Business Insurance

SPECIAL ISSUE

AT THE MILLENNIUM

Much of Bill's time was spent addressing the human capital risks that threatened Summit's ability to compete in global labor markets and realize the full potential of its people. Many of these risks, such as those relating to the attraction and retention of skilled employees, were untransferable. But they could certainly be mitigated. By statistically modeling the drivers of employee turnover, Summit had developed employee retention strategies that substantially reduced its vulnerability to volatile labor markets.

By Bill's calculation, risk mitigation strategies relating to Summit's human capital alone had protected $8 billion, or 15%, of the company's average market value in 2009. Everyone in the company had acquired a personal interest in risk management with the introduction in 2006 of risk weighting into Summit's IPC (or individual performance-based compensation) formula. Techniques of this kind measurably enhanced and stabilized Summit's earnings and reduced its cost of capital.

in its products (although it continued to affirm its belief in their eco-friendliness.) Second, it joined with other food manufacturers to lobby governments to address GM foods in the Millennium Round of trade talks, then entering their fourth year.

The strategy worked. In 2005 the Millennium Round produced an international agreement on trade in GM foods that was supported by an exhaustive battery of scientific tests. This took the heat out of the public protests. Five years later, all the major confectionary manufacturers were routinely using GM cocoa in their products. Summit had suffered badly from ill-coordinated risk management over the GM foods issue, but in the end proved a major beneficiary of the Millennium Round, because the DNA of its cocoa plants offered higher yields than that of its competitors and was more resistant to disease.

To Bill, there were lessons to be drawn from all this. Executives in the 1990s had understood

Advances in risk quantification were only part of the story of the past decade.

Advances in risk quantification were only part of the story of the past decade. Equally important had been the organizational changes that Summit had made. Ten years ago, relations between Bill and the head of government affairs at Garamond Corporation had been friendly but remote. Today, Summit's government affairs director was an important member of the company's risk committee.

The change had begun after Summit's confectionary division (mostly the old Garamond business) was badly hit by a consumer boycott over its use of genetically modified, or GM, cocoa in the spring of 2003. Summit's well-publicized plans to challenge the Swiss at the premium end of the confectionary market were dashed and the company's best-selling Summit bar was hastily renamed. (The press coined the term "brand contagion" for the risk that this name-change conspicuously failed to cure.)

After this fiasco, the board of Summit developed a two pronged strategy to insulate it from such problems in the future. First, on Bill's advice, it proclaimed that it was "listening to its customers" and would suspend the use of GM ingredients

that risk and opportunity were inextricably linked, but they had not appreciated the multitude of ways in which creative risk management could unleash new opportunities. They had not fully grasped how risk management could provide competitive advantage.

Some risk managers had grasped these things, intuitively at least. But in those days, risk managers had not yet achieved the pivotal role that many of them now enjoyed, either as chief risk officers or as key members of their companies' risk committees. In those days, most risk managers' responsibilities were largely limited to those risks that could - at least in part - be transferred through insurance.

Suddenly, Bill had a thought. He swiped his card through the reader in the armrest of his seat, flipped open his database screen and called up search. "Risk and insurance," he said. Twenty-four thousand entries, give or take. He clicked on the first. To his surprise, an old black and white image of a keen-eyed Victorian gentleman emerged on the screen. The caption read: "'The problem is not insurance, it is risk.' *Henry W. Marsh.*"

When the New York Chapter of RIMS had asked him to deliver the keynote speech at its annual dinner, he'd had little difficulty suggesting a theme. "How about 'The Difference a Decade Makes - Risk Management 2000 to 2010.'" he'd said.

Suggesting the theme was easy. The hard part was to shoehorn the experience of a decade into thirty minutes. Ten years ago, he was the risk manager at Garamond Corporation, a middle ranking confectionary manufacturer based in Kansas with 4,000 employees and revenues of $500 million. As risk manager he reported to Garamond's treasurer and earned $150,000 a year.

