



International Chamber of Commerce

The world business organization

Policy statement

Long-Tail Risks

Prepared by the Commission on Financial Services and Insurance

Introduction

World business, as represented by the ICC, is expressing its growing concern over the increasing difficulties that refer to long-tail liability risks.

Long-tail risks are characterized by a long (or very long) period...

- (i) (from a risk point of view) between the start of the exposure and the manifestation of loss or damage resulting from the exposure
- (ii) (from a liability point of view) between the act/behaviour that created the liability and the recognition of the liability

Long-tail risks can emanate from many different areas and can also be different in their characteristics. Serving as examples in this policy document are product liability, employer's liability and environmental liability (see attached descriptions).

Long-tail risks have in earlier days been handled by the business community in a structured and consistent way, based on the classical rules of liability. During the last decades we have seen increased uncertainty in how society handles long-tail risks. As an illustration of such adverse evolution, the erosion of the causality principle is creating growing uncertainty on how the rules shall be applied. This is evident in the development in legislation and legal settlements, among others, as well as insurance market developments.

Recent developments in the area of long-tail risks

We see several trends gradually happening that have, or have had, an increasingly negative impact on risk levels faced by the business community. Some examples:

- The development in science and technology, creating new and sometimes not yet known risks (e.g. electro magnetic field – EMF, biogenetic modification - GMO, silicosis, vibration white finger - VWF and potentially nano-technologies etc). Such risks can potentially affect large numbers of people in many jurisdictions. Incapability by business to handle such exposures will have an adverse effect on society and it may even hinder or completely stop progress in science and technology.¹

¹ Please see also the related ICC Policy Statement entitled “Precaution, science, risk and trade” prepared by the Task Force on Trade and Environment, 18 November 2002.

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- Increased litigation across the world is likely to be fuelled by the decrease of social security levels that can be seen in many geographies. An increase in claims might also result from the introduction of extensive class actions legislation in more world regions (Europe may be next) without a clear knowledge about the long term economic impact of such reforms.
- The rapid increase in globalisation and the growth in the movement of goods and individuals further complicate matters should any claim be made for damages over the long term.
- The trend in legislation and jurisprudence aimed at increased victim protection is fuelling the development of new liability rules and laws with retroactive effects.
- Recent tort law development illustrates that regulators are taking for granted that businesses and the insurance industry have the capacity to pay and then distribute losses to the market. Legislation without macro-economic impact analysis or certainty of the existence of future insurance coverage is extremely dangerous to long term market stability and growth. This development is particularly obvious in environmental clean-up and other forms of public interest protection. Liability laws tend to be written with short term liability in focus and have been effective in such timeframe. However the long term implications of those legislative changes and all aspects of long term liability have been ignored.
- Markets that can assist the business community in handling long-tail risks are primarily insurance markets but also other financial institutions. Historically, markets accepted some degree of uncertainty; however the above developments are so significant in the aggregate that they may increase uncertainty to an intolerable level. The financial markets have no alternative but to reject the risks altogether and thus leave exposure to business and ultimately to society and tax payers at large.
- Due to already inherent difficulties in predicting consequences of long-tail risks, the business community, society, consumers and other stakeholders are in great need of predictability to the best extent possible.

Taking into account recent trends in tort legislation and the increasing costs and time frame in establishing legal liability one might even question whether liability insurance itself might be the right instrument to manage such risks.

Conclusions

To secure safe and sound business continuity, it is ICC's recommendation to all stakeholders (legislators, governments, business community, individuals) to always consider the following important factors:

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- Legislation with retroactive effect
Legislation made with retroactive effect is unacceptable. It is to the long term benefit of all involved to have a transparent and well understood set of rules in the area of long-tail risks.
- Cooperation between stakeholders
Without proper involvement of financial markets, governments may lose sight of the market realities and the availability of cover for the ever increasing areas of liability risks. It is the opinion of ICC that it is desirable for society in general that these risks be financed and refinanced as efficiently as possible. Therefore, a good cooperation between all involved is a necessity for all stakeholders.
- Balancing interests
There is an urgent need to achieve an appropriate balance between victims protection on the one hand and risk financing on the other that might force economic agents to consider other forms of risk financing than liability insurance only (e.g. no-fault insurance schemes).

The concerns outlining this Policy Statement can only be met if a meaningful and constructive cooperation is achieved between regulators, the business community, financial markets and other interested parties.

App. 1

Product Liability

General Product Liability is the specific liability that a manufacturer of a product has to the public for damage or injury as a result of the product being defective. The Product Liability regulation is in most countries in Europe, in line with an EU Directive, whereas in the US it depends on the law of respective State. The basic concepts are however similar.

