

Industry

FEBRUARY 2007

A Supplement to

Business Insurance FOCUS

www.IndustryFocus.com



Softening market's
Impact on captives
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Standards proposal
sparks RRG debate
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Regulator protects,
promotes industry
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IN FOCUS

Key players
in the
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insurance
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NEW IDEAS

IN ALTERNATIVE RISK MANAGEMENT

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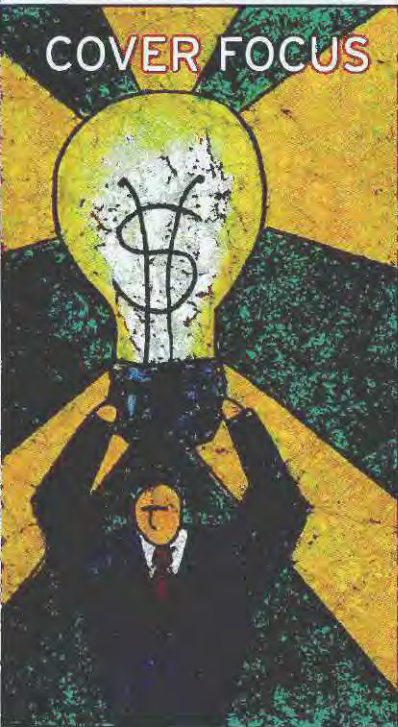
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ALTERNATIVE RISK MARKETS



Soft power

While captive markets appear to be softening, managers, regulators and captive consultants see opportunities and sustained growth ahead. **Page 10**

A higher standard

The NAIC is developing a response to the GAO report on risk retention groups. How will this affect state accreditation and managers who work with RRGs? **Page 14**

Vermont's standard setter

Vermont is the preeminent U.S. captive domicile and if one person is the face of Vermont captives it's Len Crouse. His focus goes beyond Vermont, though, as he promotes the industry and sound regulation. **Page 18**

FEATURES

View from the inside, out

CEOs and industry observers from across the property/casualty insurance and reinsurance spectrum gather in New York for the 11th Annual Property/Casualty Joint Industry Forum. **Page 20**

Fronting insurers

Fronting insurance is an essential ingredient in making many captive insurance and other alternative risk transfer arrangements program work. Here's a look at some of the key players in the fronting insurance market. **Page 22**

SOA, standard, streamlined

Service-oriented architecture and lean manufacturing principles are two trends that will grab the attention of chief information officers in 2007. **Page 23**



THREE QUESTIONS

Aon Insurance Managers' Nancy Gray discusses current trends in the captive insurance market and the year ahead. **Page 5**

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When marketing misses the mark

Over the course of the past few weeks, I've run across a couple of marketing-related stories that struck me as particularly interesting. One was kind of poignant in a way, the other more of a head scratcher.

The first item is about a once-beloved brand icon that seems to be on the verge of being lost forever. In an editorial in the Hartford Courant last month, the newspaper mourned that the red umbrella that's currently part of the Citigroup logo is likely to be lost to a rebranding effort the company plans to undertake.

The umbrella, of course, came Citigroup's way when predecessor company Citicorp acquired the Hartford-based Travelers Insurance Co. in 1998. In 2002, Citigroup spun off the insurer's property/casualty insurance business into Travelers Property Casualty Corp., but kept the umbrella.

With Travelers now part of St. Paul Travelers Cos. Inc.—and that company having adopted a red winged shield as its logo and launched a major marketing campaign along with it—that company says it's not interested in the apparently soon to be available umbrella.

But while the red umbrella might not have a place in either Citigroup's or St. Paul Travelers' future branding efforts, it does still resonate in Connecticut. Beneath the headline "Symbol of a Gentler Time," the Courant editorial recalled a 3,000-pound red neon umbrella that once adorned Hartford's Travelers Tower, which—together with the umbrella's place in Travelers ads in print and on television—branded Hartford "ground zero for the insurance industry."

It's amazing, but sometimes a logo or company brand can grow beyond the property of the company to which it belongs into a cherished symbol for which an entire community feels ownership. Here in Chicago, Federated Department Stores continues to deal with fallout from the company's decision last year to rename and rebrand the Marshall Field's department stores as Macy's.

As Field's green was replaced with Macy's red, the local news was full of reports of long-time Field's shoppers, many of whom remembered childhood trips downtown always including a stop at Field's, lining up to picket outside the former Field's flagship

store on Chicago's State Street.

One might dismiss such demonstrations as simply people not liking change, and maybe there is an element of that. Still, I don't know whether the kind of brand loyalty demonstrated by shoppers picketing a department store's name change—or a red umbrella's status as an element of civic pride—factor into marketing plans, but it seems to me it's something that should be considered.

The other item that caught my interest, the head scratcher, was a Reuters story last month about an interesting promotion conducted by consumer products giant Unilever. According to the report, a direct-mail campaign promoting a brand of margarine saw the Anglo-Dutch company sending knives to 200,000 Dutch families.

Evidently three children wound up being injured by the metal blade of the knives, and 50 parents filed complaints. Ultimately,

WHILE THE RED UMBRELLA might not have a place in either Citigroup's or St. Paul Travelers' future branding efforts, it does still resonate in Connecticut.

Unilever followed the initial mailing with a second letter urging recipients of the original promotional materials to dispose of the knife. The company said it hadn't received any requests for compensation from recipients of its pointed campaign.

Granted, sending knives in the mail did draw attention to Unilever's campaign. But it seems to me it's a good thing the folks responsible weren't marketing something like a Call of Duty video game—they might have sent out hand grenades.

It's probably an even better thing that Unilever wasn't sending out this marketing piece in the United States. Imagine the response a campaign like that might generate among some particularly enterprising plaintiff's lawyers!

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NAMIC launches climate impact Web site

INDIANAPOLIS—The National Assn. of Mutual Insurance Cos. has introduced a new Web site focusing on climate change and its impact on the property/casualty insurance industry.

The site, www.climateandinsurance.org, was launched in response to the growing discussion about climate change and the insurance industry's role in the public policy debate over such topics as flood, natural disaster insurance, emergency preparedness and response, and reinsurance.

Indianapolis-based NAMIC said the Web site will not advocate specific posi-

tions on the causes of global climate change or the increasing frequency of natural disasters around the world. Instead the site will focus on how climate change affects the insurance industry and what insurers and reinsurers in the United States and Europe are doing in response.

NAMIC plans to add such features as podcasts, blogs, videocasts and other interactive features to the Web site as dictated by the needs of the site's users.

The association also will use the site to report on the status of the National Assn. of Insurance Commissioners' Cli-



mate Change and Global Warming Task Force and other regulatory and legislative efforts on the climate change issue. **■**

BY THE NUMBERS

Insurance industry employers are expected to face difficulties replacing seasoned insurance professionals as Baby Boomers retire, according to most CPCU Society members surveyed.

Expected ease of replacing experienced insurance industry professionals

| | |
|---|-----|
| Easily replaced | 8% |
| Replaced at higher salary | 5% |
| Delayed due to search | 38% |
| Delayed by replacement training | 25% |
| Delayed by training multiple replacements | 11% |
| Can't be replaced | 8% |
| Other | 3% |

Source: CPCU Society Member Opinion Panel

Dispute resolution protocol available

NEW YORK—A nonprofit alliance of global corporations, law firms, scholars and public institutions has released a tool to help manage the cost of disputes between insurers and reinsurers.

The new procedural protocol from the International Institute for Conflict Prevention & Resolution—the CPR International Reinsurance Dispute Resolution Protocol—was developed by a

committee of insurers and reinsurers.

The protocol sets a schedule for companies in a dispute to exchange information, negotiate and, if needed, enter mediation.

The protocol, available at www.insurancemediation.org, includes a statement of best practices. Companies can incorporate the protocol into reinsurance contracts or adopt it in specific instances. **■**

Institutes unveil new course offerings on P/C developments

MALVERN, Pa.—The American Institute for CPCU and the Insurance Institute of America have launched a series of professional development courses designed to provide the most recent information on trends and developments in the property/casualty insurance market.

The Institutes' Professional Development Series readings are clustered by topic to allow users to quickly find information of particular interest and relevance. The PDS is designed as a resource, balancing learning and professional development with current work objectives and time demands. All PDS course materials and optional examinations are online.

The first two courses are reinsurance with topics that include Solvency II, catastrophe modeling, alternative risk transfer, sidecars and catastrophe bonds; and risk

management with topics that include captives, enterprise risk management, catastrophes and securitization, intellectual property, crisis management and emerging liability issues.

