under lobbying from the unions, President Clinton relaxed the rules governing the admissible evidence for establishing injury, making it harder for the mine operators to challenge the miners' claims. Proposed remedies to adequately resource the Black Lung Fund include extending the excise tax indefinitely, which was otherwise due to end in 2014 with the taxpayer funding \$8 billion of the deficit.

One of the key issues affecting the passage of the FAIR Act, from the perspective of industry and its insurers, will be the politically neutral United States Court of Asbestos

Claims. The danger of having the fund administered by the US Department of Labor, as is the Black Lung Fund, would be the potential for moving the goal posts on claimant eligibility in the future, as a result of political pressure from the unions. For example, the issue of whether asbestos claimants with lung cancer, who were once cigarette smokers, should be equally eligible for payments under the FAIR Act is one that is seriously affecting the current debate and could be prone to tinkering in the future. Moreover, the billions of asbestos particles allegedly entrained following the 11 September 2001 collapse of the New York World Trade Center may create a second wave of victims just as the 27 year life of the fund draws to a close. It is highly unlikely, given the emotive nature of the 9/11 tragedy, that these potential victims would be excluded from compensation under the Act by some unforeseen technicality.

London's concerns

Finality for all latent exposures is the Holy Grail for insurers and reinsurers, and asbestos, with its magnitude and volatility, is top of the list. In the London market those entities and groups charged with attaining this goal are watching FAIR Act developments closely. Equitas, the company

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set up to provide finality for Lloyd's 1992 and prior exposures, is concerned because the draft Act has singled it out for exclusion from the hardship relief that other insurers will be offered if bankruptcy looms. The reason given by the Act's drafters is that it is the individual Lloyds' names, who are reinsured by Equitas, that are primarily liable. If the Lloyd's policies at issue were sold

to US corporations on the basis of those names' unlimited liability this does not seem an unreasonable argument. On the other hand, some US insurer groups, such as Cigna (now ACE), have similarly ring fenced their own long tail liability problems in the past without any guarantees that policyholders will not be prejudiced yet they would be entitled to bankruptcy relief under the proposed Act. What is most disturbing though is the possibility, as reported in the financial press, that Equitas' asbestos reserves are potentially inadequate. Equitas' analyses and understanding of its asbestos exposures are thought to be the most thorough in London and its asbestos survival ratio (the number of years that reserves can sustain payments based on the average of the recent past years) is considered to be a market benchmark who other insurers should try to attain.

The two most popular methods of seeking finality in the London market are currently through commutation of the exposed policies or treaties or a court sanctioned scheme of arrangement that facilitates creditor-approved commutation en masse. David McGuigan, chairman of the London based Association of Run-Off Companies, has been reviewing developments with concern: 'From what I have read of the

latest version of the proposed Bill it still allows recourse to the courts if the fund runs out. This appears to give no finality at all and will thus not make commutation or scheme negotiations any easier. Indeed the actuarial data for any company contributing will become somewhat distorted, if it is available at all, and this may actually make negotiations even more complex.'

Likewise John Wardrop, a partner in KPMG: 'We are closely monitoring the developments in the US. Our clients who are either considering solvent schemes of arrangement, or are already in the process of promoting such schemes, are concerned to understand exactly how any new legislation in the US would impact

pean reinsurers that includes 'assisting our members to finally dispose of its latent claims exposures' in its mission statement, is directly engaged with key groups, such as the US insurers that are in favour of the Act and the Reinsurance Association of America. Attitudes to the FAIR Act within IntAP vary considerably with

ent jurisdictional isolation from the US the long reach of the proposed Act would nevertheless attempt to assess and recover contributions from any IntAP member with a past asbestos payment record exceeding \$1 million.

The prospect of an Asbestos Insurers Commission deciding how much you, as an insurance or reinsurance company, will pay into the fund is not appealing. Therefore, if the Act goes through, a market approved allocation formula is high on the agenda for the industry. However, if all you receive in return is a ticket to a lottery where the prize drawing is 27 years hence one can understand the resistance. Craig Berrington, general counsel for the American Insurance Association, put it very well recently to the Senate hearing: 'There must be finality and certainty, the fund must be the exclusive remedy for resolving asbestos claims and there should be no leakage into the tort system'. ●

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them. From these and other discussions we have had it is also clear that it may be difficult to obtain consensus on the level of contribution to be made to any fund by each insurer in the market. Resolving such issues may be an extremely lengthy and potentially costly process.'

The International Alliance of Asbestos and Pollution Reinsurers (IntAP), an association of 38 Euro-

some of the larger companies, particularly those with extensive US interests, taking a supportive line whilst some smaller companies are hinting strongly that they will not contribute willingly. An interesting feature of IntAP is that it deliberately excludes US companies from membership and it only concerns itself with members' claims emanating from the London market. Notwithstanding its appar-