CPCU—CHAPTERGRAM
PHILADELPHIA CHAPTER
THE SOCIETY OF CHARTERED PROPERTY & CASUALTY UNDERWRITERS

VOLUME 19, NUMBER 4 Peter F. Palestina, CPCU—Editor JUNE, 1986

George L. Head, Ph.D., CPCU, CLU Receives Franklin Award

The Chapter's 4th Annual Franklin Award was presented to Dr. George L. Head at a special luncheon in honor of the occasion at the Hershey Hotel in Philadelphia on April 29th.

Some 95 plus CPCUs and friends of Dr. Head came out to honor the noted author, columnist, and Vice President of the American Institute for Property and Liability Underwriters.

The keynote speaker was David C. Woodward, President and Chief Executive Officer of the Reliance Insurance Company. The award itself was presented by Chapter President Vince Phillips, CPCU.

Other guests seated at the head table for this occasion were James W. Hamilton, CPCU, CLU, Executive Vice President of the Society of CPCU; Edwin S. Overman, Ph.D., CPCU, President of the American Institute for Property and Liability Underwriters and the first recipient of the Franklin Award; Mariellen Whelan, Ph.D., Executive Vice President of the Insurance Society of Philadelphia and the second recipient of the Franklin Award; and Philip N. Spinelli, CPCU, past president of the Philadelphia Chapter of CPCU; and Pamela Godwin, CPCU, President Elect of the Philadelphia Chapter, who also gave the invocation.

Dr. Head was specifically cited for his leadership role in the field of continuing education and involvement in the risk management field both in practice and in theory. As Chapter President Vince Phillips so aptly stated when presenting the award, "George epitomizes the very reason for which the Franklin Award was created."

Chapter President Vince Phillips tells the audience why George was selected for the Franklin Award.

A standing ovation for George Head, Ph.D., CPCU, CLU

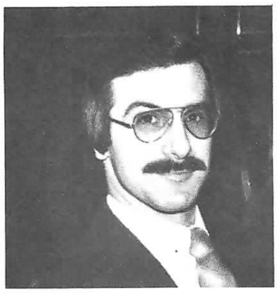
Franklin Award 1986 recipient George Head flanked on the left by the 1984 recipient, Mariellen Whelan, and on the right by 1983 and first recipient Ed Overman. Standing in background: Vince Phillips, Philadelphia CPCU President and Pam Godwin, President Elect of the Chapter.

New Officers and Directors Elected at the April 7th Business Meeting

During the April 7th meeting the following officers and directors were unanimously elected for the term beginning July 1, 1986.

President	: *Pamela H. Godwin, CPCU*
First Vice President	: *Albert P. Federico, Jr., CPCU*
Second Vice President	: *John J. Kelly, CPCU, CLU*
Secretary	: *Raymond E. Lindsey, CPCU, CPA*
Treasurer	: *Joseph L. Folz, CPCU*
Director 2 years	: *Theresa Macko, CPCU*
Director 2 years	: *Bruce L. Kelly, CPCU*
Director 1 year	: *Ronald Vogrin, CPCU*
Director 1 year	: *Joseph M. McNasby, CPCU*

President Vince Phillips announces election results for the next administration at the April 7th meeting. Standing in recognition are Ray Lindsey (Secretary Elect), Al Federico (First Vice President Elect), Pam Godwin (President Elect), and John Kelly (Second Vice President Elect).



Vince Phillips
President

President's Corner
BOTTOM LINE: IT'S YOU

The 1985-86 year has been a very exciting one for the Chapter, and for me personally. The caliber of our gatherings and topic matter; a highly successful Candidate Development Program (a prototype); as well as the spinning off, once more, of a soon to be new Chapter in Wilmington *(congratulations Paul and the Steering Committee)* are but a few of this year's highlights.

The Philadelphia Chapter is a LEADER. It's seen in this light by other Chapters; insurance organizations in Philadelphia, and others. We are a strong, energetic and formidable presence in the Delaware Valley. A reliability not to be taken lightly nor treated with apathy!!

The innovation and drive of this Chapter is something others have seen, in some cases (now) participate with us, and I hope will continue to seek. Yet it's sometimes a fact that we lose sight of because of our familiarity...

"Bottomline: You...are the innovation,...the drive,...the leadership, EACH ONE...!!

Congratulations!! to our newest CPCU designees. We look forward to seeing 'ya in Atlanta!!