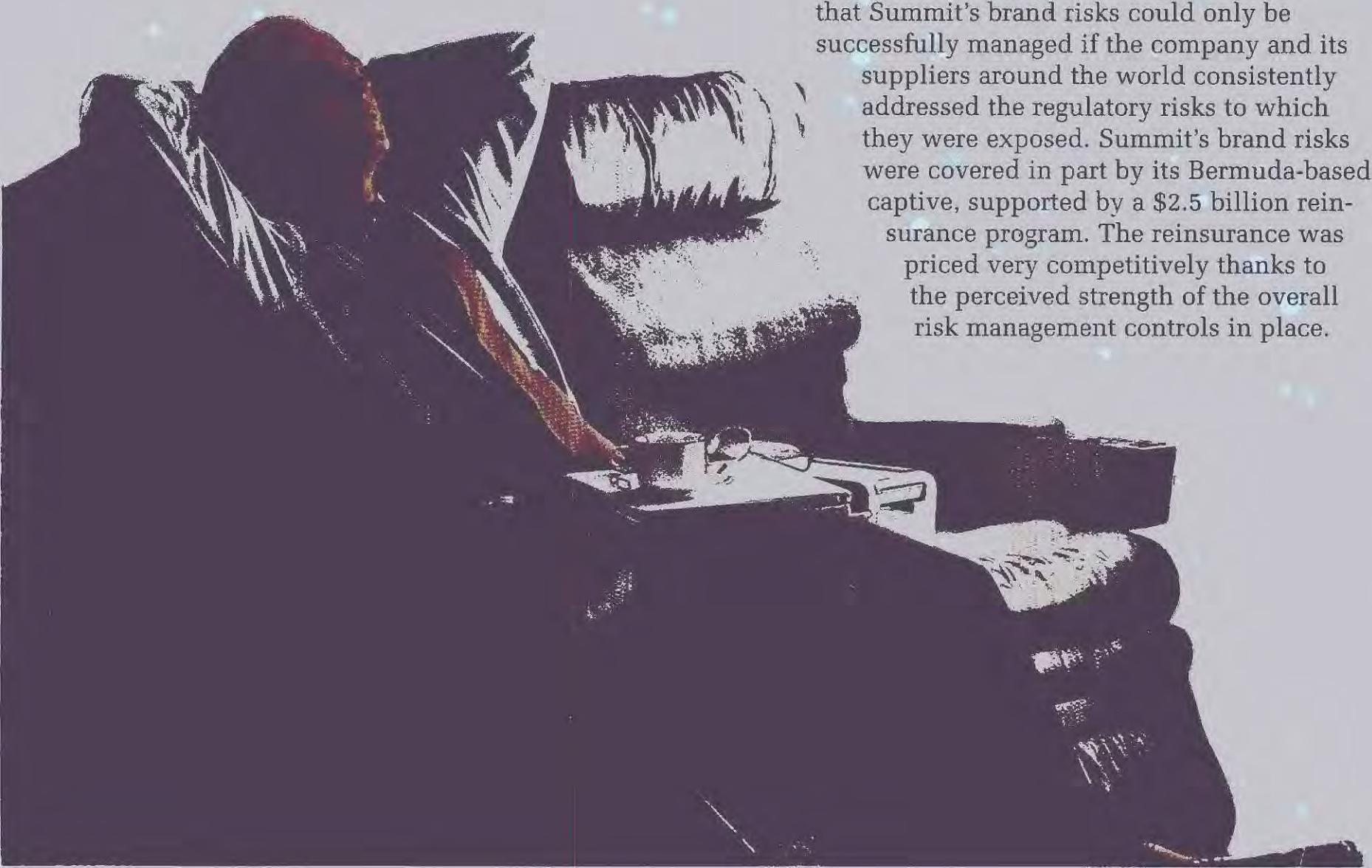
Ten years on, the world looked very different. Bill was now the chief risk officer of Summit Brands. He reported to the CEO and held stock in the company worth almost $4 million. Summit Brands was the global food and drink conglomerate that had bought Garamond after it stumbled badly in 2001 as a result of appalling publicity from the celebrated cocoa fermentation scandal.