Articles for each cluster of readings come from various industry publications. Questions at the end of each reading help students measure their understanding of the material. Students are not required to answer the questions unless they wish to earn the certificate of completion. To earn a certificate of completion, students must correctly answer 150 questions within a 12-month period.

PDS courses are open to anyone, and they are not required to complete or maintain any Institute certificate or designation program.

More information and a demonstration are available online at www.aicpcu.org. **■**



With captive insurance having become a commonplace risk financing tool and captive formations continuing regardless of traditional market conditions, some suggest that the alternative risk transfer market is no longer alternative. Recently, Nancy Gray, Burlington, Vt.-based executive director of North American operations for Aon Insurance Managers, discussed current trends in the captive insurance market and what she sees in the year ahead.

Q: By all indications, the traditional insurance market is experiencing softening in rates. Would you expect that to have any impact on new captive formations in 2007?

A: Last year for the most part, we did see soft market conditions

and we did see more new formations across all industry sectors.

In terms of where we're seeing the growth, it's across all industry sectors. There are some areas where we're seeing particular growth. Health care is one area where we're seeing growth. Another area where we're seeing captive growth is property development. We're seeing a lot of captives formed for securitization purposes for life companies.

There are a lot of captives that were formed in '06 that are writing property (coverage). Vermont in particular is attracting a lot of those captives. They're forming the captives and using them to access reinsurance markets.

Q: A number of U.S. states are now captive domiciles and, while Vermont remains the largest onshore domicile, several states seem to have become quite viable. Have many onshore domiciles succeeded by carving out particular niches for themselves in the captive market?

A: The U.S. domiciles are growing at a greater pace than the offshore domiciles. I think the U.S. domiciles have done a good job of promoting themselves. You don't really need to be in Bermuda. What we've seen in the past is a lot of companies said, 'I have to go visit my reinsurer in Bermuda, so I might as well set up my captive in Bermuda.' But now with a global market, you don't really need

to do that.

There are approximately 25 domiciles in the U.S. now. What they've done for the most part is taken Vermont captive law and copied it. So they haven't been able to give themselves a competitive advantage (with their laws). However, they have been able to find certain niches for themselves.

Vermont continues to be the domicile chosen by more of the Fortune 500 companies, so you'll see from their perspective a more diverse spectrum of companies forming in Vermont. In terms of new formations, Vermont licensed 38 new captives in '06. Nevada was second; they attracted 33 new captives. They tend to be operating in the middle-market area for captives. South Carolina was third; they licensed 29 in '06. Their growth is coming from the securitization captives, with some health care.

Q: What is the current state of the reinsurance market for captives? Is reinsurance readily available? Are any lines particularly problematic?

A: For the most part coverage, pricing and capacity is not an issue; it is a soft market condition. But you do have certain perils that are very difficult—windstorm, earthquakes. Captives can be part of the solution to that. They can fill in some of the gaps, but they aren't the entire solution. Captives aren't formed to be writing those kinds of limits. ■

Venture launches Vertibrands marketing spin-off

WEST CHESTER, Pa.—Program administrator Venture Insurance Programs has launched an independent marketing communications firm to support program administrators and retail agencies.

The spin-off firm, Vertibrands Inc., is a full service marketing communications firm that will serve insurance program administrators in noncompeting vertical industries and retail agencies in noncompeting geographic regions.

Based in West Chester, Pa., Vertibrands will operate independently of Venture. Richard Look, who had been communications director of Venture Insurance Programs, will serve as Vertibrands' president.

Among the advertising, marketing and public relations services offered by Vertibrands will be brand planning, positioning and corporate identity development; advertising review and development; media research, plan-

ning and placement; public relations; direct marketing; interactive communications such as Web sites, webcasts, sponsorships and video development; inquiry fulfillment; and conference support.

Venture Insurance Programs is Vertibrands' first client. In addition to insurance industry companies, Vertibrands plans to work with businesses in other select industries served by its insurance clients. ■



Hedge fund manager Fermat Capital Management will use AIR's modeling tools as it invests in securities linked to natural risks such as European windstorms.

Fermat fund taps ALERT, CATRADER to assess risk

BOSTON—Hedge fund manager Fermat Capital Management L.L.C. has chosen AIR Worldwide Corp.'s catastrophe risk management systems for use in managing Fermat's catastrophe bond investment portfolio.

Fermat is one of the largest investors in catastrophe bonds. The Westport, Conn.-based hedge fund manager has licensed AIR's CATRADER catastrophe risk modeling application and ALERT, AIR's online real-time loss estimation service.

Fermat said the AIR's catastrophe models enable the fund manager to generate loss estimates for a wide range

of potential investments, with those simulations allowing better management of portfolio risk and improved assessment of potential returns on catastrophe-related investment instruments.

Using ALERT in conjunction with CATRADER will help Fermat determine portfolio risk in real-time as events occur.

AIR has provided modeling support to the catastrophe bond securitization market since 1997, both through consulting and through CATRADER.

Boston-based AIR is a unit of the Insurance Services Office Inc. **IF**

Hartford hits the road with Vault training

SIMSBURY, Conn.—The Hartford Financial Services Group Inc. is taking its Vault group disability insurance training program on the road to provide easier access for group benefits professionals across the country.

Hartford's Vault program covers group short- and long-term disability insurance contracts, benefits, underwriting and pricing. Participants can earn continuing education credits for life and health licenses in most states.

More than 150 professionals from across the United States have graduated from the Vault program in Connecticut. The insurer, whose life and disability insurance and financial products business is based in Simsbury, Conn., plans to hold its educational seminar in six cities this year: March 5-8 in Maitland, Fla.; April 23-26 in Palm Springs, Calif.; May 14-17 and Oct. 15-18 in Avon, Conn.; June 4-8 in Philadelphia; Sept. 10-13 in Cincinnati; and Sept. 24-27 in Chicago.

The program began in 2005 in response to benefits professionals' desire for in-depth training on disability insurance. Vault graduates have credited the program with giving them the knowledge and tools to craft benefit plans that protect the financial and physical health of their employer clients and their employees.

Tuition for the program is \$1,595 per person. The fee includes course materials, meals and refreshments, designation exam and state filing and certification fees for continuing education credits. For more information or to register for the program, visit www.thehartford.com/vault. **IF**

ROAD WORK

Hartford plans to hold its educational seminar in:

- Maitland, Fla.
- Palm Springs, Calif.
- Avon, Conn.
- Philadelphia
- Cincinnati
- Chicago

THE QUOTE

'WHAT WE SEE ARE captives being used a lot better, as a complement to the existing market.'

DAVID EZEKIEL
PRESIDENT AND MANAGING DIRECTOR
INTERNATIONAL ADVISORY SERVICES LTD.

Shand Morahan launches retooled attorney program

DEERFIELD, Ill.—Shand Morahan & Co. Inc., the underwriting manager of Evanston Insurance Co., has launched a revamped lawyers professional liability program.

Designed Protection for Law Firms is aimed at hard-to-place attorneys and law firms. Deerfield, Ill.-based Shand said the updated program has a more competitive policy form and application plus risk management enhancements, and is available free to policyholders.

Among the program's services is a lawyers risk management hotline, a confidential telephone hotline staffed by attorneys with expertise in legal profession risk management and defense of lawyers professional liability claims and ethics-related disciplinary proceedings.

A lawyers risk management guide offers 80 core risk management strategies, while a professional practices guide for nonmedical professionals offers 230 strategies on 75 topics such as claim mitigation, client relations and marketing.

Shand Morahan is a wholesale-dedicated surplus lines insurance underwriting management unit of Richmond, Va.-based Markel Corp. **■**

Gallagher to buy Toronto-based broker

ITASCA, Ill.—Arthur J. Gallagher & Co. has entered into an agreement to acquire Toronto-based Lowndes Lambert Group Canada Ltd.

Terms of the transaction, which was expected to close this month, were not disclosed.

Lowndes Lambert has offered risk management, commercial and personal lines insurance services for 50 years. The property/casualty broker specializes in transportation, hospitality and pharmaceutical businesses.

Philip G. Kane, Lowndes Lambert's president and chief executive officer, and his associates at the firm will continue operating from their eight Canadian offices under the direction of James S. Gault, president of Itasca, Ill.-based Gallagher's Brokerage Service Division—Retail.

Gallagher said the acquisition will expand its geographical reach and provide new business opportunities through the Canadian broker's niche practices. **■**



Workers at a Hindustan Aeronautics Ltd. facility in Bangalore, a city that is the hub of India's growing aerospace industry.

