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EDITORIAL

THE LIABILITY CRISIS

1986 seems to be the year of the "insurance crisis". The surface problems have to do with the premium and underwriting actions of liability insurers—but a deeper look reveals that the crisis involves not only the insurance component, but all of the other parts and pieces that make up our confusing liability system.

As we begin to suspect that the entire system is breaking down, we find that one group blames another. Today's scapegoats seem to be "greedy" plaintiffs, "self-serving" insurers, "opportunistic" attorneys, and "stupid" juries—in no particular order. There is more than enough blame to go around; nor is there a dearth of "band-aid" solutions. In another recent crisis investigators of the space shuttle tragedy seriously considered whether the entire structure might be flawed. Objective observers of the liability matter might do likewise.

Before the development of liability insurance, the system was relatively simple and internally consistent. It was clear public policy that the innocent victim (IV) be made financially whole by a payment from the wrong-doer (WD). The general public (GP) stood on the sidelines, except that it was up to a GP jury to determine where justice lay.

But the underlying principles changed with the invention and subsequent spread of liability insurance. Insurance transfers the financial consequences from the WD to the entire body of liability premium payors, and hence to the general public. That it is the GP, and not the WD, that pays the IV award (*and* the huge mark-up arising from lawyers' fees and insurance company expenses and profits) is logically obvious, though evidently little understood. Only very recently has GP begun to feel this burden, and its beginning to do so may be in large measure responsible for the current crisis.

The foregoing reasoning may lead us in two quite different directions, depending upon the emerging public attitude as to whether it is willing to accept the transfer of the liability risk. Assuming for the moment that it is not, the logical solution is the banning of liability insurance—making every potential WD go "bare". The effect of such a 180-degree turn in public policy would be to relieve the GP burden, while IVs, trial attorneys, and some WDs would be the important losers.

But if the public choice were to go the other way, then surely the GP should have the say as to *how* it meets this deliberately assumed obligation. Might it not opt for a no-fault system, modeled perhaps after workmens' compensation, under which IV is compensated no matter how his tragedy came about, and under some well-thought-out indemnity schedule? IV awards might well be smaller, but they should be quicker and much more certain. Liability insurance might well be replaced by new forms of two-party insurance.

Those who may be attracted to liability system reform have no grounds for optimism. The present system is so ingrained, and the forces against meaningful reform so strong, that nothing is likely to come of these ideas in any foreseeable future—unless the crisis becomes so severe that drastic solutions come to be seriously considered. *C.L.T.*

WORKDAY PROBLEMS

Our March issue proposed a new feature, a column through which readers present interesting problems that come up through work. A pilot problem with a partial solution was published by way of illustration.

We now expect that WORKDAY PROBLEMS may run in approximately every other issue for as long as the interest lasts. Robert Likins, who originated the idea and is also the contributor of a second problem appearing below, has agreed to assume general responsibility. He will appreciate your sending *your* problems to his *Yearbook* address. He can be reached through his *Yearbook* phone number as well.

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LOAN ACCOUNT PROJECTION

My company has a closed block of life policies, all issued in 1970 or earlier, that carries a 5% policy loan rate. Despite the gradual run-off of this closed block, the 5% policy loan account has been growing. Management asks me to project this account (A_t) over the next 25 years, with emphasis on when it may be expected to reach its peak.

Available is the following information, all as to this closed block only: For each year-end 1970 to 1985 - (a) A_t, (b) the mean reserve MV_t, and (c) the insurance in force F_t, by plan, age, and duration cells.

My approach is to break the problem into two pieces: (1) the projection of MV_t, and (2) the projection of the A_t/MV_t ratio. The product of these two should give the projection sought.

For the first I propose to use model office methods, using persistency factors from the history contained in (c) above. The lowest duration is 15 years and only "ultimate" factors are needed.

More difficult is the projection of the ratio, a measure of the extent to which this block has been or will be "fully" loaned. This ratio is presumably a function of economic factors (especially interest rates) and may well have an upward bias as the public becomes better informed.

It is my hope that a regression study on the %-loaned rate over the years since 1970, with some (lagged?) measure

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