Bill smiled ruefully at the thought that the brand risks that had knocked 40% off Garamond's market value in less than a month were now routinely quantified and managed by CROs. At Summit, such risks were factored into a comprehensive brand analysis model that weighed the opportunities and risks presented by different operational and marketing strategies. The residual risk that Summit considered worth taking could - if the company wished - be insured or reinsured.

But at the beginning of the decade, brand risks hadn't been Bill's problem. They were regarded as mostly unquantifiable - and therefore largely untransferable. His job in those days was to handle what were known as "hazard" risks. He recalled a RIMS survey in which he'd participated in the summer of 1998. The survey had listed the three risks that most preoccupied risk managers back then. They were workers' compensation, general liability and product liability.

Twelve years later these were still important risks, but few CROs would call them the most critical risks they faced. Today, Bill would unhesitatingly identify the risks most threatening to the assets that drove Summit Brands' market value. These were brand risk, human capital risk and regulatory risk relating to food ingredients and processing standards.

The benefits of Summit's comprehensive approach to risk management were daily apparent. For example, regulatory standards relating to food safety became ever more demanding as science advanced. Bill knew that Summit's brand risks could only be successfully managed if the company and its suppliers around the world consistently addressed the regulatory risks to which they were exposed. Summit's brand risks were covered in part by its Bermuda-based captive, supported by a $2.5 billion reinsurance program. The reinsurance was priced very competitively thanks to the perceived strength of the overall risk management controls in place.



2010
A Risk Odyssey

Bill Jowett sat back in his seat as his train pulled out of Philadelphia and began to gather speed across the snowy countryside. In 45 minutes he would be in New York and his opportunity for quiet reflection would be gone.



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Welcome to the millennium

With the approaching new millennium, it seems fitting for *Business Insurance* to take a long look at insurance and where it's been as well as where it might go next.

After all, the concept of insurance is thousands of years old and likely will be around for thousands more, in one form or another. All *BI* staff members learn about the origins of insurance at an early stage, after reading the Insurance Information Institute's guide to how the industry works, "Sharing the Risk," in which insurance is traced to a group of Chinese merchants who allegedly divided their cargo among multiple boats to avoid a catastrophic loss if any one vessel failed to survive a treacherous river voyage.



Insurance has come a long way from this form of basic cargo risk management (except for the sue and labor clause, which apparently still has relevance in the modern era), but the goal of spreading the financial risk of various perils remains the same.

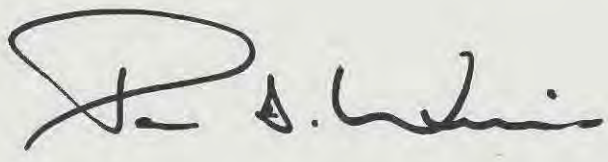
When planning for this special issue—*Business Insurance* At the Millennium—we wrestled with whether to look backward and analyze the industry with the benefit of hindsight, or to explore what the future may hold. In the end, we decided to do both. Our approach is sort of like the ghost of insurance past, the ghost of insurance future and the ghost of insurance present, to paraphrase Charles Dickens.

Once we had decided to apply the triple-trigger theory of millennium reporting, the next step was to decide whether to do a serious report on the commercial insurance industry's past and future, or a more whimsical, tongue-in-cheek approach. And once again, rather than make a difficult choice, we decided to do it both ways.

As a result, you will find in this issue serious and, we hope, thought-provoking reports, such as examinations of Lloyd's of London's rise in the U.S. marketplace and a look at how the risk management and employee benefit management professions might evolve. At the same time, we offer such features as an interview with a 2000-year-old risk manager (with apologies to Mel Brooks), a market report from year 2100 renewals and a keynote address to the 138th annual Risk & Insurance Management Society conference.