April Meeting Update
HENRY A. WALSH, JR. EXPLAINS THE CURRENT REINSURANCE PROBLEMS

ARTICLE CONTRIBUTED BY: The P.R. Committee

The topic of conversation at the April 7, 1986 Breakfast Meeting was the current reinsurance problem. We were enlightened and entertained by the presentation of Henry A. Walsh, Jr., Senior Vice President, Reliance Reinsurance Management Company. As a point of general information, Mr. Walsh advised us that the Reinsurance Association reports net premiums of roughly $8,900,000,000. This figure does not include premiums that are ceded overseas. Of this amount 90% is commercial insurance, and a large portion of that is liability insurance.

In explaining some of the problems of the current reinsurance market, Mr. Walsh shared with us many graphs depicting the extremely long lag that the reinsurance market experiences in realization of claims that it writes in liability areas. Using the example of liability insurance, we were shown that, while a primary insurer may realize 90% of its incurred losses after 9 years, the reinsurer may only realize 50% of its potential loss by this time. When we consider the many layers of retrosession that may be involved, it is staggering to think that the final reinsurer may realize only 10% of their incurred losses 7 years after coverage is written.

This excessively long tail presents special problems in pricing of reinsurance. The trending and development factors used become particularly important. Mr. Walsh shared with us a unique prospective on IBNR, dividing it into IBNER—Incurred by not Enough Reported (Reserved)—and IBNYR—Incurred by not yet Reported. But, as Mr. Walsh pointed out, the material effect is the same.

The most frightening aspect of Mr. Walsh's presentation was the likely insolvency of some of our reinsurance markets. The surplus of the reinsurance companies reporting to the reinsurance association is 4.7 billion dollars. When looking at the long tail of many classes of liability insurance, these companies could have reserve inadequacies many times that figure. It was Mr. Walsh's anticipation that of the twenty or so companies reporting to the Reinsurance Association four of them would be insolvent within the next few years. In fact, Mr. Walsh reported that much of the large reserve increases the companies are putting up include substantial sums for re-insurance write-offs.

In his concluding remarks, Mr. Walsh offered the Claims Made Policy as a solution to the long tail problem.

Harry Walsh, Jr., Senior Vice President, Reliance Management Co. prepares to address the April 7th crowd on the subject of current reinsurance problems.

Part of the audience attending the April 7th meeting.

Holding their Personal Sponsorship Awards at the April 7th meeting are Art Hanebury, Bill Simonton and Joe Folz flanked to the left by President Vince Phillips and to the right by Director Joe McNasby. Jim Hamilton, who also received the award, could not be present. (See page 5 for related article)

See you in Atlanta

The Society of CPCU's 42nd Annual Meeting and Seminars begins on Sunday, September 28 and concludes on Wednesday, October 1, 1986 in Atlanta, Georgia. Under the theme **"Innovation: Meeting Today's Challenge,"** a dynamic array of top insurance practitioners and business leaders have been assembled as speakers and moderators for 13 seminars. These panel discussions will focus on recent developments and new technologies in the fields of risk management and insurance.

We encourage our chapter members to attend and hope to see you there.

Congratulations to Our New Completers

Congratulations are in order to the following six persons who have completed their CPCU courses in early 1986. We hope to see them at our meetings and in September at the National Convention in Atlanta.

William P. Curtis, Jr.
Seth D. Freudberg
John L. Jud
Joseph W. McCrea
Samuel B. Priddey
Lee Topps

A Message to the Membership

BY: JOHN J. KELLY, CPCU, CLU
Chapter Secretary

John J. Kelly, CPCU, CLU

During the April breakfast meeting, the officers and directors for the CPCU chapter year 1986-1987 were elected. Hopefully, the fact that no member dissented with the slate of candidates indicates that the nominees were considered to be the best CPCUs for the job of achieving a position of honor for the Philadelphia Chapter-CPCU.

Alas, that is likely to be "wishful thinking." The reality of the situation is that very few members of the chapter are willing or able to devote the time and energy to chapter affairs. This unfortunate fact is not unique to the CPCU chapter; voluntary organizations of all types suffer from what must be termed "membership apathy."

There's little doubt that the demands of our jobs (you know, those migraine-causing hobbies that pay the mortgage, etc.) leave too little time to devote to our families and our other passions; the thought of contributing time to the CPCU chapter sends a shiver up and down all but the strongest spines. However, each member would be wise to consider why he or she went to all the trouble to become a CPCU if he or she is not continually seeking to achieve the idealistic goals which are the heart of the designation.

