

# Business Insurance

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\$4

## House, Senate impasse dooms terrorism relief bill Insurers empty-handed

By MARK A. HOFMANN

**WASHINGTON**—The clock has run out on congressional efforts to create a federal guarantee for terrorism insurance before the year-end renewals, and buyers are bracing for tough times ahead.

The Senate failed to pass terrorism insurance legislation before the House adjourned last Thursday afternoon. The House had passed its own bill in late November, but disagreements over terrorism-related tort reforms and an unrelated dispute over farm policy stalled Senate action.

Although Congress could pass a bill after lawmakers return next month, that will be too late



Sen. Gramm



Rep. Oxley

to have any impact on year-end renewals. And for risk managers and the business community in

general, that could be very bad news. Insurers have said repeatedly that, absent some sort of federal guarantee, they will have no choice other than to either exclude terrorism coverage altogether or subject it to low sublimits within policies.

"This does have a profound impact on the market, in that many insurers were holding back as long as they possibly could in the hope and expectation that Congress would act. Now, they've got a decision to make," said Joel Wood, senior vp of the Council of Insurance Agents & Brokers in Washington. Mr. Wood said he didn't believe this would be a uniform decision, but

See **TERROR**/page 33

## Late News

### United Airlines faces Sept. 11 lawsuit

One of the first liability lawsuits from the Sept. 11 terrorist attacks has been filed in a New York federal court, although it remains to be seen how many other victims' families will choose to go to court rather than participate in the federal Victims Compensation Fund. Ellen Mariani, the widow of Louis Neil Mariani, a retired dairy worker from Derry, N.H., filed suit in U.S. District Court in Manhattan Thursday against United Airlines Inc., charging the airline with wrongful death. Mr. Mariani was a passenger on United Flight 175, which terrorists flew into 2 World Trade Center. In electing to sue, Ms. Mariani chose not to participate in the government-supported Victims Compensation Fund, which Congress created through legislation that also bars those receiving fund benefits from suing the airlines. Fund regulations unveiled this week would adjust payouts based on such factors as a victim's age, marital status, earnings and whether the individual had children. Payouts will range from a minimum of \$300,000 to more than \$3 million.

### P/C industry posts nine-month loss

The U.S. property/casualty industry posted a net loss of \$3.1 billion in the first nine months of 2001—the industry's first-ever net loss through nine months—according to the Insurance Services Office Inc. and the National Assn. of Independent Insurers. The loss, which compares with a \$16.8 billion profit in the year-earlier period, was primarily driven by losses from the Sept. 11 terrorist attacks, an ISO/NAI statement said. Insurers' net underwriting loss widened by 79.9%, to \$37.5 billion. Other factors contributing to the net loss include a 5.7% decline in net investment income and a 45.7% decline in capital gains, the statement said.

### Parity mandate stripped from bill

Following a widely expected setback, backers of legislation to mandate total parity for mental health care services in group health plans say they will renew efforts next year to enact the

See **LATE NEWS**/page 2

## Travelers doesn't fit Citigroup umbrella

### Early promise of convergence not realized

By SALLY ROBERTS

**NEW YORK**—Citigroup Inc.'s planned divestiture of Travelers Property Casualty Corp. sends a strong signal that the much-hyped convergence of the financial services industry may have failed to recognize essential differences between banking and property/casualty underwriting, analysts say.

In addition, as an independent entity, Hartford, Conn.-based Travelers Property Casualty Corp. is likely better positioned to grow by acquisition, they say.

Last week, New York-based Citigroup announced plans to spin off Travelers P/C, which is the sixth-largest U.S. property/casualty underwriter, based on 2000 net written premiums of \$9.9 billion. Citigroup plans to sell up to 20% of Travelers P/C in an initial public offering during the first quarter of 2002 and then spin off the remaining shares to Citigroup's shareholders in a tax-free transaction.

Citigroup will retain Travelers Life & Annuity Co. and will maintain a relationship with Travelers P/C in the distribution of homeowners and

automobile insurance policies. Citigroup also will provide investment advisory services to Travelers P/C.

Robert I. Lipp, who oversaw the integration of Aetna Life & Casualty Co.'s property/casualty operations into Travelers in 1996, will resume his position as chairman and chief executive officer of Travelers P/C.

By spinning off its property/casualty insurance business, Citigroup can focus on higher-growth financial services business and a new "open architecture" business strategy that allows the company to distribute its products through other insurance companies, Citigroup executives said.

During a conference call to analysts last week, Sanford I. Weill, the chairman and CEO of Citigroup, said that, given the state of the property/casualty insurance market—including rising prices—it made sense to sell a portion of Travelers P/C and use the proceeds to grow Citigroup's other businesses.

"We think, and we can't emphasize this enough, that the power of profitability is moving

See **CITIGROUP**/page 33

## Claims trust to get tough with asbestos claimants

By DOUGLAS McLEOD

**NEW YORK**—The Manville asbestos claims trust is seeking to reduce or eliminate payouts to millions of potential claimants as it grapples with an explosion of new claims that it says threatens compensation of the most seriously injured asbestos victims.

The Manville Personal Injury Settlement Trust last summer cut the pro-rata amount it pays on all approved claims to 5% from 10%, after seeing its new claim filings more than double during the first half of this year. Many of these new claimants show no signs of illness, trust officials charge.

Now the trust is asking a federal court to order changes in its claims handling procedures to cut the amounts payable to less seriously injured claimants and to bar claims by anyone not exposed in an "industrial" setting, such as during

See **MANVILLE** /page 34



Mr. Lipp



Johns Manville

## Special Report

# YEAR IN REVIEW

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## Inside

### Settlement betrayed policyholder: Court

A federal appeals court ruled that two insurers violated their fiduciary duty through a settlement under which a plaintiff amended its claims so that they would not trigger coverage for the insurers' policyholder.

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### Y2K and terrorism crisis responses

In Commentary, Senior Editor Mark Hofmann views the government's response to national crises, comparing the Y2K crisis to the current terrorism threat.

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### Past is prologue for hard market

An editorial written in 1987, at the end of the last hard market, offers some lessons to industry participants on the role professionalism plays in any market.

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### Australian panel probes HIH collapse

HIH Insurance Ltd. likely had unfunded liabilities of billions of dollars when it went into liquidation, according to testimony before a government commission.

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### NAIC reviews report on rollback

A report critical of California's Proposition 103, which required insurers to roll back auto insurance rates, was discussed at the recent meeting of the National Assn. of Insurance Commissioners.

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### REPORTING WEEKLY ON CORPORATE RISK, EMPLOYEE BENEFIT AND MANAGED HEALTH CARE NEWS

Business Insurance (ISSN 0007-6864) Vol. 35, No. 52, is published weekly by Crain Communications Inc., 360 N. Michigan Ave., Chicago, IL 60601-3806. Periodicals postage is paid at Chicago and at additional mailing offices. POSTMASTER: Send address changes to Business Insurance Circulation Department, 1155 Gratiot Avenue, Detroit MI 48207-2912. \$4 a copy and \$97 a year in the U.S. \$130 in Canada and Mexico (includes GST). All other countries \$230 a year (includes expedited air delivery). Canadian Post International Publications Mail Product (Canadian Distribution) Sales Agreement No. 0293512, GST No. 136760444, Printed in U.S.A. Copyright © 2001 by Crain

**CONTINUED FROM PAGE ONE** measure. The Senate had earlier approved the proposal, which was advanced by Sens. Pete Domenici, R-N.M., and Paul Wellstone, D-Minn., as an amendment to a bill appropriating funds for the Departments of Education, Labor and Health and Human Services. No comparable provision was included in the version of the appropriations bill passed by the House of Representatives. But the parity proposal was stripped last week from the bill after House Republican members of a conference committee unanimously voted against its inclusion. Sens. Domenici and Wellstone promised to continue working to pass the legislation.

### Liability upheld in spilled-milk lawsuit

In a spilled-milk case, California's Supreme Court unanimously ruled that store owners can be liable for customer injuries when the store fails to clean up dangerous conditions within

a reasonable time period. The court, in *Richard M. Ortega vs. Kmart Corp.*, however, did not define what constitutes a reasonable amount of time. In the case, the high court concluded that "evidence of the owner's failure to inspect the premises within a reasonable period of time is sufficient to allow an inference that the condition was on the floor long enough to give the owner opportunity to discover and remedy it." Mr. Ortega originally won a \$47,200 jury award after falling and injuring his knee.

### Alea forms Bermuda holding company

Reinsurance company Alea Group Holdings, formerly of Baar,

# Late News

Switzerland, has formed a Bermuda holding company and has boosted its capital to more than \$500 million. The reinsurer, which is owned by New York-based private equity firm Kohlberg Kravis Roberts & Co. L.L.P., will use a \$250 million capital injection from KKR to increase its underwriting in the rapidly hardening worldwide reinsurance market, said Dennis Purkiss, chairman and chief executive officer of Alea. The new holding company, Alea Group Holdings (Bermuda) Ltd., would allow Alea to seek a stock exchange listing in New York should it decide to do so, Mr. Purkiss said. He added,

though, that there are no immediate plans for Alea to launch an initial public offering. Another KKR-owned company, Willis Group Holdings Ltd., redomiciled to Bermuda shortly before it launched an IPO earlier this year.

### Zurich expects loss for 2001

Zurich Financial Services Group warned Friday that it expects to post a loss of \$200 million to \$400 million for 2001, compared with net income of \$2.33 billion in 2000. For the first half of 2001, ZFS reported

net income of \$861 million. Full-year results will be released March 21. Contributing to the decline were losses from the Sept. 11 terrorist attacks, which ZFS estimates at \$760 million after tax, the Zurich, Switzerland-based insurer said in a statement. In addition, ZFS said that it expects indirect costs from the terrorist attacks to total up to \$250 million. Indirect costs include reductions in life insurance results, interest income and asset management fees. Also, capital gains for 2001 are expected to be about \$2.3 billion lower than last year, ZFS said.

### Employer health care group founded

The Washington Business Group on Health is launching the Institute on Health Care Costs & Solutions to examine ways to help employers address the rapid rise of health care costs. The new group also will promote defined contribution-style health care funding, said Helen Darling, WBGH president. The institute also will evaluate disease management programs and will examine whether tiered copayments for prescription drugs actually save employers money, according to Ms. Darling.

## Happy holidays from BI

This double issue of *Business Insurance* will be the last one published in 2001. The next issue will be delivered to BI readers on Jan. 7, 2002, featuring a special report on 2001 rankings and industry statistics.

*Business Insurance's* Daily News

by e-mail and online will resume Jan. 2, 2002.

All the material in the Late News and FTR columns is generated from daily reporting by BI. Sign up for your free daily e-mail of breaking news at [www.businessinsurance.com](http://www.businessinsurance.com).

## E.C. scrutinizing regulation of Lloyd's

The European Commission is asking the U.K. government to provide information on the regulation of Lloyd's of London to determine whether the insurance market is solvent under E.U. rules. The commission has requested additional information regarding the regulation and supervision of Lloyd's. The

## LLOYD'S

commission is basing its inquiry on the European Union's first nonlife insurance directive of 1973, part of which states that the financial supervision exercised by national authorities includes the verification of the state of solvency of an insurer's entire business.

## Briefly noted

PHICO Group Inc.'s bankruptcy filing last week will not affect the rehabilitation proceedings for its insurance subsidiary PHICO Insurance Co., a spokeswoman for the Pennsylvania Insurance Department said. In the filing with the U.S. Bankruptcy Court for the Middle District of Pennsylvania in Harrisburg, PHICO lists ACE Insurance Co. as its third-largest creditor, with the Bermuda-based insurer being owed \$497,000 in directors and officers liability insurance premiums....W.R. Berkley Corp. has formed an excess medical malpractice underwriting unit in St. Louis, called **Berkley Medical Excess Underwriters L.L.C.** The unit will offer excess coverage for health care providers that are either self-insured or own a captive and reinsurance coverage for primary insurers. The limits to be offered by the new unit have not yet been determined, according to Eugene G. Ballard, chief financial officer at W.R. Berkley.

## Ruling blocks ex-worker's mass e-mailing to current Intel employees

# E-mails constitute trespassing: Court

By JUDY GREENWALD

**SACRAMENTO, Calif.**—An ex-employee who made unauthorized use of a company's e-mail system was trespassing, a California appeals court ruled in a decision that is expected to be influential nationwide.

The appeals court applied to the Internet an ancient legal theory that forbids the use of someone else's property without permission. The Dec. 10 decision by the 3rd Appellate District of the California Court of Appeals in Sacramento upholds a lower court's injunction forbidding a disgruntled former employee from using the e-mail system of Santa Clara, Calif.-based Intel Corp. to communicate with current employees.

Employer attorneys say the 2-1 majority decision is a logical application of the ancient "trespass to chattels" legal doctrine and gives companies some much-needed protection in the modern era from un-

wanted e-mail.

But the ex-employee's attorney maintains that the decision not only inappropriately extends the doctrine but also abrogates the First Amendment right to free speech.

intel®

According to court papers, after Kourosh Kenneth Hamidi was fired in 1995 by Intel, he began to air grievances about the company through e-mail. Despite Intel's requests that he stop, Mr. Hamidi repeatedly flooded Intel's e-mail system with messages that were sent to as many as 35,000 employees, the court papers say. After the company's security department proved unable to block the e-mails, Intel asked a trial court to issue a perma-

nent injunction stopping the campaign. The company sought no damages.

Intel "showed it was hurt by the loss of productivity caused by the thousands of employees distracted from their work and by the time its security department spent trying to halt the distractions after Hamidi refused to respect Intel's request to stop invading its internal, proprietary e-mail system by sending unwanted e-mails to thousands of Intel's employees on the system," the decision says.

The majority decision also held that First Amendment protections do not apply in this situation. "The Intel e-mail system is private property used for business purposes," it says. "Intel's system is not transformed into a public forum, merely because it permits some personal use by employees."

In his dissent, though, Justice Daniel Kolkey said that the e-mails did not cause damage required to

establish trespass claims.

"Intel was not dispossessed, even temporarily, of its e-mail system," Justice Kolkey wrote. The "overwhelming weight of authority is that trespass to chattel requires injury to the chattel or to the possessor's legally protected interest in the chattel." But this is not the case when it comes to employees opening and reading unsolicited e-mail, he wrote.

Mr. Hamidi's counsel, Ann Brick, a staff attorney with the American Civil Liberties Union Foundation of Northern California in San Francisco, said, "We thought it was a disappointing decision. It stretches the legal theory that Intel used here to cover a situation that it was never intended to cover."

"It's a little bit like me going in and using your computer when you're not in the office and leaving a message on it that is perhaps defamatory, and instead of you su-

See INTEL /page 31

Employers urged to prevent backlash against Middle Eastern people, customs

# Bias in the workplace creates exposure

## AVOIDING BACKLASH BIAS

The EEOC says that the prevention and correction of discrimination should include:

A written policy defining and prohibiting harassment and discrimination

A complaint procedure properly communicated to employees

The prompt investigation of all complaints

The strict enforcement of disciplinary action in legitimate cases

The education of employees when unfounded complaints are filed

By JOANNE WOJCIK

Backlash discrimination against individuals thought to be of Middle Eastern ethnicity is fast becoming a problem for employers, which face increased liability if they do nothing to stop the abuse.

As of Dec. 6, the U.S. Equal Employment Opportunity Commission announced it had received 166 formal complaints of workplace discrimination specifically related to the Sept. 11 terrorist attacks. The problem is becoming so pervasive, in fact, that the EEOC chose it as the topic of its first meeting of the Bush administration, held Dec. 11 in Washington. The EEOC also issued an alert to employers, addressing workplace discrimination and harassment related to religion and ethnic origin.

"Anyone who looks Arab is being target-

ed, even some Italian-Americans," said Richard Chaifetz, chairman and chief executive officer of ComPsych Corp., a Chicago-based employee assistance program. ComPsych has seen "an extraordinary increase" in calls from employers seeking help in addressing the problem, Mr. Chaifetz said.

The harassment is taking many forms, ranging from nasty notes and ethnic slurs to tire slashings, he said. While employers cannot always prevent such harassment, they need to take steps to address it when it does occur, Mr. Chaifetz advised.

"It's the employer's job to make sure discrimination doesn't occur in the workplace," he said. Employers must have clearly published policies for investigating and addressing discrimination complaints, he said. "They must have policies and procedures in place. The employer is liable if no action is

taken and they are aware of or should have been aware of it occurring."

"We also tell employers that diversity management should be an initiative for any company. If a company does not have a formal program in place, now is the time to start," Mr. Chaifetz said.

Betsy Bosak, director of affirmative action, diversity and employee relations at Cleveland-based TRW Inc., testified during the recent EEOC meeting that TRW took several actions to help its employees deal with the terrorist attacks.

The employer created a Web site, titled TRW Unity, to post important and relevant TRW information and announcements; hosted an employee panel presentation about Islam and the Sikh, Hindu and Buddhist religions; and held noontime seminars

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## Government answers questions about health claims deadlines

### New Labor Department rules require faster response

By JERRY GEISEL

WASHINGTON—Employers and insurers now have additional guidance to comply with a Labor Department regulation that sets new, faster deadlines for resolving health care claims.

That regulation, published late last year, establishes one set of deadlines for plans to advise enrollees whether or how they will cover a procedure and another set of deadlines for claims filed after a service has been provided (*BI*, Nov. 27, 2000).

Generally, for urgent pre-service claims, such as when an enrollee asks a health plan whether it will cover a procedure, a plan would have to notify the enrollee of its benefit determination within 72 hours of the procedure, while for non-urgent claims the deadline would be 15 days.

Q & A

For post-service claims, benefit determinations would have to be made within 30 days of receipt of a claim. These new deadlines will go into effect for plan years starting on or after July 1, 2002.

Since the regulation was published, employers have raised numerous "nuts and bolts" questions about the regulation, and, in an unusual move, the Labor Department last week released 22 pages of guidance, presented in a question-and-answer format. That guidance, while far from being definitive, answers many questions that have been raised.

"There are always lots of questions about new regulations, and the Department of Labor has taken the time to address quite a number of them," said Henry Saveth, an attorney with William M. Mercer Inc. in New York.

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Employees who conduct business by phone while driving could create new liabilities for their employers.

## Employers held liable for accidents

### Rulings hinge on injuries caused by employees on cell phones in cars

By SALLY ROBERTS

MIAMI—Two recent cases highlight the employer liabilities that may arise from distracted driving.

Dyke Industries Inc. earlier this month was ordered to pay nearly \$21 million to a 79-year-old woman who remains on a respirator following a March 29 car accident involving one of Dyke's salesmen.

The Ford Explorer driven by Dyke employee Lazaro Luis Leiva was involved in a collision with another vehicle, and a passenger in that car, Alicia Bustos, was seriously injured. Cellular telephone records revealed during the trial show that Mr. Leiva was talking to one of his clients on a cell phone seconds before he dialed 911 after the accident.

Ms. Bustos and her husband sued Mr. Leiva and his employer, Dyke Industries, a Little Rock, Ark.-based wholesale lumber company, in Miami-Dade County Circuit Court last June. They charged that Dyke Industries was vicariously liable for the accident because Mr. Leiva was acting within the scope of his employment when the accident occurred.

A jury on Dec. 14 awarded Ms. Bustos and her husband \$20.9 million, the largest-ever personal injury verdict in Miami, said Michael A. Haggard, of the Coral Gables, Fla., law firm of Haggard, Parks, Haggard & Bologna P.A. Mr. Haggard represented the plaintiffs.

See CELL PHONES/page 6

## Greater Bay's purchase of ABD one of biggest bank/broker deals

By ROBERTO CENICEROS

PALO ALTO, Calif.—Greater Bay Bancorp, a bank holding company making its first foray into insurance, plans to buy brokerage ABD Insurance & Financial Services Inc.

The acquisition would enable Greater Bay Bancorp to expand its financial services, while ABD would gain the capital needed to preserve its ability to grow and compete.

The acquisition would be the second-largest bank acquisition of an insurance brokerage after Wells Fargo & Co.'s 2000 purchase of Acordia Inc.

Palo Alto, Calif.-based Greater Bay's offer of up to \$193.6 million in a cash-and-stock deal would give the bank ownership of the 16th-largest broker of U.S. business, according to *Business Insurance's* 2001 ranking. The deal is expected to close in the second quarter of 2002.

The merger ensures that ABD will re-

tain its autonomy, name and culture, said Bruce Basso, chairman of the Redwood City, Calif.-based brokerage. ABD pursued the arrangement to help it maintain those characteristics, he said.

ABD is a commercial lines brokerage placing more than \$1 billion in premiums and earning more than \$100 million in revenue. Along with placing property/casualty risks and group health insurance, ABD provides a range of risk management and loss prevention ser-

vices to a client base of midsize and Fortune 1000 companies.