If we overlooked something noteworthy, or failed to consider an alternative future for the industry, please let us know. We have hundreds of years to correct such omissions before the next special millennium issue.

This issue is the result of months of planning and hard work by the entire *Business Insurance* staff. I hope you find it as fun and interesting to read as we did to put it together.



Paul D. Winston
Editor

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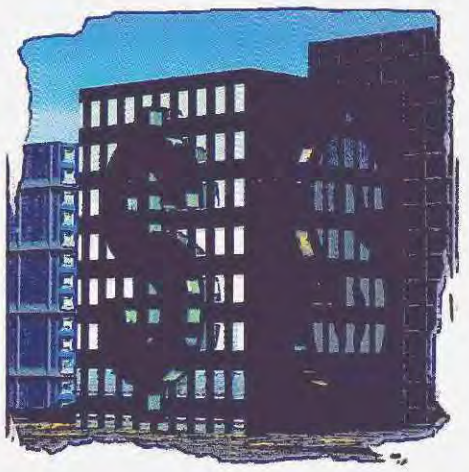
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Wisdom from one who saw Y1K

In reporting on the risk management events of the past millennium, Business Insurance *sought out individuals whose perspectives were informed by lengthy experience in the field. We were fortunate, indeed, to locate one risk management professional with a particularly extensive tenure.* BI *Associate Editor Michael Prince and Senior Editor Rodd Zolkos recently had the chance to chat with him about his career and so, with apologies to Mel Brooks, here is* BI*'s interview with the 2,000 -year-old risk manager.*



Thanks for taking the time to talk with us. To start, perhaps we should ask what got you into the risk management business?

Happy to do it. Believe me, time is something I've got.

Well, when I was a boy, there weren't many choices. As a kid, of course, I thought about being a centurion—the flashy uniforms, the shiny swords, the horses, stabbing people and all that—what kid wouldn't?

One day I looked around and it struck me. With all the wondrous things going on in the world—the great construction projects like the Baths of Caracalla—and with trade getting near the very edges of the world, business was bound to start booming, and I wanted to be part of it.

Then I thought, maybe a spice company, say, could use somebody who could tell the caravan leader, "Maybe if you didn't go exactly the same way each time you go to Asia Minor, you wouldn't get attacked by the Huns. That's how Attila got his start, you know, in a local crew doing a caravan smash-and-grab and then fencing the goods in the Cathaytown section of Baghdad. And maybe if on the way back you split up into two caravans and each took a different route, even if one group got attacked, at least half the cargo would get through.

The idea excited me, and it was something I could do, so I got into risk management. As it turned out, my first job was with Mortonius the Elder, Salt Works & Exotic Spices. So I got to put my risk management ideas into practice pretty quickly.

What did you study in college?

I took an alchemy major with a minor in contemporary soothsaying from MSU—Mesopotamia State University. This was after my discus scholarship fell through with Spartan State. I think it turned out to be a good education for a risk manager. You know, the logical, fact-based approach of alchemy coupled with the open-mindedness of soothsaying.

Later, I decided I needed to beef up my business skills, so I went back and got my MBA—Master of Bartering Administration—from Alexandria Tech.

Alexandria was an exciting place to be back then. Ptolemy always had something interesting going on. Plus, the Egyptians invented beer, you know.

What was the biggest mistake you ever made?

I'll tell you something. If you stay in this business for any length of time at all, you'll make mistakes. You just have to learn from them.

But you want specifics. OK, not being more adamant with Nero about buying that fire cover, that's one I'd like to have back.

There was the whole mess with that early-return-to-work program I tried to develop while I was working for Theodorick and Squinte, Ye Olde Fishmongers—London's largest in the mid-14th Century, by the way. Some folks said an idea like that would never work, but I think it would have been a great success if the Black Death hadn't come along. Bad timing.

I guess the worst might have been when we tried that enterprise risk management approach at the Dutch West India Co. back in the 1600s.