Perhaps an honest response would indicate that many members were seeking to improve their economic position, and that they were disillusioned if the designation did not automatically and immediately lead to a sufficiently higher compensation level. Alternatively, perhaps they gave every last drop of spiritual fluid to the rigorous process of achieving the designation, and are now among the ever-growing number of "Burnouts."

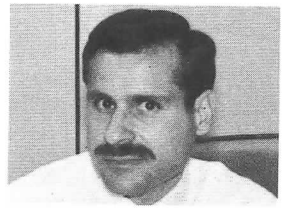
These are sad and alarming thoughts, because the state of affairs of the risk and insurance management community are in greater disarray now than perhaps any other time in history. You all know the problems; what we need are solutions. If the CPCU is the consummate insurance professional, it makes sense that the CPCU should be expected to provide the impetus to finding the solutions.

Some years ago, it was common to hear the opinion that the insurance industry was able to hire only those who could not find employment in other industries; the inference was that the industry was filled with the dregs of society. You might agree that the problems the industry faces today will not be solved by dregs. At no other time has there ever been so great a need for intelligent, informed and motivated people. The Philadelphia Chapter-CPCU will continue to exist only if it can expect its members to fill this need.

If you are wondering how to get involved in the chapter affairs, please call any of the officers or directors. We need your help in constructing programs for membership meetings and seminars; in assisting candidates for the designation; in so many projects. We'd also like to see you involved in the various social and community activities that are part of our affairs. In short, we'd like to think that the membership believes that the designation is something to be proud of; we'd like to think that the time and effort expended by the relatively small number of active members are not for naught.

"Another Year"

BY: AL FEDERICO, JR.,
Program Chairman



Al Federico Jr.
2nd Vice President

In most volunteer organizations, moving "up the chairs" is a common practice and it is no different in the Philadelphia Chapter. Although there are elections which solicit any member, in fact it just doesn't work that the escalator rise of the current officers is stopped. Not that this is bad, mind you, since the number of volunteers are not as many as you might think and there is an extensive learning process in managing a viable functional organization the size of our chapter. This all leads me to my point — I MADE ANOTHER YEAR!

Each year requires new duties and although all important, the post of Program Chairman usually allows one to strut his/her "stuff." It also allows one to provide a stage for all the world to see how Failure looks closeup. I have always found that delegation of duties in a volunteer organization is very difficult and thus I decided to essentially run a one-man show. That is not to say I did this completely alone. I did get invaluable assistance from John Kelly and Peter Palestina and support from a host of others. I was blessed by speakers that essentially knew their topics, could speak somewhat articulately, but most important, they all, I repeat, *all* showed up on time (except the one snowout). Waiting for your speakers gives a whole new meaning to sweat (I should be used to it since I do work for Swett & Crawford). Developing timely topics, knowledgeable speakers in various formats (not to mention a good breakfast) to enhance our education and professionalism was my intent and goal. Only YOU will be my judge if I have succeeded but I must say that now that the year is over I enjoyed every bit of it. I want to thank the regulars that come to every meeting as they provide the support and base that every organization needs. So to everyone I hope you enjoyed it as I look forward to "another year," next year as First Vice President.

If you have any questions, please call me.

Best Regards,

Al

THE FOLLOWING IS A RECAP OF THIS YEAR'S PROGRAM

September 11, 1985	**The Companies Speak Out**
October 11, 1985	**Coping with Chaos - A Broker's Point of View**
November 11, 1985	**D&O and Pollution Liability**
December 11, 1985	**The CGL Claims Made Policy - Points of View**
January 7, 1986	**Excess & Surplus Lines**
February 7, 1986	**Legislative View from Harrisburg** *(Joint with CLU)*
March 7, 1986	**Tort Reform - Myth or Reality?** *(Joint with RIMS)*
April 7, 1986	**Current Reinsurance Problems**
April 29, 1986	**The Franklin Award -** *presented to George L. Head, Ph.D., CPCU, CLU*
May 7, 1986	**Claims - The Nether World**
May 13, 1986	**Franchising for Small Businessmen** *(Joint with Bucks County CPAs)*
June 3, 1986	**Business Meeting -** *Speaker to be Announced*
June 13, 1986	**Spring Social -** *Cruising Down the River on board the "Spirit of Philadelphia"*

David Woodward, President Reliance Insurance Co. Addresses Franklin Award

The following is the text of the address given by Mr. Woodward at the April 29th Franklin Award luncheon.