Emerging markets offer strong industry growth

Insurance business in emerging market countries continues to grow, according to a new sigma study from Zurich, Switzerland-based Swiss Reinsurance Co., with indications that growth will remain strong in coming years.

The study examined insurance industry trends in emerging markets in five regions: Asia, Latin America and the Caribbean, Central and Eastern Europe, the Middle East and Turkey, and Africa. In 2005, life insurance premiums increased 7.5% in the markets studied, Swiss Re said, while property/casualty premiums increased 6%.

Robust growth in life insurance business in emerging market countries is driven by improving economic fundamentals and rising household incomes, Swiss Re said, though some markets have experienced a negative impact from regulatory changes, such as the withdrawal of favorable tax benefits in Russia or adverse effects from pension fund or

accounting regulation changes in Chile, Colombia and Mexico.

Among the trends in the property/casualty area in emerging market countries, Swiss Re noted that the \$1.8 billion in losses Mexico suffered from Hurricane Wilma in 2005 underscored the importance of adequate protection against natural catastrophes there. Market liberalization in some countries also stands to benefit insurance business, such as India's removal of tariff rates from nearly all lines of business, which is expected to open up insurance industry competition there.

Swiss Re said its outlook for emerging insurance markets is favorable, though some countries will be challenged by the tightening monetary policy of major central banks along with rising geopolitical risks.

The study, "Insurance in emerging markets: sound development; greenfield for agricultural insurance," can be found online at www.swissre.com. **■**

David Margrett, chief executive officer of Willis Group Holdings Ltd.'s Global Specialties unit, will take on the additional roles of chairman and CEO of the broker's London-based U.K. unit, Willis Ltd., upon the retirement of **Richard Bucknall** at the end of March. Mr. Bucknall, who also serves as vice chairman of Willis Group, will remain with the broker in an advisory role until the end of the year.

As part of a restructuring aimed at combining the company's global capabilities into a single service platform, Chicago-based Aon Corp. has named **Dennis Mahoney** chairman of its new Chicago-based Aon Global unit and **Steve McGill** CEO of the new unit. Mr. Mahoney, who has been chairman and chief executive of Aon Ltd. in London, will relocate to Bermuda. Mr. McGill, who is also CEO of Aon Risk Services Americas, will remain in Chicago. **Peter Harmer**, who has

led Aon's Australia/New Zealand operations for the past seven years, will succeed Mr. Mahoney as CEO of Aon Ltd.

Peter Presperin has been named CFO of Catlin U.S., Hamilton, Bermuda-based Catlin Group Ltd.'s Atlanta-based U.S. underwriting unit. Mr. Presperin most recently was CFO of Zurich Financial Services Group.



Mr. Turner

Maitland, Fla.-based J. Rolfe Davis Insurance has named **John A. Turner** president. Before his promotion, Mr. Turner was a vp.

Warwick, R.I.-based Beacon Mutual Insurance Co. has named **James V. Rosati** president and CEO. Mr. Rosati has been an investment banker with Providence, R.I.-based Riparian Partners Ltd., which specializes in mergers and acquisitions.

Gregory M. Vezzosi has joined San Antonio-based specialty insurer Argonaut

Group Inc. as executive vp and chief operating officer. Mr. Vezzosi most recently was senior vp, specialty commercial, for St. Paul Travelers Cos. Inc. He is Argonaut's first COO.

Maureen Breakiron-Evans has joined Stamford, Conn.-based Towers Perrin as chief financial officer. Ms. Breakiron-Evans comes to Towers Perrin from CIGNA Corp., where she was vp and general auditor.

Plantation, Fla.-based third-party administrator Broadspire Services Inc. has announced that **Dennis Replogle** will once again be the company's CEO. Mr. Replogle, who is also the company's president, had served as president and CEO prior to Broadspire's sale to Crawford & Co. last year, when Robert R. Kulbick was named CEO. Mr. Kulbick has resigned from the company.

Hamilton, Bermuda-based White Mountains Insurance Group Ltd. has named **Raymond Barrette** chairman and CEO.

As CEO, he succeeds Steven E. Fass, who is retiring from active management of the company.

Parsippany, N.J.-based GAB Robins North America Inc. has named **Michael G. Repoli** president of North American operations. Most recently, he served as the underwriting officer and advisor to the board of Chelsea Rhone Corp.

Stephen Kellar has been promoted to CFO and vp, finance at Brighton, Mich.-based LifeSecure Insurance Co. Previously, he was the company's director of finance.

Albany, N.Y.-based Capital District Physicians' Health Plan Inc. has named **Barbara A. Downs** COO. Previously, she was senior vp of corporate administration.

Springfield, Mass.-based Massachusetts Mutual Life Insurance Co. has named **Michael R. Fanning** senior vp and COO for the U.S. Insurance Group. Previously, he was a vp of new individual business at MetLife Inc. **F**

National Union e-tool offers form functionality

NEW YORK—The National Union Fire Insurance Co. of Pittsburgh, Pa., has released a Web-based application for its PrivateRisk Protector portfolio of coverages that allows brokers to more easily process applications.

Using the interactive application for PrivateRisk Protector, brokers can electronically process applications in a single session.

It also allows brokers to close the application while storing all the data that has been input so the broker can e-

mail the same application to a recipient who can complete it online and return it to the broker.

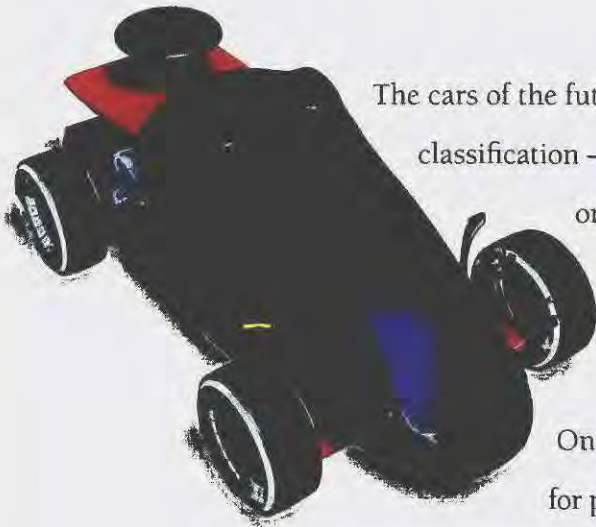
The interactive application can be used in conjunction with American International Group Inc.'s AIG ePro, a Web-based system that allows brokers to quote and bind PrivateRisk Protector coverages online.

New York-based AIG unit National Union offers a variety of management and professional liability coverages designed for private companies through

its PrivateRisk Protector program. Among the coverages offered under PrivateRisk Protector are directors and officers liability, employment practice liability, pension trust liability, fidelity and crime coverage and Internet media liability.

The only software required to run the interactive application is Adobe Reader 7.0.5 or higher. More information on the interactive application of PrivateRisk Protector can be found at www.aignationalunion.com. **F**

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Slow, steady, stable growth ahead