Greater Bay is a financial services holding company with \$7.5 billion in assets. It is traded on the NASDAQ stock market and has a network of 11 Northern California bank subsidiaries. Greater Bay is ranked 96th among the nation's banks and thrifts in terms of assets.

While ABD would retain its independence after the merger, it also would gain access to additional capital needed to expand under its current name, Mr. Basso said. Risk managers can be assured, he said, of having ABD as an independent alternative that would not disappear by selling to a national competitor.

The challenge of how to perpetuate itself—a hurdle ABD would overcome with this deal—is a challenge faced by many independent insurance agencies and brokerages.

"ABD is now a permanent fixture in

See ABD/page 32



# Insurers' action betrayed policyholder, court rules

By MICHAEL PRINCE

**CHICAGO**—An insurer cannot pay a policyholder's opponent to revise its lawsuit so the insurer no longer has to defend its policyholder, a federal appeals court has ruled.

In a stinging reproach, a unanimous three-judge panel ruled that two insurers' attempt to evade their duty to defend the policyholder violated their fiduciary obligations.

"We have difficulty imagining a more conspicuous betrayal of the insurer's fiduciary duty to its insured than for its lawyers to plot

with the insured's adversary a repleading that will enable the adversary to maximize his recovery of uninsured damages from the insured while stripping the insured of its right to a defense," the Dec. 6 opinion by the 7th U.S. Circuit Court of Appeals states.

The case arose from a 1996 suit by Lockwood International B.V. against Volm Bag Co. Inc. in Wisconsin. The suit alleged that Volm interfered with Lockwood's business in making and selling machines to weigh and bag produce.

Volm turned to its two commer-

cial general liability insurers, North River Insurance Co. and Fidelity & Guaranty Insurance Co. FGIC, a unit of USF&G Corp., which is owned by The St. Paul Cos. Inc., denied that its policy covered the suit and refused to defend Volm. North River, a Fairfax Financial Holdings Ltd. unit, defended Volm but said it would cover only some of the allegations in the suit.

In 2000, the insurers agreed to pay Lockwood \$1.5 million—with each insurer paying half—to settle claims that could be covered by the policies. As part of the settlement,

they also agreed "to contrive a complaint that would eliminate any remaining contractual obligation of the insurance company to defend the insured," the 7th Circuit ruled.

The trial court approved the settlement and dismissed the insurers from the suit.

Volm appealed, arguing that North River and FGIC still had an obligation to defend it in the suit.

"The people that we were hoping would come to our aid further imperiled us," said David Gauntlett of Gauntlett & Associates in Irvine, Calif., who represented Volm. "It is

the most egregious and the most aggressive insurer tactic I have ever encountered" in a coverage dispute.

The 7th Circuit panel reversed the lower court's decision. Because Volm did not agree to the payment to Lockwood, the maneuver violated the duty of good faith inherent in insurance contracts in Wisconsin, the panel said.

Insurers may settle covered claims and eliminate their duty to defend. But the insurers took this too far, the panel ruled. North River and FGIC "did not merely settle covered claims; as part of the settlement, they paid Lockwood to convert some of the covered claims to uncovered claims. That was not dealing in good faith," Judge Richard Posner wrote for the panel.

Even the reworked complaint would not, however, eliminate the insurers from the suit, the 7th Circuit said. The facts of the case, and not the wording in the complaint, determine whether a duty to defend exists, the opinion states.

To overcome this hurdle, Lockwood agreed not to try to prove allegations that would trigger the duty to defend. But such a trial would have been unprecedented and unworkable as the insurers—no longer parties to the suit—would need to monitor the testimony and object to anything that might trigger coverage, the 7th Circuit ruled.

While the appeal was pending, Lockwood and Volm settled their dispute for an undisclosed amount.

Mr. Gauntlett said Volm is considering its legal options against the two insurers for their actions. Under Wisconsin law, insurers owe policyholders a fiduciary duty, which could entitle Volm to seek damages, he said.

North River last week sought a rehearing, saying the 7th Circuit "misunderstood the settlement," said Jeff Schmeckpeper, a partner with Kasdorf, Lewis & Sweitlik in Milwaukee, the insurer's attorney. He said the insurers' settlement did not violate any duty to Volm.

*Lockwood International B.V., North River Insurance Co. and Fidelity & Guaranty Insurance Co. vs. Volm Bag Co. Inc., 7th U.S. Circuit Court of Appeals; No. 01-1275.*

## Errors & Omissions

Due to a production error, a Dec. 10

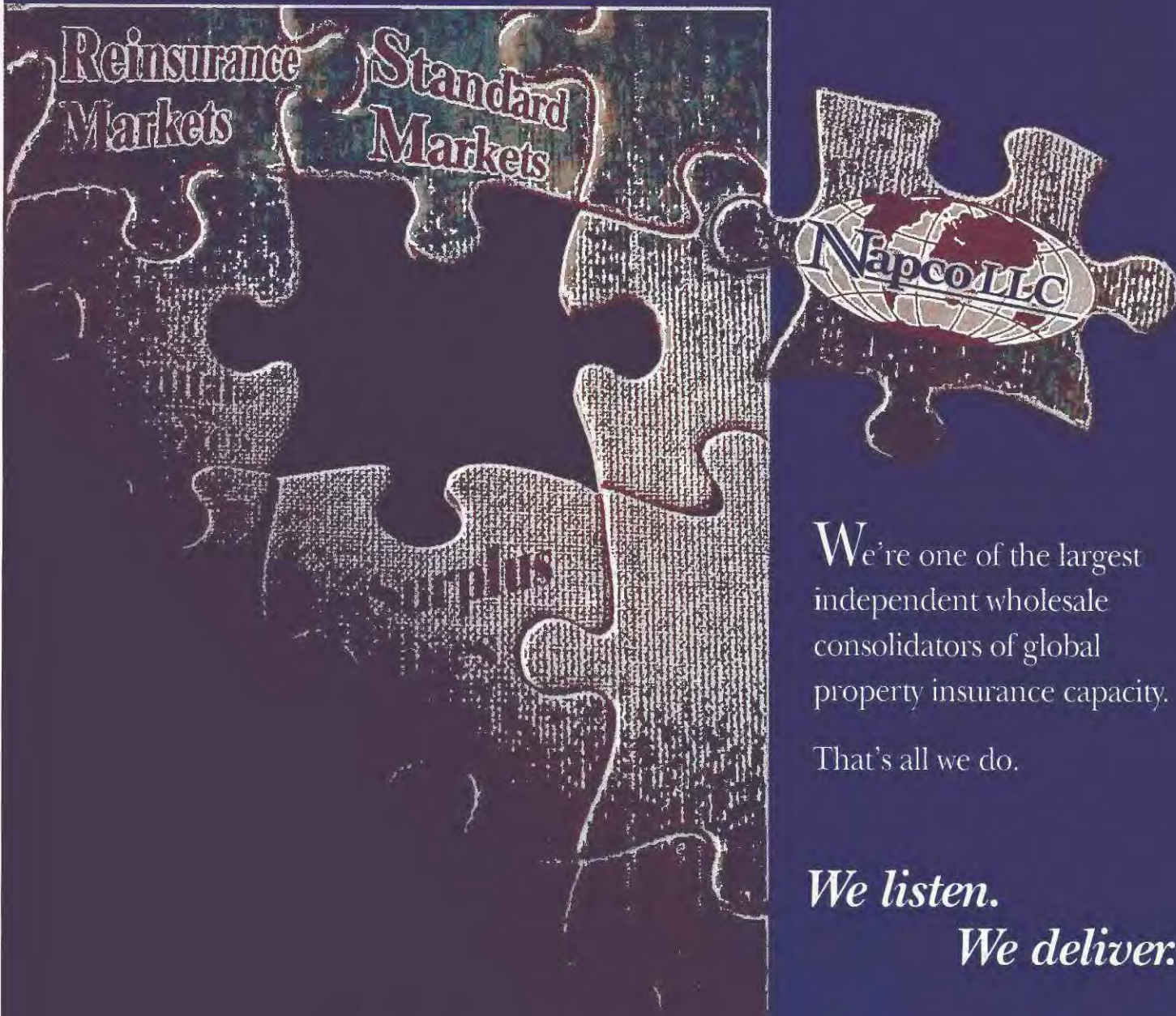


Mr. Levine

photo in the Comings & Goings: Industry column was incorrect. The photo was of Jay M. Levin, an attorney with Cozen O'Connor in Philadelphia. The correct photo, at left, is James H. Levine. Mr. Levine was named president and CEO of Vista Insurance Partners Inc., a San Antonio-based wholesale brokerage unit of Summit Global Partners Inc.

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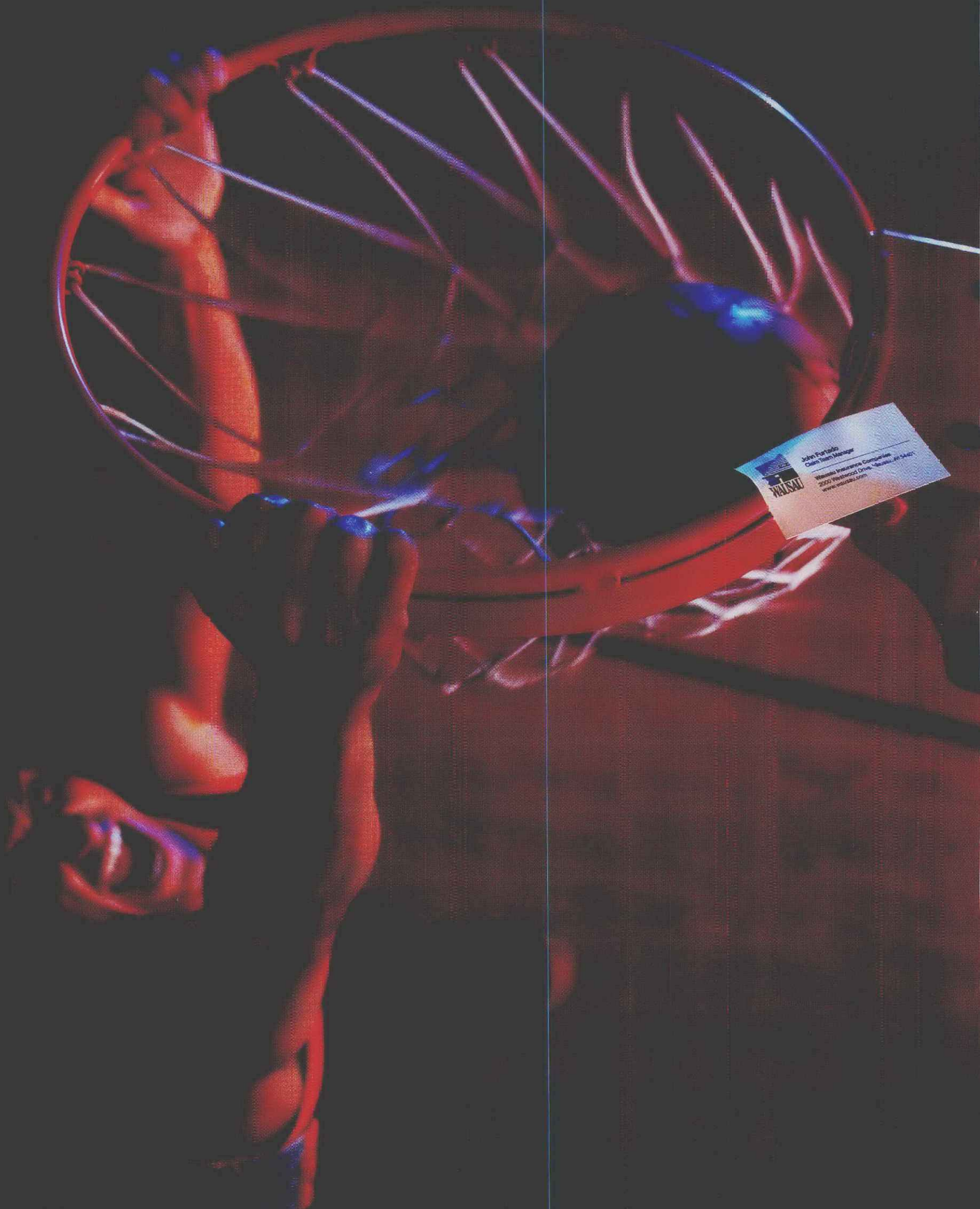
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What can we do to help you?

# Cell phones: Distraction liability

Continued from page 3

Mr. Haggard noted that there was no question that Mr. Leiva was distracted while he was driving. Mr. Leiva "wasn't negligent because he was on the cell phone, but it's obviously an issue," he said. "This might prove why."

Dyke Industries, which declined to comment, has a \$16 million commercial auto insurance policy underwritten by The St. Paul Cos. Inc., Mr. Haggard said. St. Paul also declined to comment.

Meanwhile, a circuit court judge in Leesburg, Va., recently denied the demurrer by the Palo Alto, Calif.-based law firm of Cooley Godward in a cell phone-related case.

The judge's ruling permits a \$30 million wrongful death lawsuit to proceed against the firm. The case involved one of its former associates, Jane Wagner, who accidentally struck and killed a 15-year-old girl while driving her car and, the plaintiff alleged, conducting business on a hand-held cell phone (*BI*, July 16).

The suit, *Yoon vs. Wagner*, alleges that Cooley Godward is not only vicariously liable for the accident but also directly negligent.

**The lawsuit charges that the driver was acting within the scope of her employment when making cell phone calls to clients and that her employer encouraged the use of cell phones to conduct business.**

Among the suit's charges are that Ms. Wagner was acting within the scope of her employment when making cell phone calls to clients and that Cooley Godward encouraged the use of cell phones to conduct business. The suit also alleges that the firm failed to establish a policy about the safe use of cell phones while driving.

According to transcripts from

the Nov. 5 demurrer, Cooley Godward's attorneys argued, among other things, that it was Ms. Wagner's driving activity that caused the accident and that because she was driving home at the time of the accident, she was not acting within the scope of her employment.

In his ruling, Judge Burke F. McCahill of the Circuit Court of Loudoun County, Va., granted plaintiff attorneys time to amend their direct negligence claim, and he rejected the demurrer on the vicarious liability claim.

"If the evidence leaves in doubt the question of whether the (employee) acted within the scope of the employment, the issue is to be decided by the jury and not as a matter of law by the trial court," Judge McCahill said.

*Alicia Bustos & Ruben Bustos vs. Lazaro Luis Leiva & Dyke Industries Inc., Miami-Dade County Circuit Court, No. 01-13370 CA30.*

*Yoon vs. Wagner et al., Loudoun County Circuit Court; CL 24892.*

## BI's Commentary introduces new columnists

Beginning this week, *Business Insurance* presents five new columnists whose commentaries will alternate with those of Editor Paul Winston on this page.

The columns of *BI* Senior Editors Mark Hofmann, Dave Lenckus,

Doug McLeod, Joanne Wojcik and Rodd Zolkos will be appearing in this space on alternating weeks. All are seasoned veterans of *BI*, having covered the ins and outs of risk management and employee benefits for many years. Some will offer

sober opinions and others will provide offbeat musings; all have interesting views about the industry they cover.

We hope you will enjoy reading their commentary in the weeks to come.

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## Commentary

# Of bad times and bad timing

It's hard to believe, but it's been only two years since the doomsayers were working overtime, warning us that things would never be the same again after the New Year rolled around.

They were talking about something that we called the Y2K bug. Remember that?

For those who have mercifully banished this pest from their memories, the bug was a computer glitch made possible by a programming shortcut. Instead of using four digits to signify a year—such as 1999—the programmers opted to use only the last two—99. This worked fine, up to a point.

According to experts of all stripes, that point was going to be midnight, Dec. 31, 1999. At that moment, the world's computers would crash, or start malfunctioning, or maybe just get a little persnickety because they would not be able to read "00" as "2000."

Nobody knew exactly what would happen at that point in time. One of the more-benign theories was that the computers would think it was 1900 instead of 2000. That might mean that the government computers would automatically issue presidential proclamations over the signature of William McKinley rather than that of William Clinton. Many people would have welcomed such a development.

Others claimed that not much of anything would happen. There would be an isolated glitch here or there but nothing that would cause mass, or even minor, disruption.

The really scary people said that everything was going to blow. The power grid would freeze and the lights would go out on Broadway. The ATMs would refuse to spit out twenties. Radar screens would go dark, and planes would fall from the sky. And insurers would exclude coverage for any and all of it. Some of these folks accompanied their dark prophecies with offers of do-it-yourself survival kits at more-than-reasonable prices.

Fortunately, this wasn't taking everybody by surprise. Thankfully, serious people took the threat seriously. Government task forces and special committees assured us the sky would not fall. I spent countless hours in a series of hearing rooms on Capitol Hill, listening to experts assure us that though there would be problems they were not insurmountable. There were fixes to be had, and, by God, we'd use them. We had to recognize the problem and deal

with it.

Well, Jan. 1 came and went. The data continued to flow. The bite of the Y2K bug went unnoticed, and the hysteria that accompanied it barely merits a footnote. Radio stations stopped playing R.E.M.'s "The End of the World as We Know It" every hour or so.

The doomsayers went back to wherever doomsayers go, and Y2K faded from memory.

Nothing had changed except the date on the calendar. Everything else was the same as it had been.

I thought about the Y2K scare a few weeks as I made my way to a hearing on Capitol Hill.

Authorities had declared the building where the hearing was scheduled to be held off limits due to anthrax fears. So the senators had to gather in a subterranean chamber beneath the U.S. Capitol. I walked through a Capitol devoid of tourists—for security reasons—went down the stairs and ended up in a subterranean windowless hearing room.

It wasn't the usual congressional hearing room, either. It was appointed well enough, but it was more like a meeting room that you'd find in a hotel by the interstate in say, Greensboro, N.C., or Kenosha, Wis. A plain and generic space but for the tangle of audiovisual cables taped to the carpet.

Despite the setting, I listened to serious people—in fact, some of the same senators who had been involved in Y2K response efforts—talk about serious things. In this case, the talk revolved around what the government should do to ensure that insurers could pay claims stemming from future terrorist attacks. Just as with Y2K, there were problems, but just as with Y2K, they were surmountable, and, by God, we'd surmount them.

As I walked out into the late autumn sunshine, I thought about the Y2K doomsayers. They had been wrong on just about everything. But they were right when they said the time would come after which things would never be the same. They'd just been wrong about the year—and the reason.

Senior Editor Mark A. Hofmann's commentary will appear periodically and can be found at [www.businessinsurance.com](http://www.businessinsurance.com). Mr. Hofmann can be reached at [mhofmann@crain.com](mailto:mhofmann@crain.com).



Mark A. Hofmann

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[Spotlight editor: Jerry Geisel]

## Top 10 employee benefit stories of 2001

1. Health insurance costs soar at near-record rate
2. Patient protection legislation stalls in Congress
3. Congress passes sweeping pension reform legislation
4. EEOC withdraws enforcement of Erie County ruling
5. Employer interest in consumer-driven health care swells
6. IRS issues final COBRA health care rules
7. Congress fails to pass mental health care parity bill
8. HHS issues expanded medical privacy rules
9. Declining Treasury bond rates expand pension liabilities
10. Impact of decline of stock market on 401(k) plans

Recap of the top 10 employee benefit stories begins on page 15

## Top 10 risk management stories of 2001

1. Terrorists destroy the World Trade Center
2. Congress scuttles OSHA ergonomics rule
3. Insurers, especially in Bermuda, add new capacity
4. Property/casualty market dramatically hardens
5. Reliance Insurance Co. enters liquidation
6. Governments worldwide consider terrorism insurance plans
7. Asbestos costs escalate, insurers toughen claims review
8. IRS drops economic family theory for captive tax deductions
9. Underwriters carve out e-commerce coverage from policies
10. Tax ruling that UPS captive was a 'sham' is overturned

Recap of the top 10 risk management stories begins on page 22

# High costs a top concern of benefit managers

## Inflation drives plan changes, cost shifting

By SALLY ROBERTS and MICHAEL PRINCE

Rising health care costs dominate the list of top concerns of 2001 for employee benefit managers.

With costs shooting up this year and prices for next year increasing at rates not seen in nearly a decade, benefit managers are scrambling to find some way to keep the cost increases within reason.

The downturn in the economy, coupled with rising medical costs, has hit the Miami-Dade County Public Schools particularly hard, said Scott Clark, its administrative director in the office of risks and benefits management. Lower sales tax revenue has inflicted cuts on school budgets throughout the state, he said.

"It's a good thing that our health care costs didn't spike for 2002," he said. "Otherwise, we would have been in major, major trouble."

For the 2002 plan year, the Miami-Dade County public school system switched health care providers after it was unable to negotiate a new contract with its largest provider, UnitedHealth Care, according to Mr. Clark. "It was disappointing," he said. "Employees liked

UnitedHealth Care and its open-access product."