Let me confess to considerable nervousness in carrying out my task as speaker at a luncheon honoring such a distinguished insurance industry figure as George Head, in front of a group of industry professionals.

There is a terrible irony that someone like myself, still a comparative newcomer to the industry, should even be on the same program as George, one of the most respected and learned experts in his field.

When the invitation arrived, I figured that the Society's computer had gone on the blink and that my name had somehow gotten mixed up with that of someone who was both an insurance company president and expert on insurance. However, after some reflection, I realized that was impossible.

So, perhaps the Society has some other motive in inviting me. Perhaps they felt that by allowing an untrained, non-CPCU insurance executive to air his ignorance in the shadow of one of their staff, such as George, it might work wonders for enrollment.

So, there it is. The reason you have me here today is to make an audience of CPCUs realize that all that time they spent studying was not completely wasted.

Having disclaimed any pretensions whatsoever to knowing anything

(continued)

March Joint RIMS Meeting

Tort Reform—Myth or Reality?

ARTICLE CONTRIBUTED BY: The P.R. Committee

March 7, 1986, was the date for the Joint CPCU RIMS Breakfast Meeting. The topic of discussion was one of key importance to both insurance and risk management professionals—Tort Reform. Addressing the subject of Tort Reform was Mr. John P. O'Dea, Esq., Partner, Stradley, Ronon, Stevens & Young; Mr. William W. Spalding, Partner, Fell & Spalding; and Ms. Kathleen M. Turezyn, Assistant Professor of Law, Windern University and Delaware Law School.

Mr. O'Dea addressed the subject of Tort Reform from the viewpoint of the plaintiff's attorney. He advised us that no data had been developed that supported a need for Tort Reform. That is not to say it isn't needed, rather that the supporting data has never been collected. He then shared some staggering numbers that were supplied by the Insurance Information Institute. The figures deal with the number of Bodily Injury Claims filed in Federal Court. In 1940, the number of suits brought were $000,000. This number had increased to $206,000 in 1982. As a matter of fact, the 1982 figure is $26,000 higher than the 1981 figure, roughly a 14% increase.

Probably even more enlightening, were the figures that Mr. O'Dea shared with us regarding jury awards of $1,000,000 or more. In 1962, there was one such award. In 1983, the number grew to 360. This is more than one per working day. And again, keep in mind that this does not include settlements of $1,000,000 or more.

Mr. O'Dea does not believe it is the contingent fee which has inflated the number of Bodily Injury suits, and the dollar value of the awards. His area of expertise is in Catastrophic Bodily Injury Claims. In most cases, his client cannot be made whole. The monetary damages sought are some form of compensation for their loss.

It was Mr. O'Dea's position that the main reason for the high damage demands are the very high limits of insurance purchased by most businesses and individuals. When a plaintiff attorney becomes aware that the amount of insurance covering the alleged neglative party is $10,000,000 he is likely to "go for the juggler." He contends that it is the high limits of liability sold by the insurance industry which has so inflated these demands.

Mr. Spalding's expertise was in the defense of these negligence suits. He explained to us that the two goals of a Tort System were to (1) deter further negligent actions, and (2) equitably compensate victims. He does not feel that the current system meets either of these two criteria.

Mr. Spalding shared with us the results of several liability actions as an example of the ineffectiveness of the current system. In one case, a young couple was seated in their car and pulled over to the side of the road. A police swat vehicle rammed into the couple's car, leaving the young man a parapalegic. After hearing his case, the jury awarded this gentleman $600,000 and further found that his wife was 10% negligent in the case. In the second situation an ambulance service company answered the call to transport under emergency conditions an elderly gentleman with Alzheimer's disease. While his 70-year-old wife was getting into the ambulance, one of the ambulance attendants inadvertently shut the door on her hand. This resulted in her losing the tips of several fingers. The jury award to this woman was in excess of 1.2 million dollars.

Mr. Spalding pointed out that surely the above does not depict a system that is equitably compensating its victims. He further did not believe that the 1.2 million dollar verdict against the ambulance company would not significantly change their handling of emergency situations so that a similar accident could not happen again in the future.

Mr. Spalding felt that there were a few things that insurance companies could do to improve their claims experience. One way was to expend more effort in training claims adjusters, so that they are capable of developing an initial file with much of the necessary information. Mr. Spalding also felt that companies tend to be pennywise and poundfoolish. They look for a lawyer with a very low hourly rate. Therefore, they get the most inexperienced lawyer in the firm. This, however, can lead to many unnecessary hours being spent on a file which can end up costing twice as much in the long run. In addition, this inexperienced lawyer may not ever turn up information that could be vital to the defense of a Tort Action.