Busy year expected in captive market

By Meg Fletcher

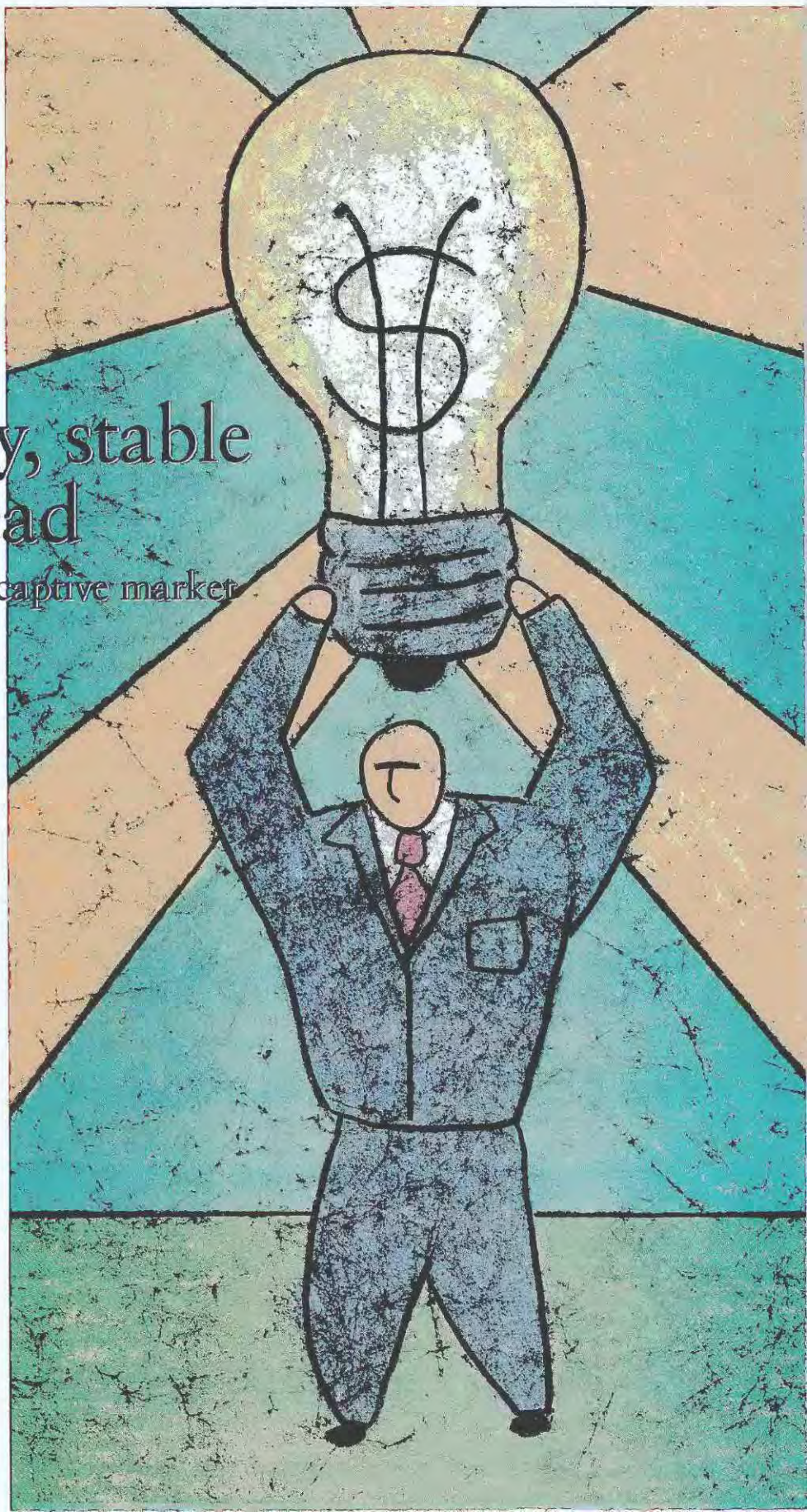
Despite a general softening of the insurance marketplace, captive service providers and regulators still expect 2007 to be a busy year.

Providers will be helping buyers find more affordable coverage for a few lines, including medical malpractice insurance. They also will be dealing with new demand for warranty and property coverages, several observers said.

"We've not seen a lot of exodus from the market, although the growth has slowed down," said Julie Boucher, managing director of Marsh Management Service Inc. in Burlington, Vt., which has more than 260 clients. Overall March Inc. manages more than 1,000 captives.

Formations include coverage-specific captives such as life reinsurance or warranty coverage, she said. In addition, owners are still interested in using captives to obtain terrorism coverage, Ms. Boucher said.

"There is a general softening, but it is sporadic, depending upon the risk," said Gary Osborne, the Montpelier, Vt.-based president of USA Risk Group. There is continuing demand for medical



malpractice, commercial auto and workers compensation coverages, he said.

His company, which formed 24 captives last year, expects to form nearly as many this year, Mr. Osborne said.

"I expect there to be a (net) increase in the number of captives formed in 2007, but not as much of an increase as in the last few years in the hard market," said Jon Harkavy, executive vp of Risk Services L.L.C. in Arlington, Va., an organizer and manager of risk retention groups.

Demand for captive services also extends offshore, two Hamilton, Bermuda-based executives say.

"There have been a lot more inquiries and discussion about how to use a captive," said Philip Barnes, managing director of Aon Insurance Managers (Bermuda) Ltd. In addition, a number of newcomers continue to use rent-a-captives as a stepping stone to establishing a captive of their own, he said.

"The industry is mature enough for double-digit growth to have to slow down," said David Ezekiel, president and managing director of International Advisory Services Ltd., an independent Hamilton, Bermuda-based captive manager with 180 clients.

ORGANIC GROWTH AHEAD

Growth will be primarily "organic and internal" as captive owners add more lines of coverage, such as employee benefits, he said. In addition, more experienced captives typically have greater capital resources that allow them to take on more risk and reinsure

less, Mr. Ezekiel said.

"What we see are captives being used a lot better, as a complement to the existing market," Mr. Ezekiel said. If the commercial market is prepared to sell coverage for very little, that's where captive owners should buy it, rather than paying more to obtain it through a captive, he said. During such soft markets, a captive may go dormant and run off claims.

While most lines of coverage are softening, there is still buyer demand for some specific lines, industry experts say.

'THE INDUSTRY IS mature enough for double-digit growth to have to slow down.'

DAVID EZEKIEL
INTERNATIONAL ADVISORY
SERVICES LTD.

Coverage premiums for medical malpractice and contractors liability are stabilizing, but not softening like many other lines, Mr. Harkavy said.

There is continuing interest among hospital professionals to use captives to obtain hospital professional liability and general liability coverage, Ms. Boucher said. In addition, increased partnerships between health care institutions and physicians have brought more capital to the market, she said.

"The price of medical malpractice insurance has declined from the highs of three or four years ago, but it's still sufficiently high that alternatives like

risk retention groups and captives are still popular," Mr. Osborne said.

It's important, however, that RRGs have rules to protect themselves from losing price-sensitive members when traditional markets become competitive. For example, members are encouraged to continue participating in the RRG by rules that set a minimum number of years to participate before a doctor is eligible for a refund of his capital stock, Mr. Harkavy said.

Captives are designed to provide affordable coverage in addition to offering the benefits of tailoring policy forms, controlling losses, and earning income from investments and underwriting profits, he said.

A VIBRANT MARKET

During 2007, the captive market "will still be vibrant," said Thomas Hampton, commissioner for the District of Columbia's Department of Insurance, Securities and Banking.

While captive clients historically have returned to the traditional market to buy coverage and captives go dormant when prices in the commercial market fall, "I don't think that historical practice will occur," Mr. Hampton said. Companies, especially those that have completed reviews in compliance with Sarbanes-Oxley Act financial reporting requirements, often realize they need broader and more complex protection not readily available in the marketplace, he said.

The "jury is still out," though, about whether the demand for coverage from small RRGs will continue, Mr.

Hampton said.

"I think the formation of captives could continue," said Tim Wagner, director of the Nebraska Insurance Department. "It's definitely a good risk management device."

Captive service providers predict growth in agency captives as well as captives that provide warranty coverages, among others.

The prohibitions against contingent commissions have encouraged interest in agency captives, which agents typically establish with the help of a fronting carrier to help insure their most profitable clients, Mr. Osborne said. That allows agents to earn income by bearing some of the risk, Mr. Osborne said.

Agency captives are generally established in Bermuda, the Cayman Islands or the British Virgin Islands, he said. Some established U.S. domiciles won't accept them, although newer domiciles such as Arizona and South Carolina will, he said.

Interest in warranty captives continues to build, primarily from product manufacturers of cars, cell phones, computers and golf clubs, Mr. Osborne said. Such captive business requires frequent actuarial reports as well as trust agreements to avoid the service warranty problems that caused the 2003 collapse of the National Warranty Insurance Risk Retention Group, he said.

In addition, Mr. Ezekiel expects there will be continued growth among companies that are new to captive insurance and who often chose rent-a-captives for the first year or two.

PROBLEM LOOMS

A problem is looming, however, because of the current mismatch between the small size of companies interested in establishing captives and insurers' desire to deal with larger clients.

Specifically, buyer demand is increasing, although the minimum premium level for those interested in establishing captives has dropped to \$2 million annually for the four key lines—general liability, workers comp, commercial auto and property. At that premium level, "it will be hard to find a carrier to make it work," Mr. Osborne said.

Risk-linked bond market poised for rapid growth

By Meg Fletcher

ZURICH, Switzerland—The worldwide market for risk-linked securities is expected to grow rapidly over the next decade, with the volume of life bonds leading the way, followed by property/casualty catastrophe bonds, according to a study.

Swiss Reinsurance Co.'s sigma report, "Securitization—New Opportunities for Insurers and Investors," found that in the past five years, the outstanding volume of P/C securities has doubled, while the volume of life bonds has tripled to a combined total of about \$23 billion. By 2016, that volume is projected to grow to \$150 billion to \$350 billion, driven primarily by the life industry's funding needs, Swiss Re said.

"Life bonds typically securitize the flow of future premium payments of traditional life insurance policies," the study said. Investors assume burdens such as mortality and lapse risks, although the life insurer retains the obligation to pay the policies.