By switching to a CIGNA Corp. plan, however, Mr. Clark was able to maintain "pretty flat" health plan costs for the 2002 year, compared with a 30% increase UnitedHealth Care wanted to impose.

Since 1999, the school system has offered a defined contribution-style health plan, whereby employees receive a set amount of money from the school board each month to allocate toward health benefits. This design has helped to keep costs down, Mr. Clark said. He noted, however, that "it's with great trepidation that we go into 2002."

"I'm obviously cognizant of what's going on with health care inflation, and you always worry when you come into a brand-new insurance contract, like we did with CIGNA, and wonder whether they are just using us as a catalyst to get into this market. They best not come looking for 20% to 30% increases for 2003, because we just don't have it to provide them," he said.

Unlike the Miami-Dade County public school system, Walnut Creek, Calif.-based Westaff Inc. was not so lucky when it came to its 2002 health plan renewals.

See **BENEFITS**/page 14

# Disaster alters costs, jobs for many Risk managers worry about Sept. 11 fallout

By MICHAEL BRADFORD and DAVE LENCKUS

Risk managers already were dealing with price hikes and coverage limitations in a slowly hardening insurance market when the nation's worst nightmare made things even tougher.

The fallout from the Sept. 11 terrorist attacks sent rates skyward and injected chaos into many buyers' renewal negotiations. Insurers scrambled to edit terms and conditions. Some coverages—and insurers—disappeared.

Amid all of that, many risk managers were forced to rethink security concerns and make changes to keep their companies safe. Many found that risk management was gaining new recognition within their organizations.

"Things have changed dramatically," said Tom Welgoss, director of risk management at the Massachusetts Turnpike Authority in Boston. "That is the big story," he said of the attacks. "It's the largest insurance disaster ever."

Not only did the attacks make insurance coverage more expensive, it changed the way many risk managers do their jobs.

The attacks forced Dave Parker, the Tucson-based risk manager for Pima County, Ariz., to

beef up the county's loss control program. "I'm spending loss control dollars today that I wouldn't have spent a year ago," he said.

Issuing employee identification badges, shutting some entrances to buildings and posting guards in underground walkways that link up buildings and garages "costs money," he said.

Others say the attacks have created new awareness among risk managers about how to better protect their organizations.

"Some enlightening things have come out of the Sept. 11 disaster," said Paul F. Buckley, treasury director-risk management for Murray Hill, N.J.-based Lucent Technologies Inc. and subsidiary Agere Systems of Allentown, Pa.

Insurers are evaluating their accumulation of workers compensation risks in geographic areas, and businesses are reconsidering the wisdom of placing much of their intellectual capital in a single location, Mr. Buckley said.

While the days of simply dealing with market cycles might seem long ago, risk managers still face that challenge and others unrelated to the attacks.

"I'm not in that group, personally, that believes the world changed on Sept. 11," said David L. Mair, risk manager with the U.S.

See **RISK**/next page

# Risk: Attacks, market hardening create worries

Continued from previous page

Olympic Committee in Colorado Springs, Colo., and president of the Risk & Insurance Management Society Inc. "The world was, on Sept. 9, a dangerous place full of operational and financial risks. What changed was the address of terrorism. It was no longer on TV but was part of our real lives."

The attacks brought to the fore the risks of business recovery, security and the shaky financial underpinnings of some insurers, he said. "But still with us," he said, are older problems, such as the "ergonomic concerns for our workforce. We still anticipate OSHA will release standards for Congress to respond to."

**'The world was, on Sept. 9, a dangerous place full of operational and financial risks. What changed was the address of terrorism.'**

David Mair  
U.S. Olympic Committee

Mr. Parker agreed that risk managers should be watching the ergonomics issue closely. He said Congress' decision to scuttle the ergonomics standards was important for two reasons. "OSHA standards should be driven by science and industry group consensus, not by government regulators," he said. And, the decision quashed what Mr. Parker believes was "a move to federalize workers compensation. The Jeffersonians prevailed over the Hamiltonians."

The ergonomics issue could have been an even bigger one for risk managers, said James E. Green, an independent risk management consultant in Fort Worth, Texas. He said a victory by Al Gore in last year's presidential race likely would have resulted in a restrictive ergonomics standard.

Mr. Green noted that RIMS is working with the Department of Labor to help fashion "reasonable guidelines" that address ergonomics concerns without overburdening employers.

Other developments during 2001 also challenged risk managers.

One of the most important was that insurers began to exclude coverage for electronic risks, said Judy M. Lindenmayer, vp-insurance and risk management at Boston-based FMR Corp., better known as Fidelity Investments.

Fidelity covers the risk in a layer of its concentric, or integrated, risk program, she explained. Under such programs, an insurer covers a variety of risks with a single limit, rather than writing separate limits for each risk. As a result, the company never lost its e-coverage, she said. That was important because Fidelity conducts more than 80% of its financial market trades online, Ms. Lindenmayer said.

Through all the changes and challenges of the past year, risk managers say the hardening market probably will be the primary concern next year, gobbling up premi-

ums well into 2002 and possibly beyond.

The hardening has caused "a significant amount of problems," Mr. Buckley said. "Honestly, I thought one of the major things was the rapid decline of the D&O market." Last April, Lucent's D&O premiums "increased significantly" at renewal

while the company defended a D&O claim over the rapid decline in Lucent's stock value. Even so, he noted, many D&O underwriters informed him that he would have faced increases without the claim.

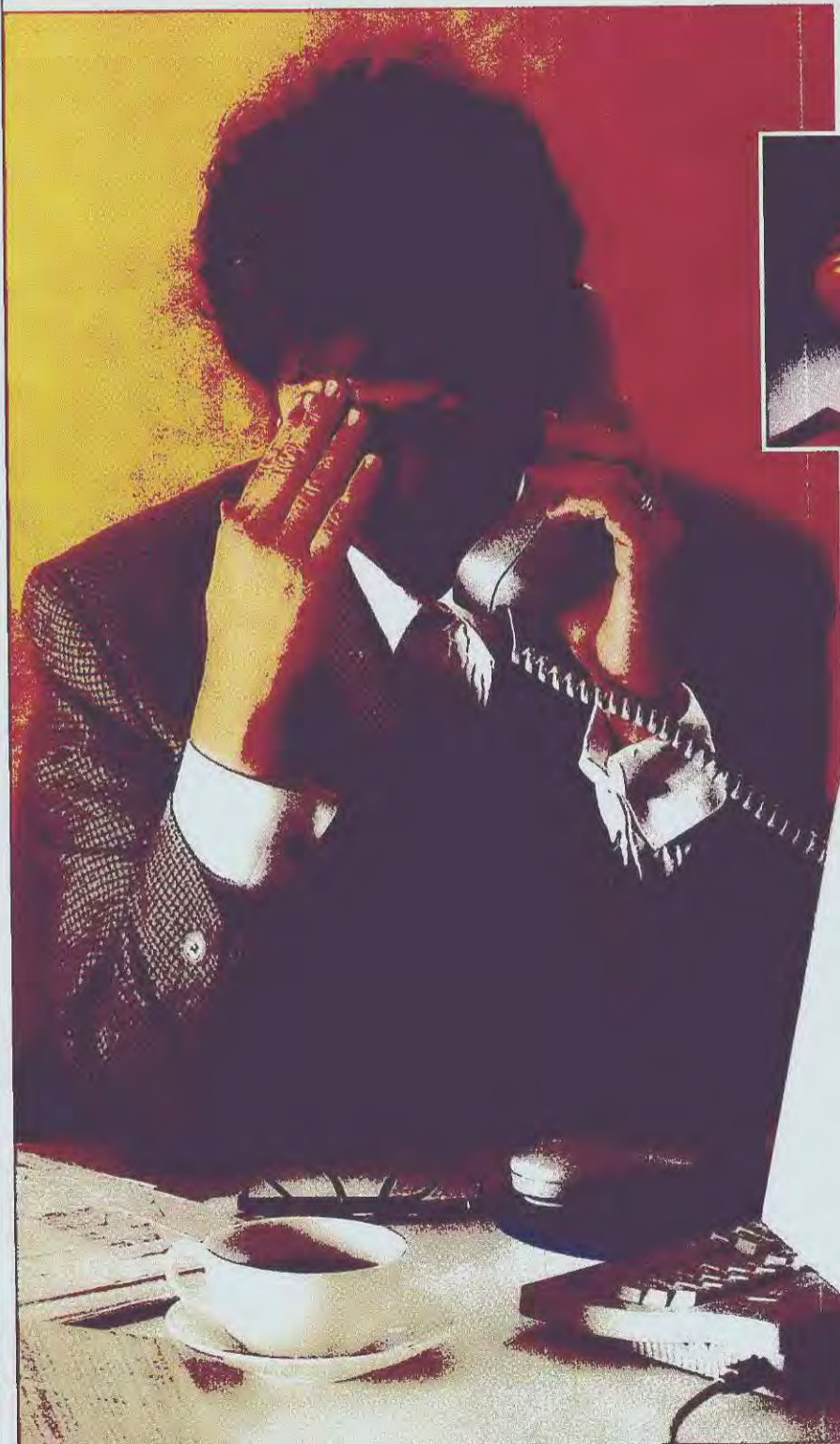
He said fallout from the hardening market could cost some risk managers their jobs if they have not

prepared top management for the coming price increases. Many risk managers took too much credit for the low costs during the soft market, Mr. Buckley said. "It will be interesting to see how many step up to take the blame" for the higher insurance costs, he said.

Mr. Welgoss agreed that past per-

formance can make a difference during tough times. Hard markets "tend to affirm the importance of sound risk management practice and the establishment of excellent working relationships, not just with brokers, but with insurance companies" that were developed during better times, he said.

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# Benefits: Rising health care costs are top concern

Continued from page 10

"It was a difficult year for us," said Jeffrey W. Pettegrew, vp-risk management and insurance. "We've absorbed increases in our health plan for the last three years, and this year we've had to pass on the entire expected increase to our employee contributions," he said. Mr. Pettegrew noted that health plan cost increases are averaging about 25% for the 2002 plan year. "It's a pretty heavy hit, with some contribution levels going up as high as 50% on an individual basis. It's an unfortunate situation."

Mr. Pettegrew said that he also received a 25% increase from Westaff's stop-loss insurer for its Jan. 1 renewal, but he was able to temper that a bit by increasing the company's retention by 10%.

American Express Co. in New York fared somewhat better and was able to hold down health care increases to about 9% for 2002, said Arleane Soto Baltrusitis, vp-benefits and health services in Parsippany, N.J.

This was accomplished by reducing the number of plans the company contracts with throughout the

United States to 49 from 101.

The consolidation gives American Express more clout with each plan, enabling it to get a better deal, she said. In addition, the company shifted more of its plans to a self-insured basis, further reducing costs. By making these changes, the company was able to keep employee contributions at the same percentage of total costs as last year, Ms. Baltrusitis said.

Soaring health care costs also topped the list of concerns for James E. Crockett, manager of risk and benefits at Denver Water. The

organization intends to shift more health plan costs to employees after absorbing a nearly 20% increase for the 2001 plan year.

"We spent \$7.5 million for health care in 2001 for our 1,000-employee workforce, and we'll spend an additional \$1.5 million for 2002," Mr. Crockett said. "We have a very excellent employee health plan with low cost to employees," he said. "We're going to have to shift more and more cost onto the employee, however, as health care rates continue to increase."

In addition to shifting more costs, Denver Water also is conducting internal educational meetings to encourage employees to use generic drugs rather than pricey brand-name drugs, Mr. Crockett said.

"The bottom line is, we want employees to ask their doctors if there is a generic equivalent they should be considering," he said.

It is not just rising health care costs that have benefit managers concerned.

Mr. Clark of the Miami-Dade County Public Schools said he is also concerned about complying with new federal medical privacy regulations.

He noted that the school system has worked hard to put together an automated online benefit enrollment program and was "encouraged" that about one-third of the employees enrolled online during the most recent open enrollment period.

**'We have a very excellent employee health plan with low cost to employees. . . . We're going to have to shift more and more cost onto the employee, however, as health care rates continue to increase.'**

*James E. Crockett  
Denver Water*

With all the information that had to be put online, however, Mr. Clark said that he was very concerned about complying with the Health Insurance Portability and Accountability Act. "We will obviously be working very closely with our benefit consultant to make sure that we are in compliance," he said.

Ms. Baltrusitis of American Express said that the declining stock market has reduced the value of its employees' 401(k) accounts.

This has particularly hurt older employees, who may have to reconsider whether they can afford to retire, as their account balances have dropped so much in value, she said.

The situation underscores the need to teach employees that retirement accounts are long-term investments that should not be evaluated in the short term.

This is somewhat easier at American Express than elsewhere, as Amex employees are generally knowledgeable about finances, Ms. Baltrusitis acknowledged.

Denver Water's Mr. Crockett said that this year's pension reform legislation has had a "major impact" on his company's employee education efforts. Denver Water offers 21 investment choices in its 401(k) plan.

"It's an educational process to make sure employees understand" all the changes due to the legislation as well as the need for retirement savings. This is especially challenging given the recent stock market declines, Mr. Crockett said.

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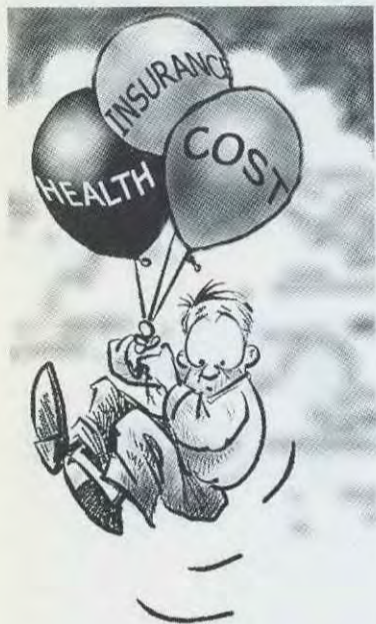
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# Top employee benefit stories of 2001

## 1 Health care costs

After years of moderate health care cost increases, employers got a rude awakening in 2001—a return, after nearly a decade's absence, of double-digit health care premium hikes.

Managed health care plans, for their part, insisted that big price hikes were needed to compensate for sagging profits, rising prescription drug costs, higher utilization rates and providers demanding and winning rate increases.



But, after swallowing two years' worth of significant premium increases, employers began to sit up and take notice in 2001. Many companies, for instance, began shifting more of the cost to employees in the form of higher copayments and deductibles, while others began implementing multitiered copayment programs to encourage the use of less costly generic prescription drugs.

Due to a strong economy and a tight labor market, however, employers were hesitant to increase the amount of premiums that employees contributed to health care coverage.

That began to change at the end of 2001, however, when many employers got word of even heftier health plan cost increases for the 2002 plan year. Benefit consultant Towers Perrin, for one, estimated the average health care plan rate increase for large employers in 2002 would be 14%—the largest year-over-year percentage increase since it began conducting its survey more than a decade ago.

Observers point to the same cost drivers as the impetus behind 2002 rate hikes, including nearly 20% increases in prescription drug costs. As a result, many employers began to boost, starting next year, premiums paid by employees, as well as considering alternative health care benefit plan designs, such as defined contribution-type health plans.

—By Sally Roberts

## 2 Patient bill limbo

The details were a little different from 1999 but the result was the same—patient protection legislation ended the year in legislative limbo.

This year's debate over a so-called patients' bill of rights looked a lot like the 1999 debate, but the roles

of House and Senate were reversed this time.

It was the Senate that approved the more sweeping—and, to employers, less-than-acceptable—bill this time around. Employers and insurers feared that the Senate bill—which emerged after Sen. John McCain, R-Ariz., joined such Democratic stalwarts as Sen. Edward Kennedy, D-Mass., to craft the bill—would subject them to liability for coverage decisions made by the health care plans they sponsored. Two years earlier, the Senate had passed a much less comprehensive

bill that didn't even get into the issue of employer liability.

The Senate bill flew into the face of principles for managed care reform set out by President Bush even before debate began. The measure won approval by a wide margin but appeared certain to draw a veto.

Back in 1999, the House passed the bill that employers loved to hate, a bill they said would saddle them with so much liability that many companies would drop health care coverage rather than face the risk of litigation. But this

Continued on next page



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Continued from previous page  
 year, the House's chief advocate of managed care regulation legislation, Rep. Charles W. Norwood, R-Ga., moved himself off center stage out of loyalty to President Bush. The result was a bill potentially less burdensome than the Senate measure, though still opposed by employers and insurers.

Even though the Senate passed its bill in June and the House followed suit with its bill in early August, no conference committee has been appointed to work out differences between the two measures. Any further action in this Congress appears less and less likely with each passing day.

—By Mark A. Hofmann

## 3 Pension reform

Employers and employees will soon benefit from a three-year lobbying effort that resulted in the passage in May of a sweeping pension reform bill.

The measure, known as the Economic Growth and Tax Relief Reconciliation Act of 2001, takes effect next year. The bill marks a big departure from the pension-related legislation in the 1980s, when Congress passed several bills that dramatically cut back the amount

of benefits that could be provided through pension plans and that added layer after layer of complex rules.

EGTRRA goes in the opposite direction. For example, the new law will allow employees to defer more to 401(k) plans, while benefit and contribution limits for other types of pension plans also will be increased.

In addition, employers that offer pretax and aftertax contribution features in their savings plans will enjoy simpler nondiscrimination testing rules, and the law will also make it easier for employers to cash out terminating employees with small account balances, cutting administrative overhead.

Another change will allow employees who move between the private, nonprofit and governmental sectors to roll over funds between 401(k), 403(b) and 457 plans. In addition, the law will reduce to six months from 12 the waiting period for employees taking hardship withdrawals from 401(k) plans to resume contributions to the plans.

The new law is a "shot of adrenaline for pension plans," said Phil Anderson, senior vp-government affairs for the American Council of Life Insurers in Washington.

Benefit experts attribute the change in congressional attitude to a growing awareness among legislators that their prior approach—cut-



ting benefits and imposing ever more complex rules—was placing employees' retirement income at risk as more and more companies were terminating their pension plans.

In addition, the improved fiscal health of federal government meant that it could afford the loss of tax revenue resulting from increased benefit limits with a corresponding increase in corporate tax deductions.

—By Jerry Geisel

## 4 EEOC guidance

Next year, employers may have definitive federal guidance on health care plans they can offer to Medicare-eligible and other retirees without violating federal age discrimination law.

The Equal Employment Opportunity Commission is developing new rules following its rescission in August of a policy that said it was discriminatory for employers to provide less coverage for Medicare-eligible retirees than for other retirees.



That policy had been in place since October 2000, two months after the 3rd U.S. Circuit Court of Appeals ruled that the Age Discrimination in Employment Act applied to retiree health plans. The decision, involving a plan offered by Erie County, Pa., stunned benefit experts, who had long thought the AEEA applied only when comparing benefit plans offered to younger

Continued on next page



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Continued from previous page and older employees.

To comply with both the *Erie County* ruling and EEOC rules, an employer would have had to offer equal health care benefits to all of its retirees or spent an equal amount of money for younger and Medicare-eligible retirees.

Employers now typically offer much richer health benefit packages to younger retirees than to retirees 65 and older. That disparity is a logical design differentiation because older retirees receive most of their benefits through Medicare.

Upgrading benefits for older retirees—one way to comply with the court decision and the EEOC rules—would have been prohibitively expensive for many companies. Reducing benefits for younger retirees or eliminating coverage also would pass muster but would result in a reduction or loss of coverage for million of retirees.

The EEOC's top official, Cari M. Dominguez, said the agency would develop a new policy consistent with ADEA but one that does not discourage employers from offering retiree health care coverage. An EEOC spokeswoman said the agency is reviewing the issue, and benefit experts hope that regulators will unveil the new guidance next year.

—By Jerry Geisel

## 5 Health plan choice

Employers increasingly are considering defined-contribution health care options in response to skyrocketing health care costs and the sluggish economy.

The popularity of such plans, especially so-called consumer-driven health plans, indicates a sharp turnaround from the end of 1999, when the concept got a bad rap in the national media in response to Xerox Corp.'s announcement that it was "exploring" the idea.



Today, by contrast, established health insurers are beginning to offer their own versions of these innovative plans that once were available only through startup companies, giving the movement the legitimacy it needs to gain momentum. Among the established health insurers dabbling in the defined contribution health care market are Aetna Inc., Humana Inc. and United Healthcare.

The concept got an added boost

in November, when the Pacific Business Group on Health, one of the nation's largest health care purchasing coalitions, announced it was entering into a partnership with Definity Health, a pioneer of the consumer-driven health plan model, to offer Definity's plan to its 44 large employer members.