The last speaker was Ms. Turezyn, who is a law professor at the Delaware Law School. Ms. Turezyn discussed the legality of many of the Tort Reform laws that have been passed in the various states. Most of these laws have been directed specifically towards the medical malpractice crisis, but serve as a model for future Tort Reform Legislation. These laws typically address three areas: Limitations on Non-Economic Damages, Limitations on Contingency Fees, and a Cap on Lump-Sum Payments.

In each state, these laws have been tested for their constitutionality. As the judicial climate varies from state to state, the interpretations have also varied. It should be noted, though, that most of the laws have met their challenges.

Ms. Turezyn summarized by stating that when drafting or supporting Tort Reform Legislation, it was important to review the opinions of the courts so that the legislation will hold. In review, there is a prevailing opinion in the business community that some Tort Reform is needed. Rather than point fingers, it is imperative for us to work together to develop a viable Tort System.

Philadelphia "I" Day 1986 Set

BY: JOSEPH L. FOLZ, Co-Chairman

As probably every CPCU must know by now, our "traditional" site for "Philly I Day," the Bellevue Stratford, will not be available to us this year.

Fortunately, the "Philly I Day" Committee meets practically yearround, and we were able to immediately, with some help from the Philadelphia Convention and Visitors Bureau, line up another hotel with the facilities necessary for "Philly I Day." One slight problem was the fact that, because of the general unavailability of the amount of space necessary for "Philly I Day," and the fact that conventions are booked well in the future, we did not have very much room to negotiate as far as dates were concerned this year. For this reason, "Philly I Day 1986" will be held on Wednesday, December 17th, at the Franklin Plaza. Actually, the date can work to our advantage, given the long amount of preparation time we now have, and the advance notice that we are giving to all participants.

Therefore, "Philly I Day - 1986" will continue to uphold the high standards set for previous "Philly I Days," and, coming so close to the holidays, can actually serve not only an educational purpose, and also continue to be our means of awarding diplomas to our CPCU completors, but also, can become part of the festive holiday season in Philadelphia this year.

We continue to need CPCUs to serve on various committees, and if you have any questions, please give me a call at (609) 234-3402.

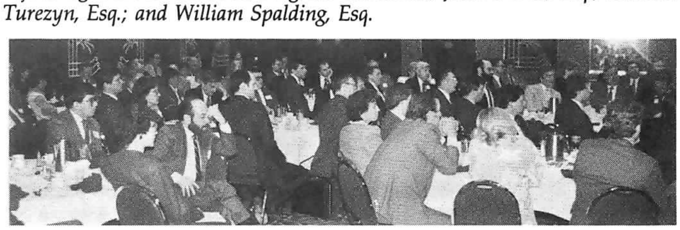
Donald Nelson, CPCU, ARM Named 1986 Business Insurance's "Risk Manager of the Year" Awardee

Congratulations to chapter member Don Nelson who recently was presented the award for "Risk Manager of the Year" given by *Business Insurance.* Don had much written about him in the April 14th edition of Business Insurance which highlighted the award.

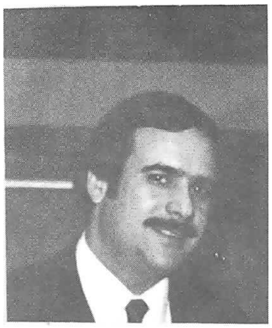
Don is Director of Risk Management for ARA Services, Inc.

Business Insurance publisher Alfred Malecki and editor Kathryn McIntyre presented the award, the ninth since *Business Insurance* instituted the competition in 1977.

March 7th speakers prepare for discussion of Tort Reform — Myth or Reality. Left to right are Al Federico, Program Chairman; John O'Dea, Esq.; Kathleen Turezyn, Esq.; and William Spalding, Esq.



Part of the March 7th crowd listening to Tort Reform discussion.



Peter Palestina
Editor

From the Editor

Many of you who know me or have been at our last two spring socials will recall that I put on a little skit entitled, "Insurnac The Magnificent," which, of course, is a take-off on "Carnac The Magnificent" of Johnny Carson fame. I'm beginning to wonder if maybe I do possess the ability to predict things. If you read my column last issue (March 1986) I said I would not be surprised if by the time you read the column, Pennsylvania would have some type of moratorium. Most of you received that issue in the mail on March 17 which is the day Gov. Thornburgh issued his emergency regulations. Keep in mind hat the issue you are reading goes to the printers approximately four weeks before you see it. Since this ability doesn't work when I'm playing poker or purchasing a lottery ticket, it was probably plain luck that it happened the day the issue was read. The prediction itself wasn't lucky, however, nor was it due to any psychic ability on my part, because any fool could see that sooner or later it had to happen.