The benefits of life securitizations include "improved profitability" by reducing sponsors' need to hold capital, which increases sponsors' ability to write new business. At times, life securitizations also provide tax advantages, Swiss Re said. "Life bonds also monetize intangible assets, fund regulatory capital requirements and transfer catastrophic risks" such as pandemic flu or a sharp mortality increase, to the bond market, the study said.

P/C insurers have many ways to transfer risk and manage capital, including traditional reinsurance as well as catastrophe bonds, catastrophe swaps, industry loss warranties, contingent capital or sidecars.

The most typical risk transfer is a cat bond transaction, in which a special-purpose vehicle enters into

a reinsurance contract with a cedent and simultaneously issues cat bonds to investors, usually through an excess of loss contract, Swiss Re said.

"If no loss event occurs, investors receive a return of principal and a stream of coupon payments that compensate them for the use of their funds and their risk exposure. If, however, a pre-defined catastrophic event does occur, investors suffer a loss of interest, principal, or both," the Swiss Re report said.

With any securitization, "it is important to choose the jurisdiction that best fits the transaction" in terms of regulatory and tax treatment, Swiss Re said. "For example, South Carolina is often used for Triple X securitizations because these bonds are based on U.S. life business and South Carolina allows organizations to form special-purpose financial captives," it said.

In addition, "transactions need to be large to be economical," the study said. "For the life bonds, transactions are complex and need to be at least \$200 million to complete the transaction efficiently. P/C bonds are often smaller, but still need to be about \$100 million," even though smaller transactions are projected to become feasible as the market matures.

Even so, the growth of life securitizations and P/C cat bonds face impediments that include insurers facing more rigorous risk-transfer tests as well as rating agency and regulatory capital models "not rewarding the full value of cat bonds," Swiss Re said.

"Standardization of cat bond contracts would facilitate growth," the study said.

The Swiss Re sigma study is available online at www.swissre.com/sigma. ■

Sellers of reinsurance services want captive clients to have a minimum annual premium of \$5 million to \$10 million, he said.

Catastrophe-prone property coverage is one line that is challenging for captives, several service providers said.

"Captives operate best with high-frequency, low-severity lines," which lend themselves to actuarial analysis and the potential for investment income, Mr. Ezekiel said. "It is very much a liability-based business" that has dealt historically with lines such as medical malpractice, auto liability and workers comp.

"The problem with property is that it is prone to very, very severe losses," Mr. Harkavy said. The issue is whether the captive has the capital or reinsurance coverage necessary to responsibly address such risks, he said.

A privately owned captive, however, can help a large company make traditional coverage more affordable by

allowing the company to take a large deductible on windstorm coverage and fund that through the captive. In addition, a company can build catastrophe reserves over the years to take an ever larger deductible in the future, Mr. Harkavy said.

Despite higher rates for catastrophic

'THE PROBLEM WITH property is that it is prone to very, very severe losses.'

JON HARKAVY
RISK SERVICES L.L.C.

property coverage, there has not been a wholesale change in the dollar amount of risk that companies are retaining, Mr. Barnes said. Among Aon's 270 clients in Bermuda, most still retain about \$500,000 to \$1 million, he said.

A small number of property owners

are participating in an unusual captive program, however.

Some restaurant and nursing home chains with multiple locations in catastrophe-prone areas are placing their property risks in captives under a tax-favored program that may allow them to build up multiyear reserves in catastrophe-free years, Mr. Osborne said.

The program is limited to companies that can qualify as insurers and elect to be covered under section 831(b) of the U.S. Tax Code. In addition, only companies that pay \$1.2 million or less in annual property premiums can participate, he said.

Under the program, the captive owner is taxed on its investment income but not its underwriting profit, so funds can accrue during catastrophe-free years. The negative aspect of the arrangement is that when there is an underwriting loss, the owner cannot carry it forward, Mr. Osborne said. ■



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A higher standard

NAIC's proposed RRG governance package would raise the bar for disclosure requirements

By Meg Fletcher

Drafters of tougher uniform financial and corporate governance standards for U.S. risk retention groups are debating a controversial issue concerning the capital requirements of reinsurers.

At issue is whether to require a reinsurer to have at least \$20 million in capital or in trust before an RRG would be allowed to take credit for the reinsurance it cedes.

Pro-regulation supporters say the National Assn. of Insurance Commissioners' traditional standard for rein-

surers is appropriate to ensure financial solvency of such groups, which consist of similar businesses with similar risk exposures that create their own insurer to self-insure on a group basis.

Pro-RRG supporters disagree, and say that a \$20 million requirement is excessive for such groups.

While those discussions continue, regulators with domestic RRG industries, and those without such industries, joined with industry representatives in crafting tighter financial and corporate governance standards for RRGs. After nearly 18 months of work, the NAIC will consider formally adopting some

governance recommendations at its March 10-13 meeting in New York.

Thus far, the proposed financial standards allow use of Generally Accepted Accounting Principles rather than mandating use of Statutory Accounting Principles. Even so, GAAP numbers would have to be converted to SAP in the footnotes of each RRG's annual statement.

It's "an important step forward" because the new financial standards are expected to become accreditation requirements, which would require states to use them. The standards would create "a more level playing field" among states concerned with RRG regulation and among RRGs themselves, said Tim Wagner, the Nebraska insurance director and chair of the NAIC's Property/Casualty Insurance Committee subgroup that is drafting the corporate governance requirements.

In addition, a wide range of proposed RRG corporate governance rules would increase disclosure requirements about the lack of guaranty fund coverage. They also would require that an RRG board have a majority of independent directors, review service provider contracts at least every five years and follow ethical guidelines.

The governance package "raises the bar for everyone," Mr. Wagner said. It will mean a change in "quite a few" RRGs because "it puts members in the driver's seat."

RRGs began operating in 1981 when Congress authorized their creation in response to recurring shortages of product liability insurance.

Following amendments in 1986, the Liability Risk Retention Act permits RRGs to offer all types of liability insurance nationwide by becoming licensed in one state. The law also pre-empts nearly all insurance laws of other states where an RRG operates, regardless of where members are located. Determining pre-emption boundaries has been a source of many disputes among RRGs and regulators.

In addition, the act bars RRGs from participating in state guaranty funds.

Almost two decades later, a 2005 congressional inquiry asked the U.S. Government Accountability Office to study RRGs after "recent failures of several

large RRGs...raised questions about the adequacy of RRG regulation," in ownership, control and governance, according to the GAO report. From 1990 to 2003, 21 RRGs failed, including the Cayman Islands-based National Warranty Insurance RRG, which reported \$74 million in losses in 2003. RRGs no longer can be established outside the United States.

Currently, U.S. RRGs are domiciled in 21 states and the District of Columbia, according to the Pasadena, Calif.-based Risk Retention Reporter.

The six largest domiciles by number of groups are, in order: Vermont, South Carolina, D.C., Nevada, Arizona and Hawaii.

STATE REGULATIONS VARY

The current act's broad regulatory exemption, however, "has resulted in widely varying requirements among states and limited confidence in RRG regulation," the GAO report said. "Many of the differences arise because some states allow RRGs to be chartered as captive insurance companies, which typically operate under a set of less restrictive rules than traditional insurers."

In addition, "some evidence exists to support regulator assertions that some domiciliary states may be creating lenient regulatory environments to encourage RRGs to domicile in their state," GAO researchers found.

Captive domiciles "all are interested in getting business," said Robert H. Myers Jr., managing partner of the Washington office of Morris, Manning & Martin L.L.P. in Atlanta. He also is Washington counsel to the Minneapolis-based National Risk Retention Assn.

Many states' economic development officials would like to follow Vermont's lead.

Since 1981, when Vermont began its captive program, the industry has paid the state \$228 million in premium taxes and \$12 million in license and examiners fees, said Len Crouse, deputy commissioner of captive insurance in the Vermont Department of Banking, Insurance Securities and Health Care Administration. The industry also has spurred development of more than 1,400 full- and part-time jobs and brought more than \$1 billion in assets

into Vermont financial institutions.

While Vermont's promoters emphasize regulators' accessibility and reputation for quality oversight, newer state domiciles tout their lower tax rates and streamlined regulation as advantages, said Thomas Hampton, commissioner for the District of Columbia's Department of Insurance, Securities and Banking.

For example, Arizona charges no premium taxes. However, most U.S. captive domiciles charge premium taxes, although the rates vary from state to state.

Most RRGs want regulators to be fair, firm and efficient, but they would also like "a little leeway," Mr. Hampton said. Regulators in each domicile must ensure the financial viability of the RRGs, "so they can't get too flexible," he said.