Beginning in 2002, a growing number of large employers will be experimenting with this plan option, which, in general, consists of

high-deductible coverage with individual health care spending accounts into which an employer makes a defined contribution annually. An employee may carry over any unused portion of the spending account from year to year. Employees then are given information on the cost and quality of the various health care services, so they can shop around before spending their money from their accounts.

And consultants predict that if

current economic conditions continue, a sizable number of employers will be following the lead of those employers in 2003.

"We do it with retirement savings plans; medical is the next step," said Bill Flannery, director of compensation and benefits at New York-based Novartis Corp., which began offering a defined contribution plan to retirees last summer.

—By Joanne Wojcik

Continued on page 20

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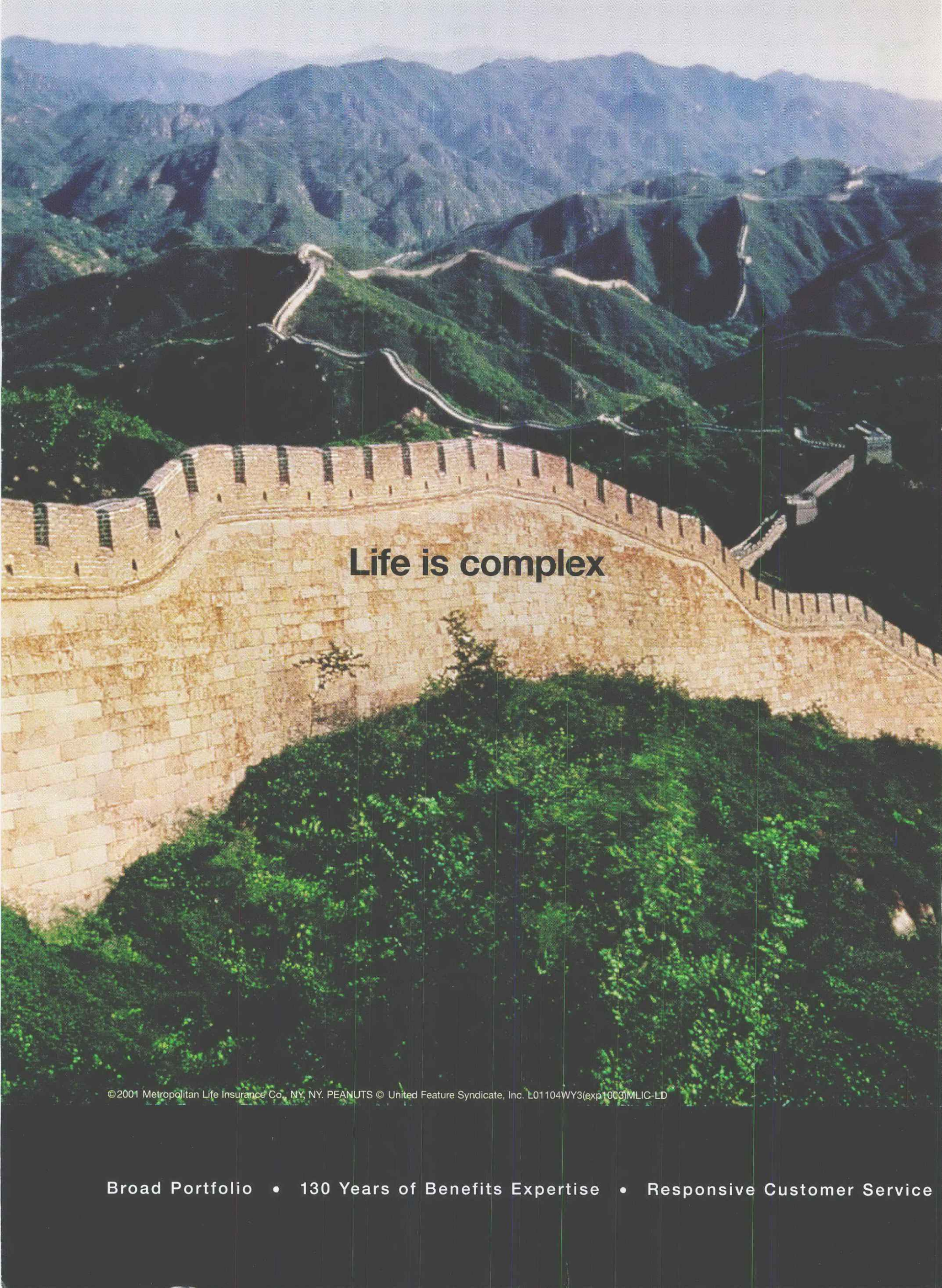
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Continued from page 17

## 6 COBRA rules arrive

In 2001, nearly 15 years after the enactment of the Consolidated Omnibus Budget Reconciliation Act, the Internal Revenue Service finally finished issuing regulations to



help employers comply with the health care continuation law.

Enacted in 1986, COBRA requires employers to extend, in certain situations, coverage under their group health care plans to former employees, their dependents and their widowed, divorced or separated spouses.

If, for example, an employee quits or is terminated, that individual can continue the coverage for 18 months. If an employee gets divorced or dies, his or her dependents can continue their coverage for 36 months. Employers can charge COBRA beneficiaries a premium of up to 102% of the group rate.

Since COBRA was enacted, the IRS has issued a variety of regulations in an attempt to address the many questions employers and other plan administrators have raised.

In January, the IRS issued final regulations to provide answers to many of those questions and eliminate much of the uncertainty among employers about how to comply with the law.

For example, one question employers have raised for years is whether they have the right to cancel coverage when a COBRA premium is short by a few dollars. Under the final IRS regulations, employers got the answer: a premium payment that is short by an "insignificant" amount has to be treated as paid in full unless the employer notifies the beneficiary of the deficiency and requires that the amount be paid within a reasonable time.

The final regulations define an "insignificant" payment as one that is short by \$50 or 10% of the required amount, whichever is less. The IRS said giving beneficiaries up to 30 days to pay the shortfall would be reasonable.

The regulations also make clear that an employer must offer COBRA coverage to eligible beneficiaries even if the company also offers a less-costly health care coverage alternative.

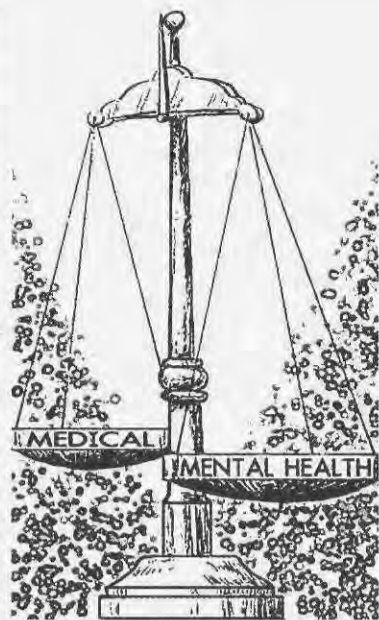
—By Jerry Geisel

## 7 Parity bill defeated

When it comes to mental health care benefits parity legislation, 2001 was not a year in which history would repeat itself.

In 1996, Congress, with extraordinary speed, adopted a mental health benefits mandate in an unusual way.

Skipping the usual slow process by which bills are introduced and referred to the appropriate committees, Sen. Pete Domenici, R-N.M., instead chose a "must-pass" bill—in this case, a Senate measure appropriating funds for several federal agencies—on which to attach a proposal banning discriminatory annual and lifetime dollar limits in group health plans for mental health care services. Ultimately, Congress accepted the proposal as part of the broader appropriations bill.



This year, Sen. Domenici and Sen. Paul Wellstone, D-Minn.—who had co-authored the 1996 proposal—first tried a different approach, introducing expanded mental health care benefits parity legislation as a freestanding bill. The new bill, unlike the 1996 law, would require total parity between mental health and other medical services.

Initially, the measure developed a powerful head of steam. On Aug. 1, the legislation, which ultimately picked up the support of two-thirds of the Senate, was unanimously approved by the Senate Health, Education, Labor and Pensions Committee and seemed headed toward easy Senate approval. But efforts to bring the bill to the Senate floor for a vote faltered due to opposition from several conservative Republican senators.

So, Sens. Domenici and Wellstone retried their 1996 approach: convincing the Senate to attach the parity measure to a broad appropriations bill.

But that strategy ultimately failed when the House Republican members of a congressional conference committee unanimously refused to accept the parity amendment, saying the mandate would drive up the cost of insurance.

Sen. Domenici acknowledged that this year's effort to achieve parity was over. But while the battle was lost, "we haven't lost the war," Sen. Domenici said, adding that he believes Congress will consider and pass parity legislation next year.

—By Jerry Geisel

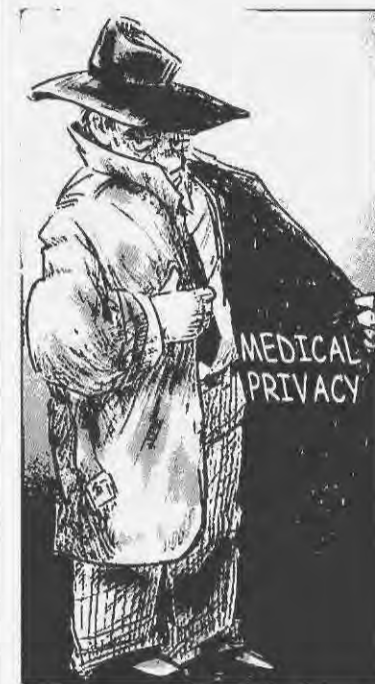
## 8 HHS rules on privacy

A last-minute regulatory announcement by the lame-duck Clinton administration had employers and insurers alike in frenzy early this year.

Less than a month before the Bush administration took office, the Department of Health and Human Services issued its final rule on medical records privacy. It wasn't a job HHS had gone looking for: Congress was supposed to issue the privacy regulation itself under the terms of the Health Insurance

Portability and Accountability Act of 1996 but failed to meet its own deadline for doing so. And when the job fell to HHS, it ended up promulgating a regulation that critics claimed went far beyond what Congress had intended.

The rule would require covered entities—including insurers, health care providers and health care data clearinghouses—to take specific actions to protect the privacy of individual medical records. Those that failed to do so would face signifi-



cant penalties, including prison under some circumstances. Although Congress intended the rule to cover only electronic records, HHS extended it to all sorts of communications. Insurers and employers foresaw a recordkeeping nightmare compounded by ambiguous language that indicated that workers compensation might also be covered by the rule.

Critics appeared to have no recourse but to live with the regulation, with which they would have to comply over a period of several years. But a paperwork error committed in the final days of the Clinton administration allowed the new HHS secretary to delay implementation of the rules and to reopen the comment period.

HHS Secretary Tommy Thompson ultimately decided to let the rule go into effect on April 14, but he promised to issue guidance in order to "correct unintended negative effects" of the rule.

The first guidance, issued on July 6, settled some employer fears about the rule's reach beyond health records and left open the possibility that the regulation's potentially onerous impact would be blunted further before employers would have to comply fully on April 14, 2003.

—By Mark A. Hofmann

## 9 Bond yield hits plans

Employers with defined benefit pension plans will pay dearly as a result of this year's plunge in U.S.

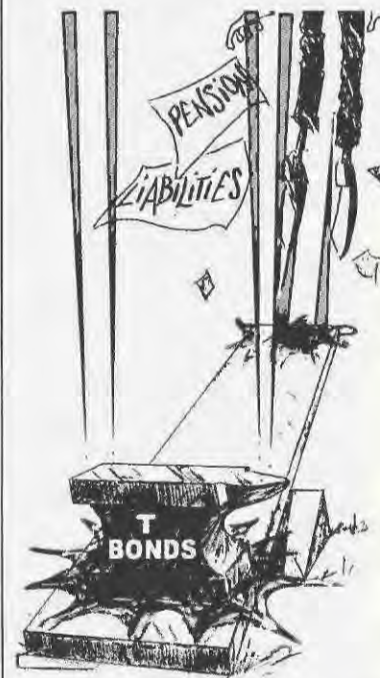
Treasury bond interest rates.

Next year, employers will have to pump tens of billions of extra dollars into their pension plans, not because the plans are less secure but solely due to a federally mandated way of calculating the liabilities on which contributions are based.

Under a 1994 law, employers are required to value pension liabilities using a four-year weighted average of the yield on 30-year Treasury bonds.

Those bond yields in recent years have been declining in recent years as the as the federal government has paid down its debt. And rates took a further tumble in October when the Treasury Department said it would not be issuing new 30-year bonds. The 30-year T-bond rate now is about 5.5%, down from 6.6% in January 2000. Pension experts estimate the four-year weighted average will be about 5.75% in January, compared with 6.3% in January 2000 and 6.6% in January 1999.

In fact, long-term T-bond rates that historically have yielded one percentage point less than highly rated corporate bonds now trail by



about two percentage points. That growing disparity has led some business groups to advocate using a long-term corporate bond index to calculate pension liabilities.

For example, eight trade groups—including the American Benefits Council, the American Council of Life Insurers and the ERISA Industry Committee—last month wrote to the Senate Democratic and Republican leadership, warning that the fall in T-bond rates has substantially inflated pension liabilities, resulting in increased employer funding obligations.

"Inflated funding...requirements will drain away...dollars at a time when employers need all the resources they can muster to keep workers on the payroll and to make the purchases and investments necessary to return the nation to economic growth," the groups said in their letter.

To remedy the problem, the groups support letting employers—at least for an interim period—measure plan liabilities using Moody's Investor Services Inc.'s AA Corporate Bond Index.

—By Jerry Geisel

Continued on next page

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# 10 401(k) declines

A tumultuous year on Wall Street raised concerns about the impact of stock market declines on the balances of 401(k) retirement savings plans.

There is a lot at stake. Just a decade ago, about 60% to 70% of employees' 401(k) account balances was invested in fixed income-type funds, such as guaranteed investment contracts, with the remainder



in equity-type funds. But today, spurred by the bull market of the past few years, the asset allocation has flipped, with the majority—more than 60%—of account balances now invested in equities.

And despite the stock market's faltering this past year, few employees have panicked and rushed out of equities, experts say.

Even after the plunge in the stock market that followed the Sept. 11 terrorist attacks, only a fraction of plan participants moved their account balances, though account activity was much higher than normal.

In a reflection of both transfer activity and the decline in equity values, the percentage of funds invest-

ed in equities is down from 75% last year. But employees continue to put about 75% of their new 401(k) contributions into equity funds.

"We are not seeing a mass change in elections, though, of course, that could change," said Don Bartolai, a principal in the Chicago office of Unifi Network.

The issue is of particular concern to employees whose 401(k) plan assets are heavily invested in the stocks of their own companies. Company stock accounted for 28.8% of asset allocation in 401(k) plans as of March 30, according to the Hewitt 401(k) Index, compiled by Hewitt Associates of L.L.C. of Lincolnshire, Ill.

Employees of troubled companies could find themselves not only without jobs but also with diminished retirement savings funds as the price of their employers' stock declines.

Most recently, the focus has been on the troubled Enron Corp. About 62% of the Houston-based energy company's 401(k) plan assets were invested in Enron stock.

More than 12,000 participants in the plan, who collectively lost more than \$1 billion as a result of the company's financial problems, have filed multiple lawsuits seeking class action status, alleging the company breached its fiduciary duties.

—By Judy Greenwald

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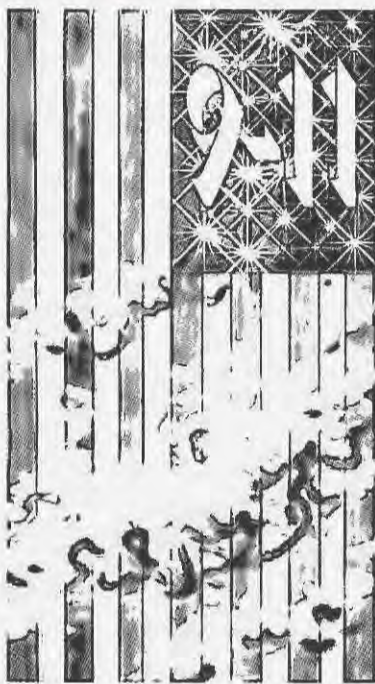
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# Top risk management stories of 2001

## 1 Terrorism strikes U.S.

It was an event that will mark the lives of all Americans, an event whose memory will be summoned merely by a date. On Sept. 11, terrorist hijackers piloted planes into New York's World Trade Center towers and into the Pentagon outside Washington. A fourth plane crashed in rural Pennsylvania after passengers tried to regain control.



Within 90 minutes of the New York attack, the WTC towers had collapsed, destroying or damaging surrounding buildings and setting fires that still burned deep within the rubble three months later.

Initial counts of the dead and missing proved high but stood this month at more than 3,000 in New York and 233 in Washington and Pennsylvania. Among those hardest hit were Marsh & McLennan Cos. Inc., which lost 295 workers in the Trade Center, and Aon Corp., which lost 200.

In addition to the devastating loss of life, the attacks produced not only the largest insured catastrophe in history but one that cut across multiple lines of coverage, from property and aviation to workers compensation and life/health.

The impact of the disaster will be felt for years. Underwriters are re-evaluating their aggregate exposures in light of the WTC losses' extraordinary breadth. The catastrophe has sharply accelerated the hardening in property/casualty markets, restricting capacity, pushing up rates and reducing the scope of many coverages. At the same time, investors have poured billions of dollars into setting up new reinsurers, mainly in Bermuda, anticipating high returns in a hard market.

With billions of dollars of insurance recoveries on the line, coverage litigation has already begun. WTC leaseholder Silverstein Properties is embroiled in suits with several of its insurers over various issues,

including whether the attack represented two events, entitling it to two full-limits payments. A WTC retail leaseholder, Westfield Holdings Ltd., is separately engaged in a dispute with its property insurer.

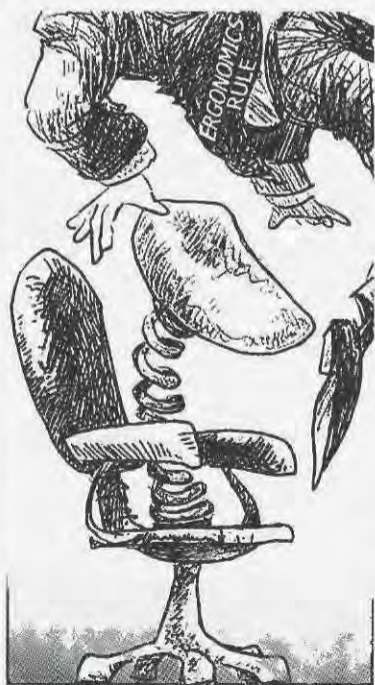
Meanwhile, efforts to clear debris from the 16-acre WTC site are expected to take a year. New York's economy has been dealt a severe blow, and how quickly and how well it recovers remains to be seen.

—By Douglas McLeod

## 2 Ergo rules

Things looked pretty bleak at the beginning of 2001 for those employers and insurers that had opposed a controversial federal workplace ergonomics standard.

Only days after Election Day 2000—and weeks before the country would know for sure who would move into the White House on Jan. 20—the Occupational Safety and Health Administration had issued the standard, despite heated opposition from business and from some members of Congress. Opponents had fought promulgation of such a standard for years, claiming that it would be too rigid and expensive and that it was not justified by scientific evidence. Organized labor had fought just as fiercely in favor of a standard, holding that it was needed to protect workers from carpal tunnel syndrome and other repetitive motion ailments.



Supporters of the standard appeared to have won when OSHA issued its standard, as rescission of the rule would be next to impossible.

But it was not impossible. Congressional opponents of the standard decided to pursue an untested strategy by invoking the Congressional Review Act. The 1996 CRA allows Congress to revoke federal standards under certain circumstances, but it had never before been used. Despite objections from

the standard's backers, both chambers voted in March to rescind it, and President Bush formally revoked the rule within days. By doing so, the president banned OSHA from issuing any substantially similar standard in the future.

That was not the end of the ergonomics debate, though. Within weeks, some lawmakers who had opposed the original standard drafted legislation calling on the secretary of Labor to issue a new standard within two years. New Labor Secretary Elaine Chao held hearings on the issue last summer and promised a proposal by September.

The events of Sept. 11, however, put the ergonomics question aside, and the matter remains unresolved.

—By Mark A. Hofmann

## 3 Capacity builds

Changes in the insurance market that no one could have foreseen when the year began have led to a year-end rush by insurers to raise capital and take advantage of rising rates.



To be sure, the market began firming in 2000. But the Sept. 11 terrorist attacks sent insurance prices skyrocketing far beyond the estimates of increases that earlier were being attributed to a normal hard cycle.

As a result, insurers moved quickly to raise new capital to write business at the higher rates. Such fresh capital would not be encumbered by the losses attributed to the attacks that had helped send prices soaring.

Nearly \$25 billion in new capital has been raised by insurers and reinsurers since Sept. 11, according to Standard & Poor's Corp.