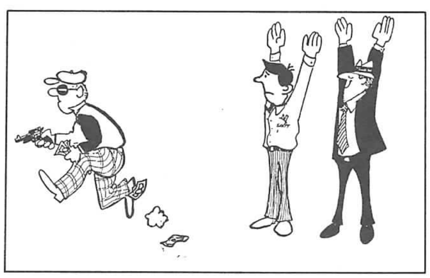
My primary message for you this issue is to ask that you keep abreast as to what is happening in our industry and as CPCUs to continue to exercise professionalism in all that you do. Get involved in chapter affairs, attend the meetings, further your studies, if possible, and above all try to maintain your sanity. A knowledgeable person will stand out from the rest and will be successful in loose, tight and normal markets.

Until the September issue, enjoy the summer, keep the grass cut and the weeds down, don't exert yourself too much, and keep your chin up, better days are ahead.

Personal Notes on Members

- **Chapter Treasurer John J. Kelly** is now employed with B.G. Balmer & Co. in Paoli. John is managing commercial accounts and provides training for account handlers. John was formerly associated with Bayly Martin & Fay.
- **Joseph P. Burke** of Mather & Co. reports that he was elected vice president back in January. Joe's responsibilities continue as Manager of Production and Services of large casualty and marine clientele.

THE ON-GOING SAGA OF "SEEPY SEEYOU"



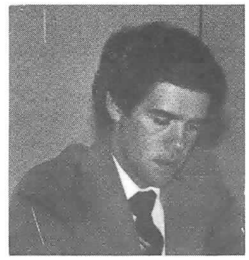
Hey, isn't that the guy who owns the company you recently billed for their renewal insurance?

Treasurer's Report

AS OF APRIL 21, 1986

Raymond E. Lindsey, CPCU, CPA, Treasurer

	BUDGETED	ACTUAL
Income.	$22,600	$21,103
Disbursements...	25,410	17,423
Excess/(Deficit)	$(3,150)	$ 3,680
CASH BALANCE:		
Checking.	$ 809	
Money Market	14,090	
TOTAL	$14,899	



Joseph McNasby
Director

News from the Candidate Development Committee

BY: *JOSEPH McNASBY*
Candidate Development Coordinator

The April Meeting of The Philadelphia Chapter CPCU is always special since at that time we are able to thank CPCUs who have so graciously donated their time to help us with our Personal Sponsorship Program and also to recognize those candidates in attendance who are in the process of working towards their CPCU designation.

This is the third consecutive year that we have been able to present Personal Sponsorship Awards.

The four recipients this year are as follows:

1. **Mr. Joseph Folz, CPCU,** nominated by Stuart Jay Lightman, CPCU;
2. **Mrs. James Hamilton, CPCU,** nominated by Pat Coleman, CPCU;
3. **Mr. Arthur Hanebury, CPCU,** nominated by Rita Hanebury, CPCU;
4. **Mr. William Simonton, CPCU,** nominated by Jeffrey Simonton, CPCU.

We would like to extend our congratulations once again to this year's recipients of the Personal Sponsorship Award.

We have been fortunate to have many dedicated members within our Chapter who have volunteered their time through our formal sponsorship program to aid CPCU candidates. I would like to take this opportunity to personally thank the following sponsors:

1. **Suzanne Crager** of Provident Bank;
2. **Shirley Dorsett** of Babb Agency;
3. **Tom Douglas** of Allstate;
4. **Bill Hampton** of Consolidated Insurance;
5. **Eileen Hinnegan** of Keystone Insurance;
6. **John Kelly** of Bayly Martin & Fay;
7. **Anne Sechler Kopanski** of CIGNA;
8. **Henry Loebell** of Clair Insurance;
9. **Terry Macko** of C&F Underwriters;
10. **Bill Mayo** of Frank B. Hall;
11. **Sally McNeill** of Reliance Insurance Company;
12. **Patricia Murray** of Rutgers Casualty;
13. **Richard Raup** of Colonial Penn;
14. **John Rucker** of CIGNA; and
15. **Lucy Smith** of CIGNA.