"It's a fine line between economic development and effective regulation," Mr. Hampton said. Without uniform standards, states seeking to grow as an RRG domicile might be tempted to engage in "a race to the bottom" in relaxing regulatory requirements, he said. Also, problems could muddy the reputation of an RRG as an alternative market option.

The District of Columbia department began licensing captives about four years ago and has 70 licensed entities, which are either captives or RRGs.

Messrs. Wagner, Hampton and Myers are among those who participated in the two NAIC subgroups' regulatory review during the past year. "It has been a mutually beneficial educational enterprise" for regulators in domiciliary and nondomiciliary states and the industry, Mr. Myers said.

Thus far, the financial condition subgroup "has done everything by consensus," said Betty Patterson, senior associate commissioner-financial division for the Texas Insurance Department, who chaired the subgroup representing Commissioner Mike Geeslin. Specifically, the group has developed accreditation standards that states would be required to apply to RRGs incorporated as captive insurance companies.

FINANCIAL CONDITION ISSUES

One key issue has been the lack of uniformity in the accounting system RRGs use to report financial information. It occurs because many domiciles allow RRGs to use GAAP, which typically allows using letters of credit, discounting loss reserves and amortizing acquisition costs. Meanwhile, regulators require that traditional insurers use the more conservative SAP accounting method that does not permit such accounting practices.

"The main argument we get from noncaptive jurisdictions is: We can't compare financial standards and information to other licensed companies," Mr. Hampton said.

The subgroup's proposed recommendation is that an RRG's financial statements may be prepared in conformity to GAAP, or some other modification of SAP, however, "a reconciliation back to SAP would be required in the footnotes," according to a summary that is yet to be approved.

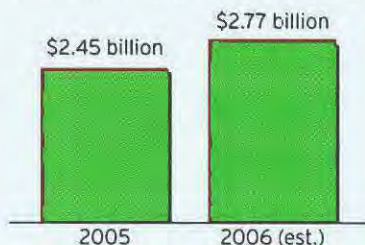
In addition, the most controversial outstanding issue before that subgroup is setting the minimum capitalization requirement for reinsurers—if RRGs want to be able to take credit for the reinsurance.

Derick White, Vermont's director of captive insurance, said in an e-mail that "most of the other states are saying they follow the traditional guidelines," which require that an admitted reinsurer have at least \$20 million of capital or a fully funded trust fund in place.

"I find that hard to believe," he said. "We worked it out with the NAIC back in the 1990s—when Vermont was being accredited—that our approved reinsurers would have at least \$10 million in capital and surplus and that is what we are pushing," Mr. White said.

LEAPS AND BOUNDS

Gross written premiums of RRGs



Source: Risk Retention Reporter



Setting the standard for an industry

Integrity, innovation and a team approach
define the style of Vermont's Len Crouse

By Meg Fletcher

MONTPELIER, Vt.—In the captive insurance world, Len Crouse and Vermont are synonymous.

As deputy commissioner of captive insurance in the Vermont Department of Banking, Insurance, Securities and Health Care Administration, Mr. Crouse is an important overseer of the captive industry in the state that is No. 1 in the number of U.S.-domiciled captives.

Mr. Crouse also is an international spokesman for the responsible regulation of captive insurance.

While Vermont was not the first state to allow companies to form captives, it was the first captive domicile to actively encourage such formations, beginning in 1981.

In the past quarter century, Vermont

issued 791 captive licenses, including an all-time high of 77 in 2003. Few have failed and no one lost money.

Along the way, the state's economy and stature in the insurance industry has benefited greatly.

Since 1981, the captive industry has paid \$228 million in premium taxes and \$12 million in license and examiners fees to Vermont, Mr. Crouse said. It also has brought more than \$1.2 billion in asset management to Vermont's financial institutions and spurred development of more than 1,400 full- and part-time jobs.

"Len sets a very high standard every day with hard work, a passion for working with the client and knowledge of the industry that's second to none," said Dan Towle, director of financial services for Vermont's Department of Economic Development.

Len is "an experienced and innovative regulator with an uncommon ability to focus on strategic issues and opportunities," said Nicholas Parillo, president of the Molly Anna Captive Insurance Co. and Canton, Mass.-based vp-global insurance for Royal Ahold N.V., the supermarket and foodservice giant. "Len's integrity and firm-but-fair demeanor have earned him the highest respect from both legislators and captive owners," he said.

GOOD LISTENER

"Len is always willing to listen to ideas and explore the ideas to eliminate those that make no sense and allow those ideas to go forward that help further the captive industry," said Michael Lusk, corporate vp-insurance and global risk management for agricultural product processor Archer Daniels Mid-

land Co. in Decatur, Ill.

Three key elements of Vermont's successful program are specialized regulators, a solid infrastructure of management and service companies as well as the state's small size, which allows for easy access to elected and appointed officials, observers said.

Mr. Crouse, 64, summarizes it more simply: "We've been around and we have a good history."

Companies that have established Vermont captives give greater personal credit to Mr. Crouse in creating a favorable—yet responsible—regulatory climate and infrastructure that allows them to better control their self-insurance programs.

Len "succeeds in establishing both clear boundaries and reliable opportunities for effectively using a captive, and is capable of guiding captive owners to successful compliance while maintaining the security and integrity of the Vermont system," said Tim East, director of risk management for entertainment and multimedia giant Walt Disney Co. in Burbank, Calif.

"Fair, firm, knowledgeable and responsive" describe the way Mr. Crouse regulates, said Molly Lambert, president of the Vermont Captive Insurance Assn. in Burlington, Vt. "He has built a regulatory infrastructure that will maintain the strength of captive insurance in Vermont for decades to come."

Leonard David Crouse grew up in Lynn, Mass., though he was born on Prince Edward Island in Canada. He has two younger sisters.

After living in Southern California in the 1960s, he returned to Massachusetts and in 1971 took a job as an examiner with the state's insurance department—his first insurance industry post. He worked there for nearly 20 years, rising to chief examiner of the property/casualty division. He holds a designation as a certified financial examiner.

Mr. Crouse left that post to join the Vermont department in May 1990 as director of captive insurance

Mr. Crouse's activist regulatory approach is designed to identify potential problem areas early and address

them. For example, a captive must receive regulatory approval before it can change its plan of operation, he said.

QUALITY PROGRAMS

In addition, he considers risk retention groups—which are organized as captives in Vermont—to be "a volatile tool" that needs to be reviewed quarterly. "We don't like entrepreneurial RRGs," some of which are controlled by managers rather than the members, Mr. Crouse said. "We are looking for quality and good, strong programs."

Of the 791 captive licenses issued since 1981, today Vermont has 567 active captives. Seventy-nine percent are pure captives, 14% are risk retention groups, 4% are industrial insureds and 3% are association captives.

The difference between the number of captives licensed and those still operating is the result of various factors, including mergers and acquisitions, Mr. Crouse said. In addition, he said a very small number of captives faced financial

tant lesson Mr. White said he learned is "always give credit where it is due. You build loyalty and good ideas will keep coming."

Mr. Raymond said he learned how to balance being a good financial regulator while promoting Vermont's captive insurance industry.

The opportunities that Vermont's alternative risk programs offer captive owners are "phenomenal," because "there are so many lines," Mr. Crouse said enthusiastically. The captive unit's small size allows it to provide "a quick response to the needs of industry," he said.

He and the members of the Vermont regulatory team share their knowledge with others through active participation on various industry panels, including subgroups of the National Assn. of Insurance Commissioners. Those groups are currently discussing more uniform financial and corporate governance standards, as the U.S. Government Accountability Office recommended in 2005.

'HE HAS BUILT a regulatory infrastructure that will maintain the strength of captive insurance in Vermont for decades to come.'

MOLLY LAMBERT
VERMONT CAPTIVE INSURANCE ASSN.

problems including a few that resulted in company rehabilitations and liquidations—although all claims were paid in full.

Most of those problems occurred "B.C.—Before Crouse," he said.

PRIDE IN TEAMWORK

Vermont has "the best regulatory staff in the nation, bar none," Mr. Crouse said.

"I take great pride in building the staff," he said. Most of the 28 staff members are examiners who are required to be certified in their field or working to obtain certification, he said.

Mr. Crouse emphasizes the contribution from the other two members of the captive unit's team—Derick White, director of captive insurance, and Pete Raymond, director of financial examinations. Both have worked with Mr. Crouse for 15 years. The most impor-

"I feel there has to be some uniformity with risk retention groups," Mr. Crouse said.