Much of the new capital went to Bermuda, where at least six new insurers have been capitalized with a total of more than \$6 billion. At least another \$3.37 billion was

raised by existing facilities.

Among the largest Bermuda facilities launched in the wake of Sept. 11 is AXIS Specialty Ltd., an insurer and reinsurer formed with \$1.6 billion by an investment fund managed by a unit of Marsh & McLennan Cos. Inc. A pair of insurers—American International Group Inc. and Chubb Corp.—partnered with a Goldman Sachs & Co. unit to raise \$1.5 billion and form Allied World Assurance Co.

Existing Bermuda insurer ACE Ltd. raised \$1 billion in new capital, and its neighbor, XL Capital Ltd., added \$820 million.

U.S. and European insurers also raised billions in new capital to fund underwriting operations. Overall, the insurance and reinsurance markets will see around \$20 billion in new capital, analysts say.

With the new capital, buyers may see a shorter hard cycle, some experts say, but many believe the influx of new capital is not enough to replace what has left the market. Therefore, they say, insurers and reinsurers will be able to keep prices high and recoup some of the losses they suffered in the soft market.

—By Michael Bradford

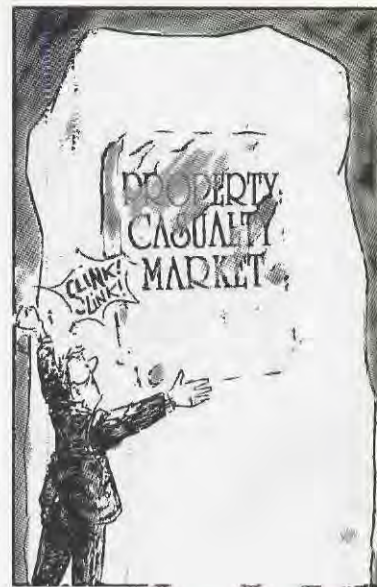
## 4 Market hardens

As the year began, it was clear that for the first time in more than a decade, insurance markets were hardening, though dramatic price hikes were the exception, rather than the rule.

At mid-year, the firming had gained momentum, with buyers facing double-digit price hikes and tougher market conditions.

And by year's end, with the market rocked by the Sept. 11 terrorist attack on top of several other catastrophes, the soft market was just a memory.

In the wake of the Sept. 11 losses, buyers renewing coverage found themselves suddenly facing dramat-



ically higher premiums. That was particularly the case on the property side, where the low double-digit increases the market was presenting at mid-year were turning into high double-digit or even triple-digit price hikes, in some cases.

The Sept. 11 losses and their impact on both insurers and reinsurers no doubt pushed property/casualty premiums to their year-end levels, but various factors were already driving a market hardening when the year began.

With insurers' earnings from their investment portfolios falling and reinsurance prices rising, the year began with talk of price "corrections." Price-based competition for market share had been replaced by disciplined pricing, with premiums more accurately reflecting the cost of risks assumed.

Through 2001, events such as the March sinking of a Petrobras offshore oil rig, June's Tropical Storm Allison, and the destruction of 11 aircraft in a terrorist attack in July at Sri Lanka's international airport all promised to continue the trend toward rising insurance costs. But the sense remained that, unlike in previous hard markets, rates might be firming, but there weren't deals that weren't getting done.

Then came Sept. 11 and industry losses estimated anywhere from \$30 billion to \$70 billion. And suddenly, many who previously thought ART was just something to be seen in galleries were considering the merits of captive insurance.

—By Rodd Zolkos

Continued on page 24

## Directories approaching

*Business Insurance* will publish its annual directories of case management services providers and prescription benefit managers on Feb. 11, 2002. That issue will include a Spotlight report on managed care trends and issues.

To be included in the case management directory, a company must directly sell case management services on an unbundled basis directly to corporate or institutional employers. *BI* defines case management as coordinating and monitoring treatment for catastrophic, complex or prolonged illnesses and injuries.

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## 5 Reliance goes under

Reliance Insurance Co., already on its last legs before September, became the first large insurer to enter liquidation citing losses from the World Trade Center disaster.

Reliance had endured two tortuous years involving growing losses, ratings downgrades, an abortive takeover, the piecemeal sales of its books of business and regulatory supervision before the Sept. 11 terrorist attacks produced the largest-ever insured catastrophe.

But it was the destruction of the



WTC—and the resulting losses—that finally convinced regulators in Reliance's home state of Pennsylvania, who were working on a rehabilitation plan for the insurer, that they were dealing with a lost cause.

When Reliance was placed in liquidation in October, the Pennsylvania Insurance Department cited a further reduction in reinsurance collections, which had been the insurer's main source of cash, since the Sept. 11 attacks.

"The company has experienced a liquidity problem by a slowdown in payments due from its reinsurers,"

said Pennsylvania Insurance Commissioner Diane Koken, when she issued the liquidation order. "This was exacerbated by recent events at the World Trade Center that have made collections more difficult."

Many of Reliance's more than 1,000 reinsurers are expected to face heavy losses from the WTC.

In the weeks after the attack, it became clear that Reliance was in far worse financial condition than had been thought. When it was placed in rehabilitation in May, the insurer reported a \$220 million deficit in policyholder surplus as of Dec. 31, 2000. But a Sept. 29 report for the first quarter of 2001 revealed that Reliance was insolvent by \$1.05 billion.

The insurer, which had been led by the flamboyant financier Saul Steinberg, for two years had published dismal operating results quarter after quarter, while its holding company sought to manage its crippling debt. But it was a loss that hit after Reliance stopped underwriting that ultimately sealed its fate.

—By Gavin Souter

## 6 Terrorism bill stalls

It was down to the wire as lawmakers struggled to decide what, if any, role the U.S. government should have in guaranteeing insurance for terrorism-related losses.

In the end, they decided not to decide and left the matter to be resolved next year, if at all (see story, page 1).

Discussion of a federal terrorism insurance program began within days of the Sept. 11 attacks. As talks among insurers, employers, lawmakers and the White House continued, the usually fractious insurance industry closed ranks behind a proposal modeled after the United Kingdom's Pool Reinsurance Co. Ltd., which can respond to terrorism-related losses. The industry consensus, however, drew little support.

The House of Representatives passed a bill in late November that would allow the federal government to lend money to insurers that faced terrorism-related losses of



as little as \$100 million per insurer under some circumstances. Insurers would have to pay the money back. In addition, the bill contained a series of civil justice reforms sought by the White House.

The White House, however, made no secret of the fact that it backed a different approach to the terrorism insurance question. The administration favored a cost-sharing arrangement between the government and the insurance industry, with total industry losses having to hit \$10 billion before a single federal cent came into play.

Although senators from both parties appeared ready to support some version of the White House proposal—three different bills were introduced by early December—disagreements over tort reform stalled introduction of a consensus bill. An unrelated dispute over farm policy pushed the matter further back on the Senate calendar, and the House adjourned before the Senate acted on terrorism insurance.

In contrast, France approved a government-backed facility for terrorism insurance coverage in December.

—By Mark A. Hofmann

## 7 Asbestos resurgence

Insurers that expected their asbestos liability headaches to fade in the

new millennium had to reach for the aspirin this year, as they faced a surprising surge of new claims against a widening array of corporate defendants.

More than three decades after the first asbestos injury lawsuit was filed, the pace of new claims has quickened, defying predictions



that the crisis would be nearing its end by now. The number of asbestos cases pending in courts in the United States doubled between 1993 and 1999 despite huge numbers of settlements in the interim, and several defendant companies have reported sharply higher rates of new claims being brought against them.

The spike in new claims pushed a number of longtime asbestos defendants into bankruptcy. Among these were auto parts maker Federal Mogul Corp.; building products makers Armstrong World Industries Inc., Owens Corning, Pittsburgh Corning Corp., USG Corp., W.R. Grace & Co. and a successor to GAF Corp.; and engineering firms Babcock & Wilcox Co. and Burns & Roe Enterprises Inc.

Furthermore, new claims are being aimed at a broadening array of "nontraditional" defendants that face rising liabilities because of the bankruptcies of traditional asbestos defendants. The new defendants range from giants such as IBM Corp., AT&T Corp. and Ford Motor Co. to small regional installers of products that contain asbestos.

Defendants and their insurers have decried many of these claims, charging that they come from plaintiffs who show no signs of asbestos-related illness. In May, London market insurers announced tougher standards for filing claims, requiring medical evidence of illness and proof of asbestos exposure for which a given defendant is responsible.

A handful of large insurers, meanwhile, have been funneling more money into asbestos reserves in light of the trends, including Equitas Ltd.—the runoff reinsurer for Lloyd's of London syndicates' pre-1993 long-tail liabilities—and CNA Financial Corp.

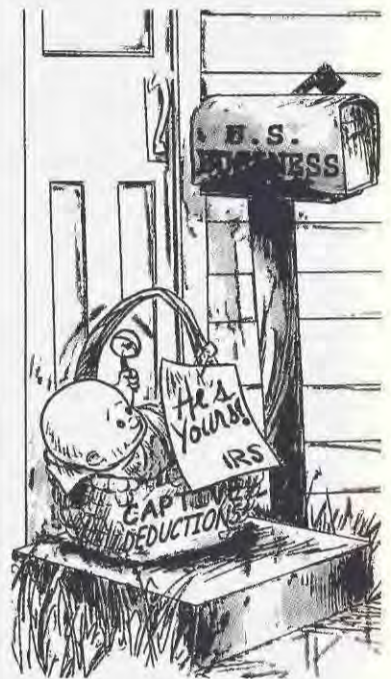
No one today is forecasting the imminent demise of asbestos liabilities.

—By Douglas McLeod

## 8 'Family' theory out

The Internal Revenue Service's decision this year to drop its opposition to captive owners deducting premiums paid to their insurance subsidiaries under the so-called "economic family" theory was a long-awaited admission of defeat.

In several cases dating back to the 1980s, captive owners have fought off IRS challenges and persuaded courts that they should be allowed to deduct premiums paid to captives.



The IRS first espoused its theory in 1977 in Revenue Ruling 77-316. The IRS held that, for related-party risks, if such risks are insured or reinsured by a related insurance company—one in the same "economic family"—the premiums involved are not tax-deductible because the risk was not shifted from the policyholder.

But courts have not accepted that reasoning. For instance, in what was regarded as the landmark ruling, the 6th U.S. Circuit Court of Appeals, in *Humana vs. Commissioner* ruled in 1989 that while parent companies cannot deduct premiums paid to a captive, their subsidiaries can. That ruling paved the way for corporations to structure their insurance transactions in a way that ensured that most of the premiums were deductible.

Other courts declined to accept the IRS' economic theory, which the IRS recognized in June 2001 when it published Revenue Ruling 2001-31, dropping the theory. "No court, in addressing a captive insurance transaction, has fully accepted the economic family theory," the ruling noted. "Accordingly, the IRS will no longer invoke the economic family theory with respect to captive insurance transactions."

Although the ruling changes little in practice, it may lead to more attempts by captive owners to deduct premiums, several tax experts said at the time. But they should still be careful. In the ruling, the IRS said it would still go after corporations deducting captive premiums when they think they have

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Continued from page 24

a good case, for example, when the captive arrangement is arguably not really insurance. So, captive owners that don't have a nontax reason for forming their captive insurers still can expect to hear from the government.

—By Gavin Souter

## 9 E-risk exclusions

A tighter reinsurance market, particularly following the Sept. 11 terrorist attacks, is making it increas-

ingly difficult for risk managers to find coverage for risks related to the Internet and other electronic data technology.

Because of reinsurers' aversion to these risks, most property insurers have been adding exclusions to commercial general liability and property policies that either limit or eliminate coverage for electronic data risks, including those related to the Internet.

In August, Jersey City, N.J.-based Insurance Services Offices Inc. filed an endorsement to the standard CGL policy that modifies coverage for electronic data and computer viruses.

In particular, the ISO electronic data liability endorsement states



that, "for purposes of this insurance, 'electronic data' is not tangible property."

To fill in the gaps these new exclusions and endorsements are creating, many insurers are offering stand-alone e-business policies that cover everything from network security liability to Web content liability and business interruption.

Many industry observers liken the emergence of these new programs to the development of environmental impairment liability insurance in the mid-1980s, after insurers began issuing pollution exclusions.

The situation is also reminiscent of the development of separate em-

ployment practices liability insurance in the early 1990s, following the exclusion of such coverage from standard policies.

But the industry observers warn that the impact this time will be much more widespread, considering that the use of electronic data technology has become so pervasive.

"The absolute pollution exclusion didn't affect everybody...but any company that uses a computer is affected" by these new exclusions, points out Michael Rossi, the president of the Insurance Law Group Inc., a Los Angeles-based law firm that specializes in insurance coverage.

—By Joanne Wojcik

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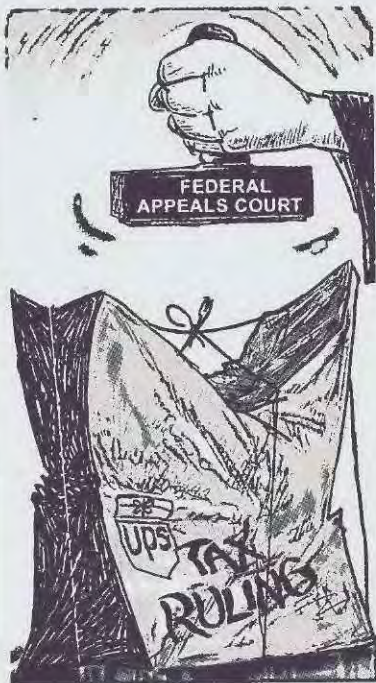
Continued from previous page

# 10 UPS tax ruling

Captive owners got a boost when a federal appeals court found that United Parcel Service of America Inc. did not engage in a tax-motivated sham in setting up a package insurance program.

Until the early 1980s, UPS self-insured \$100 of loss on each package it shipped, and charged shippers for any additional coverage they wanted. The Atlanta-based shipping giant declared the excess-value charges it collected as income for tax purposes and deducted the losses it paid.

UPS changed the program in 1984, insuring the excess coverage with a unit of American International Group Inc., which, in turn, reinsured 100% of the business with Overseas Partners Ltd. in Bermuda. UPS—which stopped declaring the excess charges it col-



lected as income—had formed OPL but later spun the reinsurer off to UPS shareholders.

The Internal Revenue Service challenged the program, and a Tax Court judge in 1999 declared it a "sham" with no business purpose

other than to avoid taxes on premium income that UPS was now funneling offshore to OPL.

A panel of the 11th U.S. Circuit Court of Appeals reversed the ruling in June, though, finding that the program had a legitimate business purpose and that reducing UPS' taxes was an acceptable aim of the plan. In its 2-1 ruling, the panel also found that the AIG fronting arrangement was not an indication of a sham and that such arrangements still entail risk for the fronting insurer.

The court found that even if AIG had been merely a conduit for premiums, OPL was an independent entity not under UPS' control, and UPS actually did lose the income from the excess-value charges it collected.

Captive experts cheered the findings of the appeals court on the acceptability of tax considerations and fronting arrangements in captive planning. UPS, meanwhile, has moved the excess-value program to an onshore insurance unit, and OPL has shifted its underwriting to business unconnected to UPS.

—By Douglas McLeod

# Dec. 17 crossword puzzle answers

Below are the answers to the crossword puzzle that appeared in the Dec. 17 issue of *Business Insurance*. The puzzle, which was created by Myron and Jodi Picoult, is also available online at [www.businessinsurance.com](http://www.businessinsurance.com), under the Commentary section.

- 44. Terrorism
- 45. Terms
- 46. Analysts
- 47. Mold
- 48. Tornado
- 49. Development

### DOWN

- 1. Diminishing
- 3. AC
- 4. No
- 6. Federal
- 8. Earned
- 9. Superior
- 10. Bermuda
- 11. Underwriters
- 13. Brokers
- 17. Price
- 18. Prosperity
- 21. O'Hare
- 22. Enron
- 23. Stalled
- 24. Prudential
- 26. Machines
- 27. Liquidity
- 29. Assessments
- 31. Combined ratio
- 37. Capital
- 38. Hurricane
- 40. Accident
- 41. Writeoffs
- 42. Lloyd's

### ACROSS

- 2. Fishman
- 5. Commercial
- 7. Expenses
- 9. Steinberg
- 12. Tenure
- 14. Hard
- 15. Asbestos
- 16. Reinsurance
- 19. Reserves
- 20. Recoverables
- 25. ACE
- 28. Financial
- 30. Reliance
- 32. Infrastructure
- 33. Donothing
- 34. Credibility
- 35. AXIS
- 36. Duck
- 39. Standard
- 43. Greenberg

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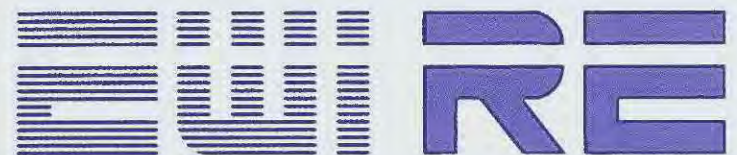
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# 10 who made news in insurance during 2001

It was another busy year for John J. Byrne. The former Travelers Group Inc., GEICO Corp. and Fireman's Fund Insurance Co. executive took over and relaunched an established insurer and then turned his attention to setting up a new reinsurer in Bermuda. He last tried to take over an established name in the industry when he



**Mr. Byrne**

launched an unsuccessful bid for Home Holdings Inc. in 1994. He then set up a new company, White Mountains Insurance Group Ltd.

In 2001, White Mountains completed both a \$2.17 billion purchase of CGU Insurance Group—

which was renamed OneBeacon Insurance Group—and the formation of another new company, called Montpelier Re Holdings Ltd. Montpelier was established in Bermuda with \$1 billion in capital.

To crown it all, Mr. Byrne this year was named Insurance Leader of the Year by the School of Risk Management, Insurance & Actuarial Science at New York's St. John's University, formerly The College of Insurance.

\*\*\*

Handling political hot potatoes can be a workplace hazard, Labor Secretary Elaine Chao found out as she was drawn into the congressional debate over a federal ergonomics standard.

After Congress rescinded a controversial ergonomics standard that the Occupational Safety and Health Administration had issued near the end of the Clinton administration, she tried to craft the response of the Bush administration to repetitive stress injuries. Her refusal to say up front whether she would issue a new standard drew fire from lawmakers on both sides of the aisle.



**Ms. Chao**

Ms. Chao said initially that the department's ergonomics plan would be made public by September, but the terrorist attacks of Sept. 11 delayed such an action, thereby making it all but certain that the ergonomics controversy would flare up again in 2002.

\*\*\*

Robert Clements is evidently not the retiring type. After a long career in top management at Marsh & McLennan Cos. Inc., Mr. Clements has set about building Bermuda-based Arch Capital Group Ltd. into a major force in the U.S. insurance market.

In October, Arch announced it had raised \$750 million in capital from E.M. Warburg,

Pincus & Co. L.L.C. and Hellman & Friedman L.L.C., bringing total capital to \$1 billion.

The new capital will support expanded underwriting and follows earlier acquisitions of a U.S.-licensed insurer, a U.S. surplus lines insurer and rent-a-



**Mr. Clements**

captive facilities in Bermuda and the Cayman Islands. They joined Arch's main operating unit, Arch Reinsurance Ltd., to give the holding company an array of insurance and reinsurance capabilities.

All of this is being led by an individual who has already generated his share of news. Mr. Clements is credited with the innovative formations of ACE Insurance Co. Ltd. and X.L. Insurance Co. Ltd. in the 1980s. He rose to the position of MMC president in 1992 and became chairman and chief executive officer of affiliate MMC Capital Inc. from 1994 until 1996. He was an adviser to MMC Capital from 1996 until earlier this year, and has been chairman of Arch and its predecessor, Risk Capital Holdings Ltd., since its formation by Marsh in 1995.

\*\*\*

Sen. Pete Domenici, R-N.M., always admitted that the legislation he helped to craft in 1996, requiring employers to offer limited parity for mental disorders in their health care benefits programs, didn't go far enough.

That measure, which expired in September, barred only plan designs that imposed lower annual and lifetime dollar limits for mental health care expenses than for other medical expenses.

Employers were free to discriminate in other, more subtle ways. The 1996 law was an important step to bringing coverage of mental illness out of the dark ages, he said. This year, Sen.



**Sen. Domenici**

Domenici, whose daughter has had mental health problems and faced coverage difficulties, tried to expand the 1996 law to mandate total parity for mental disorders.

Sen. Domenici described his measure as "a major piece of civil rights legislation." But his effort failed when congressional conferees knocked out the proposal from the appropriations bill. While disappointed, Sen. Domenici said there is a growing groundswell of support for parity and that he will work next year to get the parity legislation passed.

\*\*\*

Evan G. Greenberg, who made news last year when he unexpectedly quit as president of American International Group Inc., was in the headlines again in 2001, after he followed the lead of several former AIG colleagues by joining Bermuda-based ACE Ltd. in November.