You know how it is. We were all feeling pretty smart after that Manhattan deal and everything, so I thought 'Hey, now's the time to do something with some of our business risk.' I figured hedging our commodity exposure on New World tobacco with Dutch tulip futures was a natural. I mean, there's no connection between tobacco and tulips, right? You can't smoke tulips, and who puts tobacco in a vase?

Well, then 1637 and the Great Tulip Panic comes along and we take a beating on that one. It wasn't too much later that I relocated to the branch office in New Amsterdam for a few years.

The other one was asbestos. It was great stuff, almost like a miracle. I put it everywhere. Who knew?

What was the best move you ever made?

You know, you hate to brag, and I'm lucky enough to feel good about most of what I've done. Probably buying that flood cover when I was with H.T. Crackenslap & Sons—the big buggywhip maker—at the beginning of 1889. It was just something I thought we should do as we moved into a new state-of-the-art facility . . .in Johnstown, Pa. It was a beautiful building.

Any particular episode or incident you recall as your greatest risk management challenge?

The Hundred Years War. Just when it started to slow down and you thought it would end, it would pick up again. A hundred years they say. For me it seemed like a million.

I must have had a dozen brokers speared in a decade. You know badly that destroys continuity of service?

You've been in the business a long time. What sorts of cycles have you seen? Have you ever seen anything like the current soft market?

You call this soft. The Middle Ages, now that was soft. The market went 500 years without a price increase. During the plagues, I could have gotten all the coverage I wanted for a clean towel.

Communications have gotten so much quicker and more reliable over the course of your career. What impact has that had on you as a risk management practitioner?

It's given me bags. I used to look like a young man, but now I have bags under my eyes. The phone never stops ringing.

I can remember it was the year 808, no one disturbed me, and I got a good two-hour nap every afternoon. Now, just as I nod off, the phone rings.

I told Bell he was destroying civilization with this telephone thing but does he believe me, no. I've only been around for a couple thousand years, what could I possibly know?

What strikes you as the most significant technological advance you've seen?

Let's see. I guess what comes to mind is Gutenberg and the whole movable type thing. Printing really made this business a lot easier.

It used to be you agreed to policy terms and then waited and waited and waited for monks to inscribe the policy document. I'll admit that when printing came about, I kind of missed the fancy illuminations at the beginning of each coverage clause and the smell of freshly inked goat skin. But there's something to be said for having the policy in your hands before it expires.

Of course, you've got to take the good with the bad. A couple weeks after he invented the printing press, old Gutenberg came up with his next big invention—fine print. Thanks, Johann.

When did you first hear of the Internet?

Hmmm, it was a while ago, actually, about 1550 or so. From Nostradamus one night over a couple of beers.

Of course you'd get a couple of beers in Nostradamus and he'd always go on about something. He'd get that weird look on his face, then he's staring deep into his mug, talking about the end of world.

Still, he's the kind of guy who was a good friend to have in this business. Even 300 years later, the guy was making me look like a hero when I convinced my bosses in New Bedford at Jedediah Stumpe, Whale Oil & Blubber Fabricators, that I had serious seismic issues with opening an Indonesian facility on Krakatoa.

How about today's Y2K scare? Have you ever seen anything quite like that?

You think this is bad. You should have been there for Y1K. Now that was chaos. Everyone kept waiting for a giant turtle to sweep from the sky and destroy the world in a wall of fire. Stayed up for two months dancing on Easter Island waiting for the damned thing to happen. My feet hurt for weeks after that.

And you know how hard it is to get Armageddon insurance. Costs a pretty penny. Of course it turns out the actual Y1K had already happened a few years earlier. We didn't have calendars back then, so we sort of guessed the year and we missed by a few.

Employment practices liability has also emerged in the past few years as a major concern for risk managers. In your years in the business, have you ever seen anything similar?

Heretic risk. Had quite a run on that a few years back. A bunch of cardinals got together and started accusing everyone in sight. For a while you couldn't insure teenage French girls.

What do you dislike the most about the business?