Indications of a generally softer market nationwide are not expected to have much impact on the Vermont's captive unit.

"Market fluctuations don't affect pure captives as much as risk retention groups," he said. In addition, captives continue to offer significant benefits including better control of losses as well as access to reinsurers, he said.

Once an avid skier, Mr. Crouse now golfs often to maintain his 10-stroke handicap.

His sports loyalties lie with the Red Sox and the Patriots. In college contests, though, he roots for Louisiana State University, which one of his two daughters attended. He has one grandson.

His also is an avid reader of nonfiction books, especially history. ■

Insiders looking out

Industry CEOs see shared responsibility, discipline as keys to building on last year's gains

By Rodd Zolkos

NEW YORK—The insurance industry has the capital to deal with natural catastrophe exposures, but a sense of “shared responsibility” is required for markets to function most effectively in cat-prone areas, according to a panel of industry executives.

Speaking as part of a chief executive officer panel last month at the annual Property/Casualty Insurance Joint Industry Forum in New York, William J. Mullaney, president of MetLife Auto & Home in Providence, R.I., said, “I think the big thing in being able to talk about the issue is that it’s a shared responsibility.”

It’s important that insurers have free-market pricing, Mr. Mullaney said, and that local governments have building codes in place designed to mitigate risks.

“If you allow someone to get the right price on a nonmitigated risk, you quickly spur creativity to mitigate that risk,” said Pierre L. Ozendo, CEO of the Americas Division of Swiss Reinsurance Co. in Armonk, N.Y. On the other hand, preventing the industry from pricing appropriately in certain areas stifles creativity in risk mitigation, he said.

EDUCATING CONSUMERS

That sense of shared responsibility also applies in explaining to consumers that the industry’s 2006 profits represent just a single year’s performance, influenced significantly by low catastrophe losses, several panelists said.

“The educational requirements and responsibilities we have are never-ending,” said Martin J. Sullivan, president and CEO of American International Group Inc. in New York. He added that

the industry’s 2006 experience “was a one-year event. It’s a marathon, it’s not a sprint, and that’s the point we have to educate everyone on.”

Jeffrey A. Ludrof, president and CEO of the Erie Insurance Group in Erie, Pa., offered a similar view, saying the industry has a responsibility to help consumers learn from experiences such as 2005’s hurricanes so that they can better understand and mitigate their exposures.

But Paula Rosput Reynolds, president and CEO of Seattle-based Safeco Corp., questioned the extent to which company CEOs could take the lead in that effort.

“It’s not manifest to me that CEOs, per se, are deeply influential in terms of some of these matters,” she said.

While the industry executives felt strongly about the ability of the private market to respond to natural catastrophes, they also

emphasized the need for the federal government to maintain a role in addressing terrorism risk.

“I have a very strong belief that hurricanes are priceable and can be properly mitigated and monitored as opposed to something I believe cannot be, such as terrorism,” said Swiss Re’s Mr. Ozendo.

“Simply put, from a terrorism standpoint, you have finite capital responding to an infinite risk,” Mr. Sullivan said, so there has to be some sort of federal backstop.

Looking at various other challenges facing their companies, Brian M. Storms, chairman and CEO of Marsh Inc. in New York said that from a broker’s perspective, “Our challenges are really focused around our clients, more than ever.”

His company is focused on the value chain between the insurer and the

buyer and how the broker provides value to the transaction, he said, adding that these days, Marsh brokers often aren’t talking to the risk manager, but instead to “the C suite,” and the company needs to reposition itself to address that change.

On the subject of those buyers’ focus, Mr. Storms said he thinks they aren’t solely concerned about price. “I would have to say that while rate is a factor, that’s not really the issue,” he said, adding that commercial buyers are more interested in the insurer’s financial strength and the company’s claims paying ability and speed of paying claims.

ADDING FISCAL MUSCLE

James J. Schiro, CEO of Switzerland-based Zurich Financial Services, said that despite last year’s performance, insurers still have considerable work to do in strengthening the industry’s financial position.

He noted that insurers are competing for capital with other industries that have a higher return on equity, so despite the industry’s strong performance in 2006, strengthening the industry’s returns must remain a priority. “We need to maintain discipline, Mr. Schiro said, adding that the industry also needs to better know its customers and improve distribution.

Mr. Ozendo stressed that reinsurers haven’t enjoyed the same results as insurers. Reinsurers, he said, have to get better at “volatility management.” In addition, “The industry’s also challenged with cost management issues,” he said, “Our challenge is to be more cost-effective and be able to pass that on to customers.”

On the personal lines front, Mr. Mullaney said he’s concerned about attempts to “commodify the business.”

Ms. Reynolds, meanwhile, said she thinks the industry needs to learn how to communicate with consumers. “We live in a world of consumer empowerment,” she said, yet the industry does not know the language consumers expect to have spoken to them.

Marc Racicot, president of the Washington-based American Insurance Assn., moderated the View from the Inside Looking Out panel. ■

PROPERTY/CASUALTY INSURANCE JOINT INDUSTRY FORUM

Leaders from across the property/casualty insurance and reinsurance industry gathered in New York’s Waldorf-Astoria Hotel in January for the 11th Annual Property/Casualty Joint Industry Forum.

Outsiders looking in

Industry observers see the year ahead as one of stability after 2006's low cat losses

By Rodd Zolkos

NEW YORK—While insurance industry returns this year likely won't reach last year's levels, there is reason to be optimistic about industry performance in the near term, according to some industry "outsiders" who gathered to discuss industry issues last month.

Moderating the "View from the Outside Looking In" panel at the annual Property/Casualty Insurance Joint Industry Forum in New York, Robert Hartwig, president and chief economist of the Insurance Information Institute, noted that 2006 was a record year for the property/casualty industry with its best return on equity in 20 years.

Driving those results was strong underwriting performance, he said.

"Overall I think the industry's returns probably peaked in 2006," said Jay Gelb, senior vp and senior nonlife insurance equity analyst at Lehman Bros. Inc. in New York. While much of the industry's 2006 performance reflects the year's low catastrophe losses, Mr. Gelb noted that going forward the industry will benefit from a strong balance sheet, leading him to project industry earnings growth of 10% to 13% through 2008.

SETTLING IN

While growth in net written premiums is expected to be low in 2007, Matthew Mosher, group vp global property/casualty ratings at A.M. Best Co. Inc. in Oldwick, N.J., said he doesn't see that as a concern.

"I think what you're seeing is a type of settling," Mr. Mosher said. In commercial lines, insurers are still putting a considerable focus on risk even if there is downward pressure on pricing, he said.

"There's still more upside for P/C insurers' stocks," Mr. Gelb said. "Going forward, I would say the stocks still have room for upside, mainly because

insurers' balance sheets are solid, earnings remain at good levels, there's still pricing power."

On the personal lines side, Brian Sullivan, editor of Risk Information Inc. in Dana Point, Calif., also said he is not concerned about personal lines price. "We've seen more pricing discipline, particularly in personal lines in the past five years, than I've seen in my entire career," he said.

Regarding the likelihood of industry consolidation in the near future, Mr. Gelb said he is seeing some activity in acquisition of renewal rights rather than outright company acquisition. "But when you think about it, basically I wouldn't be surprised to see the pace of acquisition activity increase in the next two or three years," he said.

'WE'VE SEEN more pricing discipline, particularly in personal lines in the past five years, than I've seen in my entire career.'

BRIAN SULLIVAN
RISK INFORMATION INC.

Asked whether some companies are still too exposed to windstorm risk, Mr. Mosher said he thinks companies have improved their position in several ways.

"I think there are a lot of companies that have done a much better job of managing their exposure," Mr. Mosher said. In addition, many companies have done a better job in the quality of data they're capturing, paying attention to that data as well as managing their long-tail exposures.

On the subject of whether pricing is becoming too aggressive in commercial liability lines, Mr. Gelb said his company is seeing "slightly downward trends" in pricing for directors and officers and workers compensation coverage.

But a Lehman Bros. survey of 75 large buyers suggested that overall pricing will be flat and policy terms will remain

restrictive. "The risk manager also expects a stable market. We heard that from 85% of the risk managers," the Lehman Bros. analyst said.

Mr. Mosher had a similar view, saying there has been some moderation in rates, but he doesn't see significant deterioration in terms and conditions or limits.

LOCAL RESPONSE

Responding to a question put to the panel about local reaction to industry profits, George Dale, Mississippi's commissioner of insurance, said each line of business has to stand on its own in each state and must deal appropriately with the local exposures.