He had been the heir apparent to his father, Maurice R. Greenberg, as chairman and chief



**Mr. Greenberg**

executive officer of AIG. He walked away just five years after his older brother, Jeffrey Greenberg, quit AIG to join Marsh & McLennan Cos. Inc., where he is now chairman.

No reason was given for Evan Greenberg's resignation other

than a desire to "pursue other interests." His father has said he has no plans to retire, and the posts of AIG president and chief operating officer were not filled after Evan Greenberg left.

Evan Greenberg joined ACE as vice chairman in charge of worldwide reinsurance operations

and CEO of multiline reinsurer ACE Tempest Re. He now reports to ACE Chairman Brian Duperreault, who joined ACE in 1994 after a 20-year career at AIG. Several other top ACE executives also are AIG alumni.

\*\*\*

During much of his Senate tenure, James Jeffords has been charting his own course.

In 1993, for example, he was the only Senate Republican to support the Clinton administration's grandiose health care reform package. Then, two years ago, he sought a middle ground in the controversy over



**Sen. Jeffords**

employer conversions of traditional defined benefit pension plans to cash balance plans. He favored greater disclosure on the impact of the conversions but rejected more radical proposals, such as letting all vested employees choose either plan

during a conversion.

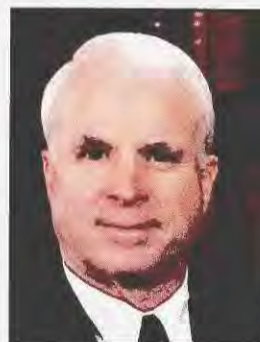
But no action taken by Sen. Jeffords had a greater impact on employee benefit issues than his decision in June to leave the Republican Party to become an independent. Through that action, the Democrats regained control of the Senate and could again set the political agenda.

In one example, patient protection legislation, which had been bottled up by the Senate Republican leadership, was immediately pushed to the top of the legislative priority list by the new Senate Democratic leadership and was passed in June by the full Senate.

\*\*\*

Sen. John McCain, R-Ariz., continued to be a thorn in the side of the man who beat him out of last year's GOP presidential nomination.

The maverick Arizonan went against the wishes of President Bush by joining Sens. Edward Kennedy, D-Mass., and John Edwards, D-N.C., in co-sponsoring a patient protection bill that went far beyond what the president said he would be willing to sign. Thanks in



**Sen. McCain**

part to Sen. McCain's advocacy, the measure—which would subject employers to some liability for the actions of health plans they sponsored—won Senate approval in June.

\*\*\*

Kansas Insurance Commissioner Kathleen Sebelius faced several challenges as president of the National Assn. of Insurance Commissioners. When she was elected in December 2000, the NAIC's focus was internal.

"We talked a lot about whether or not we were moving fast enough," she said. The NAIC sought to modernize and streamline regulation without losing consumer protections.

"Back then, the most serious challenges we had looming were possibilities of a federal charter recommendation and the numbers and speed of states achieving internal reform," Ms. Sebelius said.

The Sept. 11 terrorist attacks altered regulators' priorities, while affirming the quality of state-based regulation, she said. "I do believe the response of the insurance industry

to the 9-11 events is significant testimony to the success of the state system," she said. For



**Ms. Sebelius**

example, insurers are able to pay claims and stay solvent due to regulators' consistent financial oversight and review, she said.

Meanwhile, Ms. Sebelius and other NAIC leaders continue to work with lawmakers to obtain federal terrorism insurance

relief for the industry and the policyholders it serves.

\*\*\*

It was no small task to take a vaguely written provision of tax legislation Congress passed this year and create workable regulations to allow older employees to make additional "catch-up" contributions to their 401(k) plans.

But William Sweetnam, the Treasury Department's benefits tax counsel, did just that. Unlike some predecessors, who often operated behind closed doors, he met frequently with benefit groups to get their input on how to produce regulations that would minimize burdens on employers that wanted to add a catch-up provision to their savings plans.

And that open-door policy was successful.



**Mr. Sweetnam**

Catch-up regulations issued by the Treasury Department in October will give employers the flexibility they need to offer the feature to employees, benefit experts agree.

Before joining Treasury earlier this year, Mr. Sweetnam was majority counsel for pensions at the Senate Finance Committee, and before that was a technical consultant for benefit consulting firm Towers Perrin.

\*\*\*

The American Insurance Assn.'s Robert Vagley proved himself once again to be a rebel with a cause.

The AIA president went against the sentiments of much of the property/casualty industry when he called for consideration of optional federal chartering of insurers as way to improve efficiency in the marketplace. It wasn't the first time he'd gone against conventional wisdom: Nearly a decade ago, he'd broken with industry counterparts to support federal solvency regulation. Now as then, he drew praise and criticism for

questioning the effectiveness of state regulation.

Despite the controversy, Mr. Vagley was instrumental later in the year in achieving what many thought virtually impossible—he helped build



**Mr. Vagley**

industry consensus on a proposal for the federal government's role in guaranteeing insurance for terrorism-related losses.

## Euro rollout puts cash on the streets

## Security high around shipments

By EDWIN UNSWORTH

The imminent introduction of the euro is causing huge economic changes in Europe and is creating risk management challenges for many companies.

The Jan. 1, 2002, changeover in the 12 "Eurozone" countries that are switching to the single E.U. currency is leading to increased security measures and some increase in insurance coverage, as companies seek to protect their cash shipments, some risk managers and brokers say.

In several countries, the armed forces will play an integral role in protecting the shipments, but companies will need to heighten their security measures to guard against theft, insurance sources advise.

A total of 14.5 billion euro banknotes and 65 billion euro coins will replace an equivalent value of 12 other European currencies. These must be distributed to banks and businesses by Jan. 1, 2002 (BI, July 9).

Each of the Eurozone countries—Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Portugal, the Netherlands and Spain—is handling the distribution in its own way.

In France, many companies are continuing to use private forms of transport, and the army is helping transport the new money.

One of France's largest retail groups, St. Etienne-based Casino Guichard, says it will continue to use the same armored

See EURO/page 31



PHOTO: AFP

German Bundesbank President Ernst Welteke holds euro coins and notes, which become legal tender Jan. 1, 2002.

## Commission hears testimony on HIH failure

### Variety of actions led to collapse

By DAMIEN TOMLINSON

**SYDNEY, Australia**—HIH Insurance Ltd. likely had unfunded liabilities of \$5 billion Australian (\$2.47 billion) when it went into liquidation in March, a royal commission into HIH's collapse was told earlier this month.

Sydney-based HIH, which had been Australia's second-largest property/casualty insurer, was "like the Titanic, sailing full speed toward an iceberg," and the federal insurance regulator, the Sydney-based Australian Prudential Regulation Authority, failed to stop it, despite clear warnings, said Wayne Martin, a senior attorney assisting the commission.

In a two-day opening address to commission hearings that began Dec. 3, Mr. Martin testified that the leading causes of the insurer's problems were its disastrous acquisition of FAI Insurances Ltd. of Sydney (BI, March 1, 1999) and its poor-performing business in the United States and the United Kingdom.

Payments to HIH's management shortly before it was placed in liquidation and unrecorded builders' warranty claims also contributed to the insurer's huge deficit, Mr. Martin said.

"In monetary terms, the HIH collapse is one of the biggest, if not the biggest, commercial calamity in Australian corporate history," he said.

"How did a calamity of this kind occur—given that the company appeared to have experienced, competent managers, who were certainly well remunerated for their labors; a board of directors with diverse business, legal and accounting experience; internal and external actuaries; internal and external auditors; and was operating in an industry which was subject to specific and detailed regulation?" Mr. Martin asked.

The commission, formed in May, is headed by Western Australia Supreme Court Justice Neville Owen, a specialist in commercial litigation and corporate insolvency (BI, July 2).

The commission's first witness was David Lombe, a Sydney-based partner at Deloitte Touche Tohmatsu. Mr. Lombe testified that HIH "window-dressed" its financial performance, understated its liabilities and used inaccurate accounting.

Mr. Lombe was appointed by the APRA to investigate HIH on the day the company went into liquidation (BI, March 26).

HIH declared a profit of \$40 million Australian (\$23.9 million) for

See HIH/page 30



## Many companies' plans inadequate to handle major losses, survey finds

By SARAH VEYSEY

**LONDON**—Following the Sept. 11 terrorist attacks in the United States, many midsize European companies consider themselves poorly equipped to deal with high-impact risk.

A survey of 600 companies in Belgium, France, Germany, Italy, Spain and the United Kingdom showed that only half of the companies responded that they have formal plans in place to address the risks to their business that the respondents identified as having a high financial impact. Those risks range from increased competition to information technology security risks, fire and natural disaster and business continuity risks, among others.

London-based Marsh conducted the survey, titled "Managing Risks in Europe," contacting companies both before and after Sept. 11. The survey revealed that 31% of companies said management was likely to undertake risk reviews less frequently than once every six months. And almost 20% said that such reviews took place only on an ad-hoc basis.

Marsh research concentrated on companies with between 50 and 500 employees and revenue of between £25 million (\$36.3 million) and £350 million (\$508.7 million). The surveyed companies conducted business in the chemical and pharmaceutical, manufacturing, municipalities, retail, information technology and telecommunications, transportation and travel and tourism sectors.

Preliminary results of the survey, released to the media earlier this month, revealed that while 74% of

the U.K. companies surveyed said they had formal procedures and plans in place to address risk, only 57% of these said that, in the wake of Sept. 11, they considered those plans to be adequate to respond to a high-impact incident.

"With contracting insurance markets, retrocessionary signals in many countries and a turbulent geopolitical climate all pointing to uncertain times, few mid-sized companies seem to be proactively seeking to eliminate, mitigate or transfer risk," said Michael Turpin, executive director of Marsh Europe's corporate client practice in London. "Senior management of mid-sized companies are finding themselves increasingly held accountable for identifying threats to their business. It stands to reason that those who do not actively monitor risk are more vulnerable to a higher-severity loss."

David Gamble, executive director of the London-based Assn. of Insurance and Risk Managers, said that, in some respects, attitudes toward risk had changed since Sept. 11.

"In terms of what is available in the insurance market yes, risk managers have certainly had to rethink their attitude to risk," Mr. Gamble said. "Lots of companies are waking up to the fact that: a) insurance is costing more, and b) in terms of the way they look at risk, they have to reconsider."

Mr. Gamble said that, in the past year, AIRMIC had received a lot of interest from potential new members seeking ways to deal with the hardening insurance market. He said that the already-hardening

See RISK/page 31

## World Updates

### AXA projecting lower profits

French insurer AXA S.A. said last week it expects to report 2001 profits of about 1.2 billion euros (\$1.08 billion)—roughly half the figure it posted for 2000—when it releases full-year results next March. Paris-based AXA cited losses from the Sept. 11 attacks as well as falling investment income for the lower results. AXA expects an improvement in 2002 and said it has taken steps to achieve better results, including imposing double-digit rate increases.

### Broker alliance offers cat reinsurance

New York-based Reinsurex Intermediary Inc. and Lloyd's of London broker Bowood Partners Ltd. have formed an alliance to provide index-linked property catastrophe reinsurance to Lloyd's syndicates. Reinsurex specializes in brokering property reinsurance business and offers traditional reinsurance, capital market solutions as well as programs combining both elements. Lloyd's syndicates will be able to access Reinsurex through Bowood, a Lloyd's broker that specializes in global wholesale and reinsurance business.

### Munich Re, bank join on big projects

Munich Reinsurance Co. is extending its partnership with German bank HVB Group to include jointly financing and reinsuring large-scale projects. Under the agreement, the world's largest reinsurer will also offer alternative risk transfer products to provide refinancing opportunities for HVB. The partnership will operate through ERGO, Munich Re's primary insurance unit, and HypoVereinsbank, one of Germany's largest banks. Over the next few years, the partnership will be expanded to include marketing each other's products.

### Best affirms Lloyd's rating

A.M. Best Co. has affirmed its A-marketwide rating of Lloyd's of London, which was placed under review after the Sept. 11 terrorist attacks. In affirming the rating, Best pointed to the increase in Lloyd's underwriting capital for 2002 and to steps that Lloyd's has taken to bolster the Central Fund, among other factors.

### Switzerland to drop airline guarantee

The Swiss government will stop guaranteeing terrorism coverage for the country's airlines on Dec.

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## NEXT ISSUE

January 7

Charting Changes

Closing December 28

\*This issue will be closing early due to the holidays.

Business Insurance

## HELP WANTED

UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK

IN RE THE BOARD OF DIRECTORS OF  
THE NICHIDO FIRE & MARINE INSURANCE COMPANY LIMITED,  
DEBTOR IN A FOREIGN PROCEEDING  
Case No. 01-B-15987 (AJG)

NOTICE IS HEREBY GIVEN THAT, in connection with the petition filed on November 28, 2001, pursuant to Section 304 of the Bankruptcy Code (the "Petition"), by the Board of Directors (the "Petitioner") of THE NICHIDO FIRE & MARINE INSURANCE COMPANY LIMITED (the "Company"), the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") has entered a Preliminary Injunction Order dated December 10, 2001 (the "Order").

1. Enjoining all persons and entities with a claim arising out of a contract of insurance, reinsurance or retrocession entered into with the Company through the Company's London Agency (the "Scheme Creditors") from: (a) seizing, repossessing, transferring, relinquishing or disposing of any property of the Company in the United States, or the proceeds of such property; (b) commencing or continuing any action or other legal proceeding in connection with any claim arising out of a contract of insurance, reinsurance or retrocession entered into with the Company through the Company's London Agency (including, without limitation, arbitration, or any judicial, quasi-judicial, administrative or regulatory action, proceeding or process whatsoever); (c) enforcing any judgment, administrative or regulatory judgment, assessment or order or arbitration award obtained in connection with any claim arising out of a contract of insurance, reinsurance or retrocession entered into with the Company through the Company's London Agency, and commencing or continuing any act or action or other legal proceeding in connection with any claim arising out of a contract of insurance, reinsurance or retrocession entered into with the Company through the Company's London Agency (including, without limitation, arbitration, or any judicial, quasi-judicial, administrative or regulatory action, proceeding or process whatsoever) or any counterclaim to create, perfect or enforce any lien, attachment, garnishment, setoff or other claim arising out of a contract of insurance, reinsurance or retrocession entered into with the Company through the Company's London Agency against the Company or the Company's London Agency; (d) drawing down any letter of credit established by, on behalf of or at the request of, the Company in excess of amounts expressly authorized by the terms of the contract or other agreement pursuant to which such letter of credit has been established; and (e) withdrawing from, setting off against, or otherwise applying property that is the subject of any trust or escrow agreement or similar arrangement in which the Company has an interest in excess of amounts expressly authorized by the terms of the trust, escrow or similar arrangement;

2. Requiring Scheme Creditors that are beneficiaries of letters of credit established by, on behalf of or at the request of, the Company, or parties to any trust, escrow or similar arrangement in which the Company has an interest, to: (a) provide notice to the Petitioner's United States counsel of any drawdown on any letter of credit established by, on behalf of or at the request of, the Company, or any withdrawal from, setoff against, or other application of property that is the subject of any trust or escrow agreement or similar arrangement in which the Company has an interest, together with information sufficient to permit the Petitioner to assess the propriety of such drawdown, withdrawal, setoff, or other application, including, without limitation, the date and amount of such drawdown, withdrawal, setoff, or other application, and a copy of any contract, related trust or other agreement pursuant to which any such drawdown, withdrawal, setoff or other application, was made and provide such notice and other information contemporaneously therewith; and (b) turn over and account to the Petitioner for all funds resulting from such drawdown, withdrawal, setoff or other application, in excess of amounts expressly authorized by the terms of any contract, any related trust or other agreement pursuant to which such letter of credit, trust, escrow, or similar arrangement has been established;

3. Requiring every Scheme Creditor that has a claim of any nature or source arising out of a contract of insurance, reinsurance or retrocession entered into with the Company through the Company's London Agency against the Company or the Company's London Agency and that is a party to any action or other legal proceeding (including, without limitation, arbitration or any judicial, quasi-judicial, administrative or regulatory action, proceeding or process whatsoever) in which the Company or the Company's London Agency is or was named as a party, or as a result of which a liability of the Company or the Company's London Agency may be established, is required to place the Petitioner's United States counsel (Chadbourne & Parke LLP, 30 Rockefeller Plaza, New York, NY 10112, Attn: Francisco Vazquez, Esq.) on the master service list of any such action or other legal proceeding, and to take such other steps as may be necessary to ensure that such counsel receives: (a) copies of any and all documents served by the parties to such action or other legal proceeding or issued by the court, arbitrator, administrator, regulator or similar official having jurisdiction over such action or legal proceeding; and (b) any and all correspondence, or other documents circulated to parties named in the master service list; and

4. Providing, with respect to any Scheme Creditors, claim, action, arbitration or other proceeding which may be commenced or become known to the Petitioner in the future, or the entitlement or alleged entitlement of any beneficiary of any letter of credit established by, on behalf of or at the request of, the Company, or of any party to any trust or escrow agreement or similar arrangement in which the Company has an interest that is identified by the Petitioner in the future (each a "Subsequent Claim"), that:

(a) when informed of a Subsequent Claim, counsel for the Petitioner shall serve upon the holder of such claim a copy of the Summons, the Petition and the most recent Injunction Order entered by the Bankruptcy Court; and  
(b) the holder of a Subsequent Claim will have twenty (20) days from service of the Summons in which to file an Answer or Motion with respect to the Petition.

THE ORDER SHALL REMAIN IN EFFECT PENDING A HEARING SCHEDULED TO BE HELD ON FEBRUARY 13, 2002 AT 9:30 A.M. (THE "RETURN DATE") BEFORE THE HONORABLE ARTHUR J. GONZALEZ, UNITED STATES BANKRUPTCY JUDGE, IN ROOM 523 OF THE ALEXANDER HAMILTON CUSTOM HOUSE, ONE BOWLING GREEN, NEW YORK, NEW YORK. ALL PAPERS SUBMITTED FOR THE PURPOSE OF OBJECTING TO CONTINUATION OF THE ORDER AFTER THE RETURN DATE SHALL BE FILED WITH THE BANKRUPTCY COURT, WITH A COPY TO THE CHAMBERS OF THE HONORABLE ARTHUR J. GONZALEZ, AND SERVED ON CHADBOURNE & PARKE LLP (ATTN: HOWARD SEIFE, ESQ.), SO AS TO BE RECEIVED AT LEAST FOURTEEN (14) DAYS PRIOR TO THE RETURN DATE.

ANY PARTY-IN-INTEREST THAT HAS NOT RECEIVED A COPY OF THE PETITION, SUPPORTING PAPERS AND/OR THE ORDER SHOULD CONTACT COUNSEL FOR THE PETITIONER AT THE ADDRESS BELOW:

CHADBOURNE & PARKE LLP  
30 Rockefeller Plaza  
New York, New York 10112  
(212) 408-5100  
Attn: Howard Seife, Esq.  
Attorneys for the Petitioner

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# HIH: Many questions in failure

Continued from previous page  
the financial year to June 30, 2000, when it actually had a deficit of \$1 billion Australian (\$596.8 million), he said.

He said the FAI acquisition had contributed to the weakening of HIH and that an internal review of the acquisition revealed FAI directors knew the company was insolvent beforehand.

Payments made to HIH's management also contributed to its problems, said Tony McGrath, a partner of Sydney-based liquidator KPMG.

The HIH board approved millions of dollars in ex gratia payments to directors, including a termination payment of \$1.6 million Australian (\$790,400) to Chief Financial Officer Dominic Fodera just hours before the liquidation application was tendered to the New South Wales Supreme Court on March 15, he said.

Mr. McGrath said he was "quite concerned" when he learned of the payment hours later. "Because I was aware the company either had or was about to resolve that it was in need of appointing a provisional liquidator, I would have thought it was entirely inappropriate," he told the commission.

Also, on Dec. 14, 2000, the board approved a payment of three times his annual salary to HIH CEO and founder Ray Williams, plus other entitlements, in a package that totaled about \$5 million Australian (\$2.7 million), according to the minutes of a board meeting presented to the commission.

According to the minutes, the board also approved a termination package for Director George Sturesteps, equal to two times his annual salary plus entitlements, on Jan. 19, 2001.

In other evidence, Richard Wilkinson, a KPMG actuary, said HIH had failed to report \$40 million Australian (\$20.8 million) in builders' warranty insurance claims in the years before its collapse.

He said the company had recorded no builders' warranty claims in its computer system since 1999. A report by HIH's internal auditor, David Slee, showed builders' warranty claims dropped dramatically in 1999 and ceased in 2000. Mr. Wilkinson said the sudden absence of such claims "would have stood out like a sore thumb."