Claims disputes, hands down. I hate them. I mean, I pay my premium, and if I have a legitimate claim I expect to get it paid without having to go to court. In fact, a product liability coverage dispute almost drove me out this business back in 1796.

That was that whole ugly scene with George Washington's dentures. But I'd seen to it that my employer at the time, Ye Olde Yankee Sawmill, Furniture Makers & Tooth Works, was fully covered. So when that flock of woodpeckers attacked the president's face right in the middle of his farewell address, I was as upset as anybody. But I could sleep that night because I knew that when he sued, we were protected.

And, sure enough, when we took our insurance claim to court, we won our case, though I got the sense that old John Jay wasn't particularly thrilled about having to rule in our favor. Say what you will about separation of powers, he and George were tight, you know.

What do you think about today's crop of risk managers? With the specialized education opportunities available to them and the chances for networking with peers through groups like RIMS, it certainly seems like they're well positioned to advance the state of the risk management art.

Art? You call this art? I'll tell you art. The Sistine Chapel, that's art. You know Michelangelo was going to paint the floor, not the ceiling. The Pope wanted it on the ceiling, I wanted it on the ceiling—it seemed like a better idea. But he refused and stomped off all angry, muttering something about government interference.

Well, everyone thought he was afraid of heights. It got to the point where the Pope was going to hire someone else. But it turns out Michelangelo was concerned about safety for him and his helpers.

See **2,000 man** *on page 6*



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2,000 man

Continued from page 4

Few people know that with Michelangelo, safety was always upmost in his mind. So, I rigged up some netting in case he fell and bought them disability and life policies. Once he had all that, he agreed on the ceiling.

Government regulation always seems to affect risk managers one way or another. What have your dealings with government officials been like over the years?

Did I mention Atilla the Hun? He gave government a bad name.

Only other person to stand out is Neville Chamberlain. I used to thumb wrestle with him every day and I always beat him. He never caught on that I was cheating—you know using my index finger instead of my thumb. Must have been a screw loose in that man.

With today's heavy reliance on space satellites for communications, research and navigation, meteor storms have become a cause for concern. Could you ever have anticipated such a thing being a risk management issue when you started in the business?

Years ago we had a similar problem: falling cheese. Some thought the moon was made of cheese and they figured as it aged, it would dry up and pieces would fall to earth. Poor idiots bought lots of cheese coverage.

What makes for a bad risk manager? Who was the worst one you ever saw?

I hate to knock anyone else, but Ethelcletus the Unlucky was about as bad a risk manager as I've ever seen. I'm sorry, but when you're the risk manager for one of the major innkeepers of the early Dark Ages and you've got Huns going one way, Visigoths going the other and Vandals all around, you know you've got a big-time sacking exposure. And just reading the entrails of a goat does not constitute an adequate risk assessment.

There's a lot of talk these days about the risk manager's role in the organization. Have you seen much change over the years in terms of where you've fit into the org chart with your various employers?

Well, I used to report to lords. Then it was kings. For a while it was dictators, like Atilla with his bad breath. I remember one job where my boss was a horse. A real smart horse who taught me a lot. And could he run.

Being in this business for as long as you have, you've obviously had a lot of bosses. Who was the toughest boss to work for?

Napoleon could be a real pain. I told him when he decided to go off and try to do business in Russia that I thought relying on a just-in-time inventory system was ill-advised, and at the very least we ought to look at doing something about our business interruption exposure.

But of course he wouldn't listen to me, he was going to rule the world. So he goes off to Russia, the weather gets bad, the supply lines break down and next thing you know, he's trudging back to France. Do you think he ever said to me, 'You were right?' No way. He just stood there with his hand rammed in his vest. Mr. Big Shot.

Anyone else?