Again, my sincere appreciation for your generous donation of time and talent to this worthwhile program.

One final note from the Candidate Development Committee, and that is that we are very enthused about the continued favorable response to our Personal Contact Campaign. At each presentation that we make, the feedback is very positive and this will continue as a top priority project for the Philadelphia Chapter on an on-going basis.

DAVID WOODWARD *(continued from 4)*

about insurance, I am now going to quite unashamedly hand out some good advice to the true experts of our industry. The members of the Society of CPCUs. I feel safe in doing this for two reasons.

Your reputation for polite restraint is well known, so I am sure that whatever I say, you will not leave before I have finished.

And, secondly, I have filled the room with so many Reliance people, that no one would notice if the rest of you left. The Reliance people will get questions when they get back to the office, so I know they'll stay.

As all presidents of insurance companies do when they get a public platform, I would like to use the opportunity to talk about some of the ills surrounding our industry, because we clearly have more than a usual crop of problems. However, I have noted that the usual style of industry spokesmen is to defend the industry and to protest about the various external issues which cause our problems.

Currently, tort reform, or the need for it, would seem to be the number one candidate. It is being cited as the major cause of the industry's failure to meet the needs of the public and corporations that keep it in business.

The capacity crisis, in other words, is the responsibility of avaricious lawyers, incompetent judges, and wild juries. Certainly, not the responsibility of the insurance industry itself, which pictures itself as an

(continued)

innocent victim caught up in a legalistic conspiracy of immense proportions.

I find this difficult to accept.

Now, before I get myself into serious trouble, let me say that I think the need for tort reform is overwhelming, and I support the industry's position 100%. I also believe that until major reforms are enacted, it is financially impossible for companies, such as mine, to offer coverage for a small, but important, number of risks and, accordingly, they will remain uninsurable until reform is enacted.

However, the real capacity crisis which continues to face this industry would have occurred with or without these legalistic excesses and will not be cured by tort reform, assuming that it ever comes about.

We have to look elsewhere for the cause of the capacity crisis, and if we look, we quickly recognize the culprit, because it's a very familiar face that's been around longer than anyone in this room, and that is the underwriting cycle.

The situation we face today is nothing more than a somewhat extreme curve in the underwriting cycle that so afflicts this industry and that, unfortunately, will continue to afflict us in the future unless we start to get our act together.

So many of the problems that face us can be directly attributed to the cycle that I wonder why we all stoically accept it as inevitable instead of facing up to its root causes and at least minimizing its worst ups and downs.

Fortunately, or unfortunately depending on your point of view, we do not have enough time today to go into all of the causes of the insurance industry underwriting cycle, and I am going to reserve my remarks to just one aspect of the problem.

You may think that I oversimplify which, of course, I shall—time allows no alternative. But, the issue I want to talk about is rather different from most of the other causes, such as the influx of new capital when returns improve, cheap foreign reinsurance, and other major influences over which we have little or no control.

The issue I want to talk about is something over which each one of us has some control, whether company president or desk underwriter, but what's equally important, it probably has more to do with the vicious snaking of the underwriting cycle than any other single factor. If professionals, such as yourselves, really came to grips with it, we would see an end to the underwriting cycle and be able to develop our business in a climate far healthier than that we know. We might even enjoy a reputation for being sound businessmen.

What I am talking about is the responsible pricing of insurance products by insurance companies and agents alike.

Despite several hundred years of actuarial science, millions and millions of dollars spent on computers, immense data capture efforts by ISO and the NCCI, many companies in this industry have little or no understanding of what price to charge for their product, whether or not they are conducting business at a loss or making a dollar.

If anyone here thinks I exaggerate, just recall the rash of restated earnings and special charges that took place earlier this year.

You may jump to their defense and say that the pricing problem is brought about by the unique problem we have of having to set our price before our costs are known, that we have no idea of how big the claims will be for several years. I'm afraid it is a weak argument. There was nothing particularly unusual about loss development patterns in recent years that could account for the fact that premiums charged have proved woefully inadequate to meet claims expense. The fact is that our appalling results in 1984 and 1985 were totally predictable at the time the business was written in 1982 and 1983, yet for whatever reason, companies either couldn't or wouldn't see where their actions were leading.

How does massive industry-wide underpricing come about? If we look at the story of a fairly typical, but hypothetical, small company over recent years, we get a clue. My story starts in Year 1 of any cycle at a time when industry results are not too bad, and my example company has either just gotten itself some new capital or, maybe, a nice quota share reinsurance treaty. Let's see what happens.