The royal commission, which recessed its hearings on Dec. 19 and will resume them on Jan. 28, 2002, will also examine HIH's management, accounting practices, corporate culture, acquisitions, investments, reinsurance arrangements and incentive payments. The roles of state and federal insurance regulators in the collapse will also be scrutinized.

The commission has until June 30, 2002, to present its findings to the federal government.

## World Updates

### Continued from page 29

25. The government began guaranteeing coverage after many insurers eliminated or greatly reduced liability coverage for terrorism after Sept. 11. But last week, the Swiss Department of the Environment, Transport and Energy said that it would terminate the guarantee because the market for private insurance had stabilized. A department statement said that insurers are again offering limits of up to \$1 billion for terrorism coverage and that "while premiums are certainly high, the Federal Council believes that they are not exorbitant." Basel-based airline Crossair A.G. said that its insurance costs could rise by around \$30 million per year because of the move.

### P&I club mandates war risks coverage

The U.K. P&I Club has imposed a mandatory level of commercial war risks coverage on its members at least equal to their ships' value. The London-based protection and indemnity club said the events of Sept. 11 have highlighted gaps between the special war risks coverage that the club has provided to members since 1987 and war risks coverage available in the market. The U.K. P&I Club had provided coverage triggered by the weapons used in an attack. This special coverage now will be available only on an excess basis.

### Briefly noted

China's first specialist export and credit insurance company, **China Export & Credit Insurance Corp.**, was launched in Beijing last week. The state-owned company, known as Sinosure, is capitalized at 4 billion yuan (\$483.2 million) and was formed out of the export credit businesses of the People's Insurance Co. of China and the Export & Import Bank of China....**SCOR S.A.**'s new Irish reinsurer subsidiary, **Irish Reinsurance Partners Ltd.**, will begin writing in January. With an initial capitalization of 400 million euros (\$360.9 million), Dublin-based IRP will expand SCOR's nonlife underwriting capacity, Paris-based SCOR said....**The London Underwriting Centre** named Victor Blake executive chairman, beginning in 2002. He replaces Ken Haddon, who is retiring. Mr. Blake has been an LUC director for more than a decade....**Sajjad Jaffer** has been appointed marine liability manager in the U.K. marine department of **Chubb Europe**. Previously, Mr. Jaffer was marine liability underwriter at **Markel International**....**London-based Internet reinsurance trading platform inreon** has joined forces with **reway**, an online platform owned by Cologne, Germany-based **Gothaer Rueckversicherung A.G.**, which will become a shareholder in inreon.

## Euro: Conversion risks covered

### Continued from page 29

car company that currently transports its cash to deliver and collect euros and francs from its 3,000 stores and restaurants around the country.

Risk manager Jean-Jacques Pataud said that, during the transition, Casino Guichard will transport twice as much currency as usual, so the company has arranged additional cash-in-transit insurance coverage.

Casino Guichard discussed arrangements with its insurance company, including securing authorization to ship and store higher levels of cash. The extra premium, negotiated before Sept. 11, was "reasonable," said Mr. Pataud.

Similarly, BNP Paribas, a large French banking group, said it has arranged additional insurance coverage for cash movements during the transition.

Christian Cretin, risk manager for the Paris-based banking group BNP Paribas, said the need for all branches and administration centers to keep two currencies creates extra risk for the transition period. As a result, BNP Paribas has taken

out additional cover against theft for the period.

Insurers and brokers are divided on the impact of the euro switchover.

AXA S.A., France's largest insurer, says it has had no special inquiries for euro distribution and it has not initiated any special policies.

Similarly, Paris-based insurance brokerage **Gras Savoye S.A.** says it has seen no change in demand from its clients.

The London brokerage unit of **Marsh Inc.**, however, has devised a policy specifically for transporting and storing euros and national currencies. Paul Martin, vp of Marsh **FINPRO**, said inquiries about the policy, which has a limit of 500 million euros (\$451.5 million), have come from across Europe.

The coverages are being purchased mainly by national post offices, banks and security companies, which will have to deal with euros, Mr. Martin said.

"The feeling in the insurance industry is that the criminal gangs will see this as a great opportunity, because there will be so much money out there," he said.

According to **Europol**, the Euro-

pean Union's police agency, in the three months since the minting and printing of euro coins and notes began, there have been 27 thefts from armored trucks, totaling 5 million euros (\$4.5 million).

In the Netherlands, almost 3 billion euro coins and 360 million euro banknotes are being distributed. At the same time, almost 3 billion guilder coins and 400 million guilder notes need to be collected.

**Andre de la Beij**, cargo underwriter with **CNA Insurance Co.** in the Netherlands, said that the country's train system cannot cope with the volume of coins that need to be transported. And there are insufficient armored cars to transport the coins, Mr. de la Beij said.

Euro coins, therefore, will be transported by **TNT Post Group**, a commercial delivery company, he said.

In addition, all the Netherlands' police forces and its Royal Military Police will be taking extra measures, including deploying more than 4,000 additional staff and working hand in hand with the transportation companies to coordinate shipments.

## Risk: Firms review crisis plans

### Continued from page 29

market, followed by the collapse of London-based **Independent Insurance Co. Ltd.** in June and the events of Sept. 11, had served to make risk managers much more

concerned about ways to mitigate risks. "It isn't really that Sept. 11 was a wake-up call; we were already woke up," he said.

Mr. Gamble added that **AIRMIC** has seen an increase in networking

among members, as risk managers seek to share ideas about managing risk in a hard market.

Full results of the survey will be published next year, the company said.

## E-Mail: Court blocks unwelcome mail

### Continued from page 2

ing me for defamation, you're suing me for trespass on your computer. What Intel didn't like here was what Hamidi had to say," Ms. Brick said.

Intel "was essentially doing an end run against the constitutional protections that are involved when you sue based on the content of a person's speech," she said. Ms. Brick said she plans to appeal the decision to the California Supreme Court.

Intel's attorney, Michael A. Jacobs of Morrison & Foerster in San Francisco, said, "Intel was gratified that the court took a close look at the practicalities it was facing, and the decision represents a victory for employers who want to insure a productive computing environment."

Raymond Hixson, an employer attorney with Fenwick & West in Palo Alto, Calif., said the decision "shows that employers have a legal right to protect their e-mail and computer systems. The mere fact that a former employee can send an e-mail to former co-workers through the Internet does not mean the former employee is at liberty to disrupt the company's busi-

ness operations, so it's quite an important development."

Patricia White, an employer attorney with Littler Mendelson in San Jose, Calif., applauded the decision. "When you flood a private e-mail system with e-mails and it takes hours to delete them, to me that's as much of a trespass on the private space of business as if you had pickets sitting in the lobby," Ms. White said.

Maureen Dorney, an employer attorney with Gray, Cary Ware & Freindenrich in Palo Alto, Calif., said she was not surprised by the decision, "given the general development of case law in this area of unauthorized access to computer systems constituting a trespass."

The case will be influential, attorneys say. "To the extent that employers want to use this as a precedent to keep ex-employees from gaining access to e-mail systems," Ms. Dorney said, "it will be used for that purpose."

*Intel Corp., Plaintiff and Respondent, vs. Kourosh Kenneth Hamidi, Defendant and Appellant, Court of Appeal of the State of California, Third Appellate District, C033076.225.*

## Bias: Backlash brings risks

### Continued from page 3

hosted by TRW's EAP to allow employees to discuss their feelings, she said.

In addition, immediately following the attacks, "we placed calls to some of our Muslim employees to discuss TRW's commitment to a harassment-free workplace. We then asked them to speak with other Muslim employees throughout our company to reassure them that if they experienced any type of harassment they should contact our diversity office and we would act quickly to remedy the situation," Ms. Bosak said.

While some employers use diversity training, such programs may not be enough, warned Jeff Tanenbaum, a partner at Littler Mendelson P.C., a San Francisco-based law firm specializing in labor law. "Diversity training is geared to the overall process of making the workplace more diverse as a whole," he explained. Mr. Tanenbaum is defending two of the numerous Sept. 11-related EEOC complaints his firm is handling on behalf of employers.

Employers also need to educate employees on what constitutes harassment and discrimination, he said. In addition, they should provide training on how to prevent such behavior and should investi-

gate complaints and act on them if they are legitimate, he said.

While providing such training requires a financial investment, failing to do so could prove even more costly, Mr. Tanenbaum said. He estimated that the cost of defending a single EEOC complaint ranges from \$10,000 to \$20,000 if the case is settled early, and upwards of \$100,000 if the complaint ends up in litigation. And that doesn't include any potential jury award, he added.

Employers can purchase employment practices liability insurance to help cover some of the cost of such claims but few do, according to Gerald L. Maatman Jr., a partner at Baker & McKenzie in Chicago. Mr. Maatman, chairman of the firm's global employment law and benefits practice, is handling the defense of five Sept. 11-related harassment suits against employers.

While all of the employers Mr. Maatman is defending have EPL coverage, he estimates that as many as 85% of U.S. employers do not.

But interest in EPL coverage has been growing in recent years, said Gina M. Higgins, EPL practice leader at Marsh Inc.'s FINPRO unit in New York. Ms. Higgins said many of her clients have informed her of potential bias claims related to the Sept. 11 attacks.

She estimates that the purchase

of EPL coverage by Marsh clients has climbed 60% in the past year, and that "60% of our accounts have addressed this in some way, shape or form."

In the past, many employers relied on their directors and officers liability insurance to cover employment-related exposures. But because "the frequency and severity of these claims has been increasing steadily, most publicly traded companies' boards of directors are requiring stand-alone policies," Ms. Higgins said.

Nonetheless, even those employers that have EPL coverage could end up paying for Sept. 11-related complaints if they fail to report them early enough to their insurers, warned Ann M. Longmore, senior vp and national EPL practice leader for Willis North America Inc. in New York.

"Once there's a formal filing, they must inform their insurer," Ms. Longmore said. Unfortunately, "many employers that have received formal EEOC notices don't tell their insurers. They usually wait until there's a suit," she said.

Ms. Longmore said that part of the problem is that, in many cases, EEOC complaints aren't communicated to the risk management department by the human resources department.

# Comings & Goings



Mr. Turner



Mr. Dowd



Mr. Curcio



Mr. Vance



Mr. Mathison

## Insurers:

Philadelphia-based ACE USA Inc. announced a new management structure that includes the creation of four new positions:

**Marshall Turner** was named president of Atlanta-based Westchester Specialty Group. He previously was an executive vp.

**Brian Dowd** was appointed president of ACE USA's Specialty

P&C Group based in Philadelphia. He formerly was executive vp of ACE USA Property.

**William Curcio** was named president of ACE Risk Management, also based in Philadelphia. He previously was president of ACE USA Special Risk Facilities.

**John Lupica** was named president of ACE USA's Professional Risk Group, based in New York. Before this, he was executive vp of the group.

In other insurer changes:

**J. Alexander Fjelstad III** has been named president and chief executive officer of RTW Inc., a Minneapolis-based insurance holding company. Mr. Fjelstad, a former director and officer of RTW, succeeds **Carl B. Lehmann**, who resigned.

Also at RTW, **Alfred L. LaTendresse**, the company's former chief financial officer from 1990 to 1998, returned as executive vp and president of RTW subsidiary American Compensation Insurance Co.

**Richard S. Banas** has been named executive vp and chief underwriting officer of XL Capital Ltd.'s insurance operations in Hamilton, Bermuda. Mr. Banas previously served as managing director of OneBeacon Insurance Group, a unit of White Mountains Insurance Group Ltd. in Boston.

## Brokers:

**Larry Vance** has been promoted to president of Fox-Everett Inc. Insurance Co., and **Bill Mathison** has been promoted to executive vp of the Jackson, Miss., brokerage. Mr. Vance previously oversaw the company's employee benefit division, while Mr. Mathison was executive vp of property/casualty operations.

The Horton Group has promoted **Douglas R. Henderson** to Milwaukee branch president from senior vp. The Orland Park, Ill.-based brokerage also named **Barbara A. Reilly**, formerly a senior account executive at Liberty Mutual Insurance Co., as vp of its Risk Management Services Division. **Dustin T. Conrad**, a former assistant vp at Aon Corp., was named vp of Horton's Benefits Solutions Division. Both Ms. Reilly and Mr. Conrad will work from the company's Orland Park headquarters.

# ABD: Purchase one of biggest bank deals

Continued from page 3

the insurance world," Mr. Basso said. "We are not subject to the realities of most competitors that eventually have to deal with perpetuation in some manner. We have now solved that problem."

**'There are a lot of indications that a deal of this magnitude could work.'**

Timothy Cunningham  
IMCG

A merger specialist who advised Greater Bay on the deal stressed that ABD did not seek the deal out of desperation.

ABD has significant premium volume and revenues and was not desperate to perpetuate itself nor to conclude a deal, stressed John Wepler, senior vp-mergers and acquisitions for consultant Marsh, Berry & Co. Inc. in Concord, Ohio. But ABD executives were astute to team up with a bank that has an entrepreneurial bent, said Mr. Wepler, who represented Greater Bay in the merger.

Greater Bay's intention is to increasingly position itself as an ad-

viser offering capital and risk services to middle-market commercial customers, Mr. Wepler said. The ABD acquisition would boost the bank's revenues from non-interest income to 30% from 12%, he said, noting that Wall Street looks favorably on banks increasing their non-interest revenue.

Greater Bay stock rose \$3.31, or 13%, to \$28.81 per share following the announcement.

The deal is not intended as a retirement package for ABD's current executives, Mr. Wepler added. Key ABD people are "locked" into continuing the brokerage operation with employment and non-compete agreements and a pool of dollars set aside as an incentive to assure their retention. Merger terms contain "earn out" payments amounting to tens of millions of dollars for meeting certain goals.

The merger agreement also calls for ABD executives to serve as directors of Greater Bay, Mr. Basso said.

"There are a lot of indications that a deal of this magnitude would work," said Timothy Cunningham, a Chicago-based principal for brokerage consultant IMCG. However, he added, success is not guaranteed in such mergers and may not come easily or quickly.



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# Terror: Impasse in Congress stalls federal relief

Continued from page 1

added, "I'm a lobbyist, not an underwriter."

"RIMS is disappointed that Congress failed to get the terrorism bill as respects reinsurance enacted," said David Mair, president of the Risk & Insurance Management Society Inc. and associate director-risk management of the U.S. Olympic Committee in Colorado Springs, Colo.

"To use a sports analogy, they've lost their chance at the gold medal, and now we're going to hope that when they reconvene in January, they're going to take a shot at winning the silver and enact legislation. The inaction is going to significantly impact the ability of policyholders to obtain adequate insurance," he said.

Risk managers who aren't facing Jan. 1 renewals are nonetheless concerned about the possible impact of federal inaction.

"I think it's very serious. It puts the carriers in a difficult situation in regard to pricing their product going into next year" if reinsurers exclude terrorism, said Jim Green, an independent risk management consultant who acts as risk manager for Justin Industries Inc. and Acme Building Products Inc., both of Fort Worth, Texas. Mr. Green, who renews on Feb. 1, said he is particularly concerned about the potential impact on workers compensation.

"In other kinds of insurance, a carrier can exclude terrorism and war risk. You can't do that with workers comp," because it's a statutory program, he said. "Reinsurers

may exclude terrorism coverage to the insurer, but the insurer can't do so to the policyholder. How's he going to price that? We don't know," said Mr. Green.

"From our standpoint, if we have

**'To use a sports analogy, they've lost their chance at the gold medal, and now we're going to hope that when they reconvene in January, they're going to take a shot at winning the silver and enact legislation.'**

David Mair  
U.S. Olympic Committee

any problems, it will be with business interruption insurance," said Ted Jeske, risk manager and national safety manager for HTA Inc. of Key West, Fla. HTA, which runs tours and other attractions in six cities, faces a March 31 renewal.

Mr. Jeske noted that HTA's DC Ducks operation—which features rebuilt World War II amphibious vehicles that travel from downtown Washington before entering the Potomac River near Reagan National Airport—"was effectively shut down because of Sept 11." In addition, the company's tourist trolleys couldn't get to Washington-area monuments for several days. "It will hurt us on our business interruption if we have a terrorism ex-

clusion to contend with," he said.

Looking further ahead, Lance Ewing, senior director of risk management for GES Exposition Services Inc. of Las Vegas, noted that because GES' program doesn't renew until July, the situation hasn't had a great impact on his company. He said he "would have liked to have seen Congress come together" on the terrorism insurance issue. "But for those of us who are going to renew in July, it gives them a chance to get it right," he said.

The business community is also concerned about how federal inaction will affect the economy.

"There are very serious implications, not only in terms of those companies that can't get (terrorism coverage) directly. For example, one of the major sectors that needs this type of coverage is the transportation sector. Higher transportation costs will adversely affect the whole economy," said Joe Rubin, director-congressional affairs for the U.S. Chamber of Commerce in Washington.

Mr. Rubin said he remains optimistic a federal backstop can be enacted. "Passing it late is better than not passing it at all, but I don't know how effective that will be," given the importance of the Jan. 1 renewals, he said.

Insurers vow to continue pushing for enactment of federal terrorism legislation when Congress returns next month.

Although he would have preferred to see passage before Congress recessed, "we will come back in January and pick up this ef-

fort where we left off," Robert Vagley, president of the American Insurance Assn., said in a statement.

"We have to transition from this effort and pivot into the next phase, and continue to make members of Congress quite aware of our concerns with the marketplace," said Carl Parks, senior vp-government relations with National Assn. of Independent Insurers.

"This is a carryover session; even though Jan. 1 is very important for a lot of renewals, it can still be very significant to get building on the momentum we've already generated," said Mr. Parks.

**'Even though Jan. 1 is very important for a lot of renewals, it can still be very significant to get building on the momentum we've already generated.'**

Carl Parks  
National Assn.  
of Independent Insurers

The states also will play a role, Rodger Lawson, president of the Alliance of American Insurers, said in a statement after the adjournment. He noted that insurers would be asking states for permission to exclude terrorism coverage. "We are confident that the states will act now to effectively stabilize the insurance markets and ensure the continued availability of coverage."

But less than 24 hours after

Congress adjourned, the National Assn. of Insurance Commissioners announced that its members had agreed to "begin allowing insurers to exclude terrorism losses if a terrorist act causes total insured losses exceeding \$25 million," NAIC President Terri Vaughan said in a statement. Ms. Vaughan, who is Iowa's insurance commissioner, said that "only new commercial policies and those that are up for renewal might be affected by exclusions."

Differing approaches in Congress led to the impasse.

The House bill would have allowed the federal government to lend money to insurers to cover terrorism-related losses, provided that the insurers repaid the loans. The bill's chief backer, House Financial Services Committee Chairman Mike Oxley, R-Ohio, warned the Senate several times that the House would not accept a compromise that did not contain a payback provision. Neither risk managers nor insurers liked the loan concept, arguing it would do nothing to increase availability of coverage.

The Senate took a different approach. Under consensus draft legislation spearheaded by Sens. Christopher Dodd, D-Conn., and Phil Gramm, R-Texas, insurers would have had to pay out an industry aggregate of at least \$10 billion before the federal government would step in, but they would not have to repay the government funds. Such cost-sharing was closer to what risk managers, insurers and the White House sought, but it never reached the floor.

# Critique of Prop. 103 presented at NAIC meeting

By MEG FLETCHER

**CHICAGO**—California's Proposition 103 stifled competition and suppressed savings for consumers in that state, according to a new study commissioned by insurer trade groups.

The study was commissioned in response to an earlier study by a consumer group that praised the controversial ballot initiative.

Proposition 103, a ballot initiative that California voters approved in 1988, required property/casualty insurers to roll back auto insurance rates and established other regulatory requirements, including that the state insurance commissioner be elected.

David Appel, an actuary and principal with Milliman USA in New York, found that the political uncertainty imposed on the auto insurance rate approval system by Proposition 103 cost California auto insurance buyers between \$8.6 billion and \$13 billion in potential premium reductions that insurers' were reluctant to make over the past decade. Mr. Appel reported his findings at the National Assn. of Insurance Commissioners' recent winter meeting in Chicago.

The 51-page report by Mr. Appel challenges the conclusions of an

earlier report supporting tighter regulatory controls, which was prepared primarily by J. Robert Hunter, an actuary who is director of insurance for the Consumer Federation of America in Washington.

Mr. Appel's report also found that the "CFA's 'regulatory standards of excellence' are inconsistent with a modern understanding of the role of regulation in a competitive market," because they are generally anti-competitive, he said. In addition, "CFA's 'objective analysis' of regulatory results lacks scientific rigor and is fatally flawed," he said.

"A serious analysis of California's insurance premiums indicates that Proposition 103 had no meaningful effect on auto insurance costs in California," he said.

Mr. Appel's study was commissioned by four trade associations—the Alliance of American Insurers, the American Insurance Assn., the National Assn. of Independent Insurers and the National Assn. of Mutual Insurance Cos. Copies of the report are available from those associations.