"We in Mississippi don't want to be paying for forest fires in California," Mr. Dale said. "And California doesn't want to be paying for hurricanes that hit Bay St. Louis, Miss."

Since Katrina, Mr. Dale said his goals have been settling claims with policyholders and making sure the insurance industry continues to exist in Mississippi. Some of the "well-intentioned"

politicians in his state don't seem to understand that second goal, he said.

Mr. Mosher said the new Democratic majority in Congress probably improves the chances of passing some extension of the federal terrorism reinsurance backstop. Mr. Gelb agreed, though he wondered whether a bill concerning federal insurance regulation would ever move forward.

"I think the opportunity for (Congressional passage of an) optional federal charter for property/casualty companies is zero," Mr. Sullivan said.

"In 2004 we had four large storms crush Florida. In 2005 we had two tremendous storms hit the Gulf. And we've seen almost nothing happen" in terms of a federal catastrophe plan or federal insurance regulation, Mr. Sullivan said. ■

For many captive insurance and other alternative risk transfer arrangements, fronting insurance is an essential ingredient in making the program work. Some ART program parents sometimes find it difficult to find the necessary fronting coverage, however. Here's a look at some of the key players in the fronting insurance market, and a brief overview of the types of business they do and some of their requirements.



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Liberty Mutual Alternative Markets, a unit of Liberty Mutual Group Inc., offers alternative risk transfer products for clients who want to reduce their cost of risk, have had difficulty obtaining coverage or want the potential to share in risk.

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FRONTING COMPENSATION: FEE-BASED
PRINCIPAL CONTACT: MICHAEL WEBER



Deadline approaching for ACORD nominees

PEARL RIVER, N.Y.—Applications are available for submissions for consideration for the 2007 ACORD Awards, sponsored by the Pearl River, N.Y.-based Assn. for Cooperative Operations Research and Development.

The 2007 ACORD Awards cover accomplishments from June 2006 through April 2007, and applications must be submitted by March 15. The awards will be presented during this year's ACORD LOMA Insurance Systems Forum, May 20-22 at the Walt Disney World Dolphin in Lake Buena Vista, Fla.

The ACORD Awards focus on implementations that highlight business value, business opportunities and trading partners. For more information on the awards and specific criteria, visit the ACORD Web site at www.acord.org, contact dcac-cioppoli@acord.org or call 845-620-1700, ext. 424.

P/C technology blog promises open forum

AUSTIN, Texas—A new property/casualty insurance industry information technology blog is intended to offer the P/C industry a forum for opinion, conversation and experience sharing.

The P/C Technology Blog (<http://insurancetechnology.typepad.com>) was started by George Grieve, chief executive officer of Austin, Texas-based P/C industry consultant CastleBay Consulting Corp. Mr. Grieve will facilitate the blog, which is sponsored by Guidewire Software.

The objective of the new blog is to facilitate ongoing discussion, debate and the sharing of unbiased information on a broad range of insurance technology topics.

As the blog's facilitator, Mr. Grieve will provide his technology insights and experience while encouraging other authors to share their voices.

SOA, lean manufacturing, lead IT trends on CIO radar

By Rodd Zolkos

Amigration to service-oriented architecture and the introduction of lean manufacturing principles to data center operations are the two trends that will occupy much of the attention of chief information officers in 2007, a survey shows.

The McKinsey & Co. survey, which collected information last October from 72 senior information technology executives at North American companies, found that 64% of those polled said they expect to implement service-oriented architecture this year.

According to McKinsey, that strong showing "suggests that the thinking about IT architectures is shifting to embrace global standards for interaction, both internally and with external partners and suppliers."

Service-oriented architecture proponents say the approach to IT design will bring increased flexibility and efficiency to IT systems by facilitating communication and interaction between systems, the consultant noted.

While the concepts behind SOA have been around for some time, McKinsey said interest in it has grown as companies adopt Web services standards. Despite confusion in the marketplace caused by some vendors willing to slap the "service-oriented" label on just about anything, the potential benefits of true SOA, along with "increasingly mature offerings from vendors," are prompting more IT executives to look at adopting the approach, McKinsey said.

Also of interest is that 48% of those surveyed indicated they plan to implement SOA for integration with external partners this year. Traditionally, McKinsey said, companies first adopt new integration technologies within their own

firewalls, extending those technologies to their external partners only years later. The willingness of many companies to bypass the traditional approach speaks to the high interest in SOA, McKinsey said.

Regarding the other IT trend McKinsey cites for 2007, the consultant said 28% of survey respondents had already applied or decided to apply lean principles to improve their data center operations.

Lean manufacturing is an approach centered on the reduction of various waste to improve customer value. While the technique was applied initially to manufacturing operations, it's increasingly being used in connection with services, McKinsey said.


Data centers of large corporations would appear to be particularly choice targets for a methodology focusing on reducing waste. McKinsey cites the growth in data centers over the past 10 to 15 years as IT spending has increased and cost-conscious IT executives

have consolidated smaller data centers into fewer but larger ones.

In addition to the hundreds of millions of dollars in capital equipment found at the data center of a large company, the typical data center also consumes large amounts of electricity and requires a staff of hundreds of highly skilled employees to run it.

It's the labor costs, in particular, that have grown in recent years, McKinsey said, and applying lean principles to data centers can help reduce waste and improve labor productivity by as much as 40% in some processes.

McKinsey said nearly one-third of the CIOs it surveyed intend to employ lean principles in their data centers, a share suggesting that the benefits realized by early adopters are encouraging more companies' IT organizations to move in a similar direction. ■



Applying lean principles to data centers can help reduce waste and improve labor productivity by as much as 40% in some processes.

Courts unsympathetic to insurers that fail to properly reserve rights

The District Court for the Southern District of New York last year granted partial summary judgment in *Olin Corp. vs. Insurance Co. North America et al.*, reaffirming the rule that the insurers must state with specificity all grounds upon which they reserve their rights. Justice Thomas P. Griesa held that the insurer, certain Lloyd's of London underwriters, had waived its late-notice defense.

The insured, Olin Corp., had discovered in the early 1980s that one of its manufacturing sites was contaminating groundwater as a result of activities that occurred in the 1950s and 1960s. On Feb. 15, 1984, Olin notified the Lloyd's underwriters of potential environmental damage liability.

In the notification letter, Olin stated that tests had been conducted since 1980, the Alabama Division of Solid and Hazardous Waste was informed and involved in the tests, Olin had submitted a plan to Alabama to remediate in September 1983, and Alabama approved the plan in November 1983. Olin's notice letter also estimated remediation costs.

On March 26, 1984, the insurer responded with a reservation-of-rights letter, stating, "Underwriters reserve their right re coverage and punitive damages." Significantly, the letter did not assert any reservation of rights with respect to a late-notice defense. Nor did the Lloyd's underwriters follow up with a broader reservation-of-rights letter for possible late notice until November 1993, when it was made part of an affirmative defense in litigation.

The court took a rigid stance on the underwriters' deficient reservation-of-rights letter. The court reminded the underwriters that an insurer's assertion of certain defenses to coverage is deemed conclusive evidence of the insurer's intent to waive other unasserted

grounds. The court held that the Lloyd's underwriters in their 1984 letter fatally omitted any mention of a defense based upon the failure of plaintiff to provide timely notice.

The court further found that Olin's notice letter contained enough facts to place the Lloyd's underwriters on "constructive notice" of a potential late-notice defense. For the court, the "fact that evidence later emerged that may have lent additional support for that defense does not affect the London Underwriters' waiver."

As this decision illustrates, courts have little sympathy for insurers that do not properly

IT IS A TESTAMENT that when a bona fide issue exists, courts may attempt to maximize coverage based on whether a carrier has properly reserved its rights to disclaim coverage. **IT IS THEREFORE IMPORTANT** that insurers prepare reservation-of-rights letters that are specific enough to cover all possible defenses in anticipated coverage litigation.

ly follow through and reserve their rights. It is a testament that when a bona fide issue exists, courts may attempt to maximize coverage based on whether a carrier has properly reserved its rights to disclaim coverage.

It is therefore important that insurers prepare reservation-of-rights letters that are specific enough to cover all possible defenses in anticipated coverage litigation. Generally, the letter must, among other things, be timely, be addressed to the right entity or person, fairly inform the insured of the insurer's coverage position by including potential defenses to coverage that the insurer has developed in its preliminary analysis, cite specific policy references that may be the grounds for disclaiming coverage and explain the need for further factual development if necessary.



BENNETT KATZ (above) is a partner at law firm Ohrenstein & Brown L.L.P. in New York.

BLAISE CHOW is an associate at the firm, also in New York.



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