Product Liability relates to any product put into “the stream of commerce”. The “stream” includes for example the manufacturer, the importer and the seller of the product. They may be liable not only to the first purchaser of the product, but to anyone who might foreseeably come into contact with it, if the product was defective at the time it left their hands.

Product liability law is in most EU countries based on strict liability and deals with bodily injury to anyone and property damage to consumers. An injured party should prove that the product is defective, that this defect caused the injury, and that the defect made the product “less safe than what could reasonably be expected”.

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Three types of defects

<i>Manufacturing</i>	A defect that is a result of the way the product was made <i>defect</i> rather than the way it was designed or labelled, e.g. a ladder where the steps fell out due to inadequate welding.
<i>Design defect</i>	This defect is a result of a way a product was originally designed rather than the way it was made or labelled, e.g. a ladder not strong enough to support a person.
<i>Incorrect instructions/failure to warn</i>	This defect relates to failure to adequately warn about non-apparent risks involved in using a product, e.g. a ladder that will collapse unless secured in a certain way. The impact of failure-to-warn claims can be seen in the multitude of warning labels affixed to all sorts of products.

Some types of defects may lead to liability:

<i>State of the art</i>	Even though it can be shown that scientific knowledge in the world was not sufficiently advanced to have knowledge of or detect the defect at the time when the product was put into the stream of commerce, there may be liability in some cases. Example is the use of various materials before it was discovered that they could be hazardous to health.
<i>System errors</i>	This refers to well known product defects that may be accepted by society in general, e.g. the damaging components in alcohol and tobacco.

App. 2

Employer's Liability

<i>General</i>	Driven by the necessity to provide labour safety, employer's liability evolved as a strict liability in the late 19 th century. Its traditional scope targeted labour accidents and occupational disease and thus paved the way to a series of legislation in workmen's compensation. In the course of development, employer's liability has picked up a more complex approach to protect employee rights – to fight discrimination, sexual and other types of harassment, etc. on the workplace. However, this area of law remained national in the particular countries. Due to essential differences between social security and workmen's compensation arrangements, prevailing in the various countries, but
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operating on a different basis, the trend of harmonisation of laws is still absent, even as the European Union is concerned.

The obvious answer of the industry to strict liability was liability insurance. First, employer's risks were part of general liability insurance to develop later to a self-standing product. However, the full scope of employer's liability is only seldom addressed. Typically, insurers tend to cover labour accidents and (increasingly) infringements of employee rights by the employer, but occupational disease is rather posed as an exclusion.

Long-tail risks

The reason for carriers to be careful with occupational diseases may be best illustrated by the asbestosis cases. In the US, a series of litigation was started in the second half of the 20th century by former employees, exposed to asbestos in the shipbuilding and in the construction industries during and after the Second World War, to collect damages from employers and their insurers for pulmonary asbestosis they suffered in the course of their employment. (In states where asbestosis was not considered an occupational disease, such claims were channelled to products liability litigation.) The asbestosis-cases call the attention that environmental aspects of certain occupations may induce latent processes leading to losses in the health of employees that would be manifested only later. Long-tail risks may vary from diseases to genetical harm caused to children by the exposure of parents.

App. 3

Environmental Liability

General

The term environmental liability is commonly used for the process through which responsibility for the cost of damaging the environment is transferred back to those that cause the damage; either by past or ongoing manufacture, use, release, or threatened release of a particular substance; or by other activities that adversely affect the environment and/or human health.

The principle under which environmental liability operates is sometimes called 'the polluter pays principle' which in general terms means that the person/legal entity that causes environmental damage shall be responsible for the negative consequences, as he enjoys the benefit of the activity which pollutes the environment.

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Because the environment is generally regarded as a 'public good' it is not priced in a conventional market place. As a result the charges for rectifying environmental damage may not always adequately reflect the true environmental cost for the society in large. Therefore, the general trend is to introduce more strict rules, based on the assumption that potential polluters will behave more

carefully if they risk being found liable for their damage. i.e. movement toward strict liability with less exoneration reasons, presumption of liability to the benefit of the claimant, lowering of the 'burden of proof' in favor of the claimant and also extend the liability to include ecological damage.

The long-tail mechanism of environmental liability

- A. Harmful Emission
Sources – Production, Products, Applications, Disposal
- B. Dispersion of pollutants
Pathways – Air, Water, Soil
- C. Primary Environmental Damage
Ecological Damage – Impact on air, water, soil, flora, fauna
- D. Secondary Environmental Damage
Bodily injury
Property damage
Financial loss