Commenting on the report, Mr. Hunter said after the NAIC meeting: "I think it is a very light analytical response, though it took six months."

"The insurance companies don't

deny all the good things that happened after Prop. 103. That kills their oft-stated argument that increased regulation causes all sorts of bad things, like higher rates for consumers, lower profits for insurers and sharply increased numbers of assigned risks and uninsured motorists," he said.

In other action, regulators:

- Decided to urge federal transportation officials to let Mexican trucking companies engaged in cross-border traffic use a wide variety of insurance options, including coverage written by surplus lines insurers (*BI*, Dec. 10).

- Gave interim approval to a condensed version of the Property and Casualty Commercial Rate and Policy Form Model Law.

"As part of the NAIC's many modernization initiatives, this model law is aimed at improving the efficiency of rate and form review and standardizing state laws for commercial lines insurance products," said Ohio Insurance Director Lee Covington. He chairs the Improvements to State-Based Systems Working Group, which approved the measure.

The proposed model law, however, requires additional approvals before the full NAIC adopts it.

- Urged Holocaust survivors and

heirs to submit their insurance claims to the International Commission on Holocaust Era Insurance Claims by the filing deadline of Feb. 15, 2002.

The NAIC's International Holocaust Commission Task Force recognizes that there must be one exception to that deadline: "Any claim filed as a result of a newly published list must be honored. Lists are an essential part of the Holocaust-era insurance claims process," said Illinois Insurance Director Nathaniel Shapo, who chairs the task force.

The task force also reiterated NAIC concerns about negotiations on Holocaust-era claims with German insurers. The International Commission on Holocaust Era Insurance Claims and German insurers differ on several points, including policyholder lists, audit procedures and reimbursement of company expenses.

- Adopted the association's 2002 budget.

The NAIC projects a 4.1% increase in revenue, to \$49.9 million, due in part to state insurance departments' higher assessments and higher database fees for insurers. The NAIC also anticipates a 3.8% increase in spending, to \$49.8 million, due in part to salary increases and the addition of eight staff

members.

- Gave accreditation awards to four insurance departments—Hawaii, Kansas, North Carolina and Ohio.

- Awarded its highest insurance department staff honor—the Robert Dineen Award—to Stephen J. Johnson, deputy insurance commissioner for Pennsylvania.

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# Manville: Tougher claims standards sought

Continued from page 1

the manufacture or installation of an asbestos product.

"As long as the trust remains obligated to pay the ever-increasing number of unimpaired claims it receives, it will be unable to compensate its most-deserving claimants in the manner equity demands," Robert A. Falise, the trust chairman, said in a letter to two federal judges overseeing Manville asbestos litigation.

The Manville trust's problem is not unique: Several asbestos defendants pushed into bankruptcy in the last two years are considering ways to fight what they contend are spurious claims generated by aggressive plaintiffs' lawyers.

For example, the New Orleans-based engineering firm of Babcock & Wilcox Co., which routinely settled asbestos claims before its 2000 bankruptcy filing, has asked permission of a bankruptcy judge to litigate thousands of claims from plaintiffs it says are not injured.

Trusts formed by other asbestos defendants that have already emerged from Chapter 11 reorganization likewise say that they have been flooded with new claims and have cut the amounts they pay.

A trust formed by former asbestos producer Eagle-Picher Industries Inc. of Cincinnati, for instance, dropped its payout on approved claims to 25.7% from 31.9% last year because of a "significant increase" in claim filings, court records say. Another trust established by the former UNR Industries Inc.—now Rohn Industries Inc. of Peoria, Ill.—cut its payout to 7.8% on approved claims from 12.9% following a 33% increase in claims between 1999 and 2000.

Insurers have also reacted to the rising loss trend. London market insurers earlier this year announced

tougher standards for asbestos claims, insisting on medical evidence of illness substantially caused by asbestos.

Whether the Manville trust will succeed in amending its claims procedures remains to be seen. Lawyers representing some claimants support the changes, but others have not agreed to the trust's plan, effectively blocking its implementation. Trust officials are asking the court to order the amendments despite the lack of claimant consensus.

If the changes are put into effect, though, the experience of the Manville trust will be studied by other asbestos defendants now in bankruptcy reorganization, some lawyers say.

"Manville is clearly a case to watch," said Theodore Freedman, a lawyer with Kirkland & Ellis in New York, representing Babcock & Wilcox. "It would certainly be looked at and paid a lot of attention."

The Manville trust was formed in 1987 to handle claims against bankrupt Denver-based asbestos producer Johns-Manville Corp. as part of its Chapter 11 reorganization. Quickly overwhelmed by claimant lawsuits, though, the trust created a new "trust distribution process" in 1995 under a settlement with representatives of current and future Manville claimants.

Under the trust distribution process, the trust processed claims in several "scheduled disease categories" ranging up to cases of fatal malignant mesothelioma, with all allowed claims paid at 10% of their scheduled values.

Since the late 1990s, though, the trust, like other asbestos defendants, has been hit with a startling rise in claims. In the first nine months of this year, Manville has received 69,500 new claims, com-

pared with 59,200 for all of last year; 32,500 in 1999; and 30,000 in 1998.

In response, the trust earlier this year imposed a temporary moratorium on new claim filings, and in July, it announced that it would cut its pro-rata payment on settled claims to 5% from 10%. This move has since been challenged by the Selected Counsel for the Beneficiaries, a claimant group, and the dispute is in arbitration.

Meanwhile, Manville trustees have developed a plan to amend the trust distribution process to eliminate certain types of claims and to shift more of the trust's resources to the most seriously injured victims. Under current procedures, for example, the value assigned to a malignant mesothelioma case is \$200,000—making for a \$10,000 payment at the 5% rate—which is only four times the \$50,000 value of a lung disease case that produces little disability, according to Manville court filings. The trust wants to amend the scheduled values to make payments on malignant disease claims 40 to 50 times those for nonmalignant claims.

The current trust distribution process also requires claimants to show only that they were exposed to Manville asbestos products. The trust wants to amend this to require proof of "industrial" exposure in a situation that produces asbestos dust—such as manufacturing—rather than exposure at a location where asbestos is merely present.

Continuing to cover nonindustrial exposure could open Manville to "tens of millions" of future claims, the trust's Mr. Falise says in a Dec. 5 letter to U.S. District Judge Jack B. Weinstein and U.S. Bankruptcy Judge Burton R. Lifland, who have overseen Manville matters.

## MANVILLE TRUST CLAIMS RISE

Figures as of Sept. 30, dollar figures in millions

	2001	2000
Net assets	\$1,876.5	\$2,048.3
Claim payments (9 months)	\$236.5	\$197.0
New claims filed (9 months)	69,500	44,800
Total claims filed	558,848	467,963
Total claims settled	409,204	323,654

SOURCE: MANVILLE PERSONAL INJURY SETTLEMENT TRUST FINANCIAL STATEMENTS

"A large share of the trust's claimants," the letter adds, "now have 'injuries' which are imperceptible, even to themselves, without the aid of X-ray or other imaging technology. These claimants are marshaled in mass screenings that have as their primary purpose the rounding up of claimants whose settlements will generate fees for the sponsors of the screenings."

Under the 1995 settlement that established the trust distribution process, though, any changes to the procedures must be agreed to by the Selected Counsel for the Beneficiaries and the Legal Representative of Future Claimants, another claimant group. The trust's proposed revisions have revealed a split between these groups: While the Future Claimants support the changes, the SCB has thus far withheld consent.

As a result, Manville trustees have asked Judge Weinstein and Judge Lifland to intervene, and the judges on Dec. 13 presided over a packed hearing in Brooklyn. In addition to trust officials and claimant representatives, those attending included lawyers for asbestos defendants Babcock & Wilcox and U.S. Gypsum Co., and London market insur-

ers, who argued for the trust's adoption of the London market documentation requirements.

After hearing arguments, the court ordered the parties to continue discussions and to report back in 30 days.

Elihu Inselbuch, a lawyer with Caplin & Drysdale in New York representing the SCB, said the claimant group has not reached a conclusion about the trust distribution process changes and is still reviewing claims data to decide whether changes are necessary. Mr. Inselbuch expressed a desire for the parties to settle the matter without a court order, which he predicted would produce years of appeals.

"Hopefully, we can resolve this thing in a way that makes everyone equally unhappy. That's the goal," Mr. Inselbuch said.

However, David Austern, president of Fairfax, Va.-based Claims Resolution Management Corp., which administers the Manville trust, expressed less optimism.

"The plaintiffs' bar does not have one view on this subject," Mr. Austern said. "I don't expect them to get one view in the next 30 days."

# Citigroup: Travelers P/C to be divested

Continued from page 1

away from...manufacturing to distribution," Mr. Weill said, referring to insurance underwriting. "So we think we can make profits from distributing products, and by having an open architecture, we will be better positioned" to do that, he said.

Mr. Weill also said Travelers P/C "can do more on its own than it would have made sense as a part of Citigroup."

Overall, industry observers say the divestiture has long been a likely move for Citigroup, whose products never melded well with property/casualty underwriting.

The \$70 billion merger of Travelers Group and Citicorp into Citigroup Inc. in 1998 is considered a watershed event in the financial services industry, which had been inching toward greater convergence of its sectors. The merger was seen as a catalyst for enactment a year later of the Gramm-Leach-Bliley Financial Services Modernization Act, which opened the doors to broad convergence by lowering Depression-era barriers between the banking, securities and insurance industries.

But, as Citigroup learned, property/casualty underwriting does not yield the same returns as do other financial services and is a markedly different business from banking, securities, and life and annuity business.

"It's a move that I've been waiting for them to make," said Adam Klauber, a managing director with Cochran, Caronia Securities L.L.C. in Chicago. "The one part of Citigroup's empire that didn't make sense was property/casualty."

Citigroup has based its business on being a higher-growth financial services organization, Mr. Klauber added. "That type of organization needs minimum organic growth of 10% to 12% over a long period of time. The P/C business, especially a large commercial P/C business, over cycles is just not going to have 10% organic growth."

"This was the most obvious example of a bank owning an insurance company, and if the synergies were very compelling, my sense is they may not have done this," said Jay Cohen, first vp at Merrill Lynch & Co. in New York, referring to the planned divestiture.

Citigroup's experience is a reminder to financial services organizations that property/casualty underwriting is not a transactional business like credit card and securities transactions, said John W. Wicher, principal at insurance investment bank John Wicher & Associates Inc. in San Francisco. "The fact is, P/C business is not a transaction business; it's comprised of a number of activities. I don't think financial services organizations

fully understand that," Mr. Wicher said.

Barbara Stewart, president of Stewart Economics in Atlanta, said, "I think any kind of P/C convergence with other financial services companies will probably be strictly on a brokerage basis....They're looking to collect fees and commissions."

Analysts also say that Citigroup's move may fuel further consolidation in the proper-

ty/casualty industry.

Although Citigroup executives would not discuss Travelers P/C's strategy until registration statements are made with the Securities and Exchange Commission, Mr. Lipp noted in a statement that the planned "spinoff positions Travelers Property Casualty to participate independently in the accelerating consolidation of the insurance industry."

Diane Glossman, a bank analyst with UBS Warburg in New York, said, "This is a very sizable part of the U.S. P/C business, and by being a separate entity, it enhances the potential that this company will be a much more acquisitive company."

"It will give them much better expansion—and especially consolidation—potential," agreed Mr. Klauber of Cochran, Caronia. "Longer term, especially in the large P/C market, you have to be a good consolidator to be effective," he said.

Upon news of the spinoff, Oldwick, N.J.-based A.M. Best Co. affirmed its A++ financial strength rating of the Travelers P/C pool.

Standard & Poor's Corp. lowered its senior debt and preferred stock ratings on Travelers P/C Corp. to A- and BBB, respectively. It affirmed its AA- counterparty credit and financial strength ratings on the members of the Travelers P/C pool.

## UNDER THE UMBRELLA

Travelers Property Casualty operations within Citigroup in 2000; figures are income in millions

Citigroup	\$14,140
Travelers P/C	
Commercial lines	\$1,093
Personal lines	\$307
Realized gains/losses*	\$31
Total P/C business	\$1,431

\* REPORTED IN CITIGROUP INVESTMENT ACTIVITIES  
SOURCE: CITIGROUP

# FTR

[Week of 12/17-12/21]

This roundup of news from the previous week is generated by BI's daily news reporting. To get breaking news as it occurs, log on to [www.businessinsurance.com](http://www.businessinsurance.com), or sign up online for free BI Daily News by e-mail.

## Enron requests benefits cap modification

Enron Corp. is asking the U.S. Bankruptcy Court in New York to exclude any unpaid health plan

benefits from the court-imposed cap of \$15,000 per employee, a company spokeswoman confirmed.

The cap,

which the court applied when the Houston-based company filed for Chapter 11 bankruptcy in early December, should apply only to employee wage and benefits payments and not to business and administrative expenses, including those incurred under health plans, the company said in a request filed last week. Meanwhile, Reps. Peter Deutsch, D-Fla., and Gene Green, D-Texas, have introduced legislation that would put a 10% cap on the amount of stock that 401(k) plan participants could hold of their own company in their accounts. The bill, which has been referred to the House Ways and Means Committee, was introduced in response to the Enron debacle.

## Unit's losses prompt MRM to bolster reserves

A \$30 million addition to net loss reserves of its insurance company subsidiaries will leave Mutual Risk Management Ltd. with an aftertax loss of \$6.3 million to \$8.4 million in the fourth quarter. MRM, a Hamilton, Bermuda-based captive management company, said the additional reserves are needed because losses from prior years on

some programs written by its Philadelphia-based Legion Insurance Group may exceed its limits of reinsurance protection. A.M. Best Co. has advised MRM that Legion's A-financial strength rating is being placed under review, with negative implications. Legion writes several lines, including workers compensation. MRM said it plans to raise additional capital to help the fronting company retain its rating and take advantage of opportunities for writing additional business.

## \$25 billion in new capital raised, S&P says

Nearly \$25 billion in new capital has been raised by insurers and reinsurers since Sept. 11, according to a new report from Standard & Poor's Corp. The Bermuda market has been the largest recipient of the capital influx: Bermuda startups have raised \$6.56 billion, while existing companies have raised \$3.4 billion. Furthermore, insurers and reinsurers in the United States have raised \$5.57 billion in new capital, reinsurers in Switzerland have increased their capital by \$5.35 billion, and U.K. companies have added \$1.97 billion in new capital.

## Attacks push health costs higher: Survey

The terrorist attacks of Sept. 11 will push health care costs even higher than had been expected prior to the disaster, according to a survey by New York-based Buck Consultants Inc. The survey of 94 health insurers and third-party administrators, which was conducted in October, reveals that respondents expect health care costs to rise by between 13% and 17% next year. Overall, that is

roughly a 1% increase over the last Buck survey, which was conducted just prior to the attacks. One factor expected to drive higher costs is greater use of mental health care services in the wake of Sept. 11, said Harvey Sobel, principal, consulting actuary and co-author of the survey in Buck's Secaucus, N.J., office. In addition, an increase in layoffs will result in more individuals opting for COBRA health care continuation coverage, he said.

## Court expands liability for bad faith

Insurers that fail to comply with the Colorado Consumer Protection Act could be liable for triple damages and the fees of policyholder attorneys in bad-faith cases, the state's Supreme Court ruled last week. This was the first time Colorado's highest court has addressed the issue of whether the state's Unfair Claims Practices Act pre-empts the Consumer Protection Act, said Stephen B. Shapiro, a partner at Biegling Shapiro & Burrus L.L.P. in Denver who represented the plaintiff in the case. "This certainly gives policyholders a hammer" in pursuing bad-faith claims against insurers, Mr. Shapiro said. He said he hopes that the decision will prompt insurers to be "more realistic in the handling and settlement of claims."

## Insurer groups seek to streamline financial exams

Seven insurer trade groups are polling insurers on ways to improve the efficiency of state financial examinations. The survey, which is being conducted online, was developed to "assist state insurance departments and the (National Assn. of Insurance Commissioners) in streamlining the examination process and eliminating unnecessary costs," said Stephen W. Broadie, assistant vp-financial legislation and regulation for the National Assn. of Independent Insurers in Des Plaines, Ill. Earlier this

# NAIC

year, the trade associations submitted a white paper on the financial examination process to the NAIC. The groups' recommendations included: implementing greater cost controls, improving the integration of examination planning with work done by an insurer's auditors, and providing additional training for state examination staffs.

## Briefly noted

The Pension Benefit Guaranty Corp. has terminated and taken over two underfunded pension plans sponsored by Alamac Knit Fabrics Inc., formerly a Charlotte, N.C.-based textile manufacturer that is in bankruptcy liquidation. The two plans, which have about 2,100 participants and total assets of \$16.6 million, are underfunded by about

\$6.6 million....Endurance Specialty Insurance Ltd. completed its private placement that raised \$1.2 billion in capital for the Bermuda insurer. Also in Bermuda, a public offering and private placement by IPC Holdings Ltd. raised \$547 million in reinsurance capacity earlier this month, and Montpelier Reinsurance Ltd. said last week that it is commencing operations with \$1 billion in capital, \$850 million of which was raised in a private placement....Boston-based Liberty Mutual Insurance Co. has announced a reorganization of its U.K. operations. The company said that Liberty Mutual U.K. will stop writing reinsurance and will focus on primary lines, including aviation, casualty, directors and officers liability, energy, engineering, and professional indemnity.

## BI Stock Index [12-17 - 12-21]

Up-to-the-minute data for all 87 companies that comprise the BI Stock Index can be found at [www.businessinsurance.com](http://www.businessinsurance.com)

Percentage change of BI Stock Index vs. key indicators



### Largest gains

Trenwick Group Ltd.	16.26
Argonaut Group	13.54
Ohio Casualty Corp.	11.42
SCPIE Holdings Inc.	9.98
Allmerica Financial Co.	7.76

### Largest losses

Mutual Risk Management Ltd.	-37.27
Meadowbrook Ins. Group	-9.76
Sierra Health Services	-8.24
EMC Insurance Group	-7.61
Gainsco Inc.	-6.67

### Weekly change by market segment

Brokers	0.30
Insurers/Reinsurers	1.84
Managed Care Organizations	0.37

Source: CNET Investor ([investor.cnet.com](http://investor.cnet.com))

# Q&A: Government guidance on claims deadlines

Continued from page 3

Some of those questions and answers provided by the Labor Department include:

### Q: Does the regulation apply to all group health plans?

A: The regulation applies only to plans covered under the Employee Retirement Income Security Act. As a result, plans offered by public employers, such as state and local governments, are not covered.

### Q: Does the regulation apply only to medical plans or to all health care-related plans, such as dental and prescription drug plans?

A: The regulation applies to all health care-related plans. The regulation covers any plan that provides coverage, as defined

under ERISA, for the "diagnosis, cure, mitigation, treatment or prevention of disease, or amounts paid for the purpose of affecting any structure or function of the body."

"While this seemed clear in the regulations, some employers wanted explicit confirmation," said Kathleen Rosenow, a consultant with Watson Wyatt Worldwide in Washington.

### Q: Do the deadlines for responding to pre-service and post-service claims also apply to the time in which claims must actually be paid?

A: While the regulation establishes deadlines within which claims must be resolved, it does not apply to when payments, which already have been approved, must be paid.

### Q: In what circumstances, if any, would a post-service claim be considered a claim for "urgent care"?

A: A post-service claim never would be considered, under the regulation, a claim for urgent care.

"The rationale is that the service already has been done and thus the claim can't be urgent," explained Andy Anderson, a consultant at Hewitt Associates L.L.C. in Lincolnshire, Ill.

### Q: When a plan has approved a benefit that will be provided over a period of time, such as for chemotherapy treatments, must the plan notify the claimant when the benefits end?

A: Such notification would not be required as long as the plan notified the claimant regarding the

scope of the benefit that was originally approved, such as how many treatments were to be provided, and did not subsequently reduce the course of treatment that was originally approved.

### Q: Can a plan request that a claimant's request for review of an adverse benefit determination be made in writing?

A: Generally, it would not be unreasonable for a plan to request that reviews sought by claimants be in writing. However, in the case of a review of adverse benefit determinations involving urgent care claims, the regulation allows claimants to submit a request for review orally.

### Q: If a group plan provides for

two levels of review rather than one, what standards apply for the second level of review after an adverse benefit determination by the first level?

A: In such situations, the second level of review is subject to the same standards that apply to the first level.

Practically, that would mean that the second-level reviewer could not give deference to the decision made at the first level. In addition, the second-level reviewer could not be the same person who made the first-level review decision or be a subordinate of that person.

"The second review has to be absolutely fresh," said Michael Rosenbaum, a partner with Gardner, Carton & Douglas in Chicago.



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