YEAR 1: Management decides that because business looks so good, the time has come to get more of it. Lacking any constructive marketing plan, they are reduced to dropping prices in order to build up volume. The investment income will easily make up the shortfall, and their underwriters claim that the lower price will attract the better risks.

YEAR 2: Guess what, the strategy is working. Despite the price reduction, we are getting even better results, and premium is up. The more competitive price must be bringing in better risks. So, feeling very pleased with itself, management intensifies its efforts, reduces prices further. Management conveniently ignores the fact that the loss ratio still reflects business written in the period before the new initiatives took place and when they were not aggressively discounting prices.

YEAR 3: Even better. Combined ratio is still good, business has grown 30% or 40%, the growth strategy really works.

A closer look at the combined will show that while compared to three years ago the expense ratio is way down, because of all the new business written. But, the loss ratio is actually up, four points and moving North. No one wants to dwell on that, of course, because record earnings have just been announced and everyone is euphoric.

By the way, this is usually when the chief actuary decides that the time has come to look for another job, and the CEO decides that as they are doing so well, they don't really have to replace him, so he gives the job to the marketing manager to do on the side.

YEAR 4: Volume has doubled, despite the fact that pricing is off 40%. In fact, twice as much exposure is on the books with only half the extra premium needed to cover the losses.

From this point on, the busiest part of this organization will be the claims department, that is desperately trying to rehire the people it laid off at the beginning of this story.

Management's message is loud and clear: Back to basics, clean out the agency plant, reunderwrite the book, and so on.

So, there it is in very over-simplified form how many companies got themselves into this mess, and guess what, they did it without too much help from the plaintiff's bar. Sure the lawyers truly deserve an Oscar for best supporting role, but the real villain of the piece was, quite clearly, the industry itself. And, you know, simple as this story is and inevitable as are its consequences, there will still be those around who get taken by surprise when they find their reserves are 30% inadequate, their Best's Rating is lowered a notch or two, and their combined ratios reach hitherto unheard of levels.

Now, I am not suggesting that major insurance companies and industry professionals, such as the people in this room, are unaware of what is happening to their business when price-cutting becomes rampant, because you know perfectly well you have been through it before, so you should, but you still let it happen to you. Why?

Well, first of all, the type of insane pricing action I have described generally starts with the smaller companies and new entrants to the business. More established companies have too much to lose. New money or foreign reinsurance is anxious to see a lot of premium very quickly, and they are not fussy how it's done.

Unfortunately, better managed companies get sucked in, simply trying to defend their market share.

As agents start to shop every renewal with every company on the street, the temptation to fight back, discount for discount, becomes overwhelming, particularly as the consequences of lost premium show up immediately in the statement, whereas the results of underpriced business can often remain hidden for years. *But,* remember not forever.

Still, in the heat of the marketplace, all caution gets thrown to the wind and down the slippery slope we all go together.

If you think about it, it is the most idiotic situation imaginable and, gentlemen, there is no one in this room, I venture to say, who has not played at least a part in this game. Except me. Fortunately, I arrived too late for this one. It will be my turn in about three years' time.

Now, I am not going to minimize the problem of seeing large volumes of premium disappear. We all know about fixed overhead. But, there are companies about who face up to that problem as a preferable alternative to putting business on the books at half price. And, they not only survive, but they prosper, compared to their competitors who dish the dirt with every Johnny-come-lately insurance company that appears in their agents' office. And, you know there are many agents about who recognize the pitfalls of dealing with companies that are here today and in rehabilitation tomorrow. And, sure they may lose the odd account as a result, but see who gets the profit-sharing checks year in year out and who is first in line when capacity becomes scarce once again.

The fact is that if responsible agents and companies alike held their ground in the face of underpriced competition, the free-fall would never never really get started, and we would avoid the pricing disasters such as we have seen in recent years and which have spawned the capacity crisis we face today.

The Society for CPCUs, more than any other group, should understand the overwhelming importance of responsible pricing. Its members hold positions of great influence throughout the industry. When this tight market shows signs of coming apart once again, you, ladies and gentlemen, carry vital responsibility to prevent a repetition of the last debacle. Don't betray that responsibility, because if you do, there is little hope that anyone else will be able to prevent a repetition of 1984-85 and the consequences we see today.

David C. Woodward, President and CEO, Reliance Insurance Co. addresses the audience during the April 29th Franklin Award Luncheon.