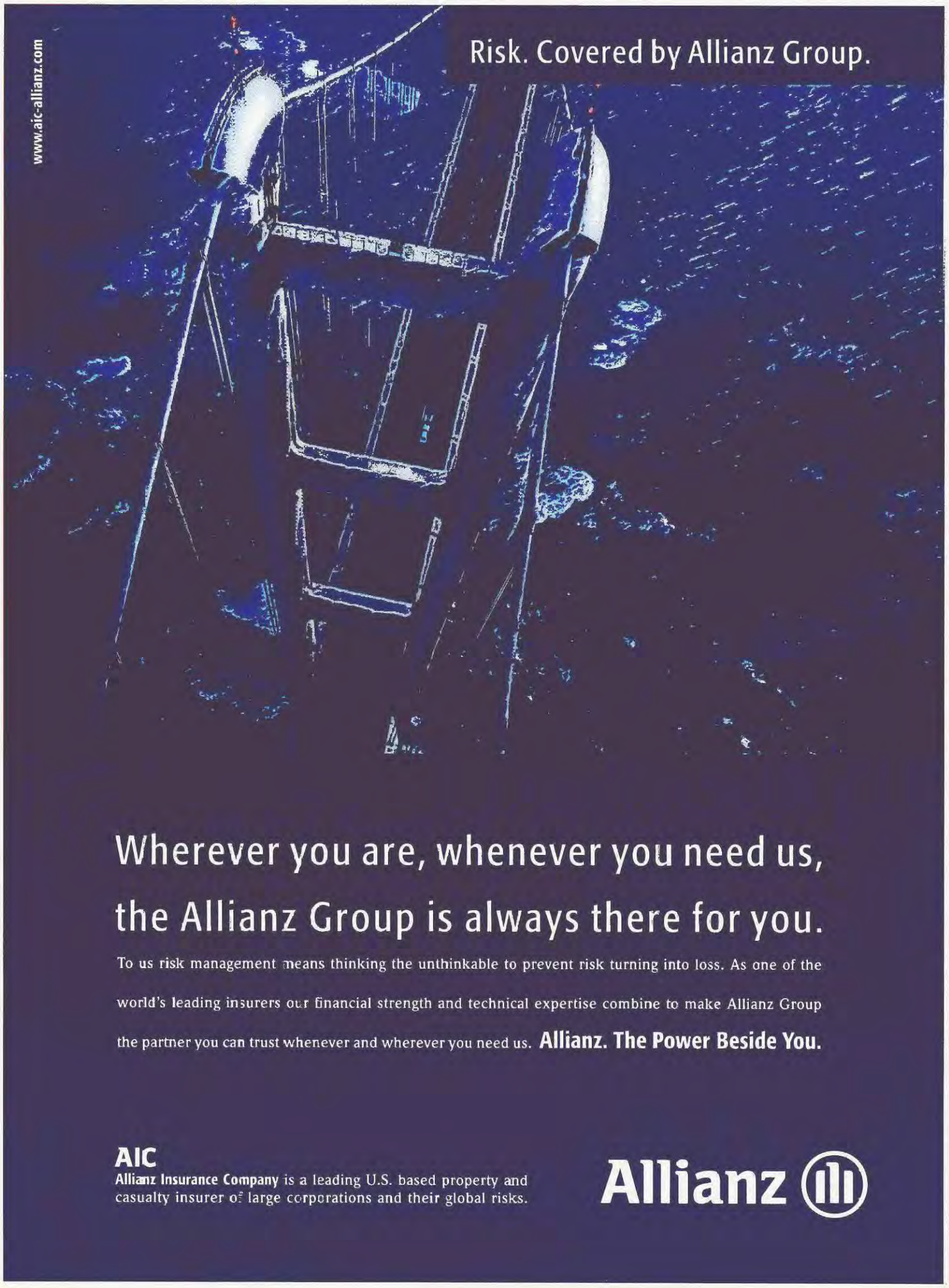
Atilla the Hun. With him it was always give me, give me, I want it now. He never said 'thank you.' And his table manners. If I was him I'd be embarrassed to leave the house.

Isaac Newton was no pleasure cruise either, always thinking he knew everything. But at least he ate with his mouth closed.

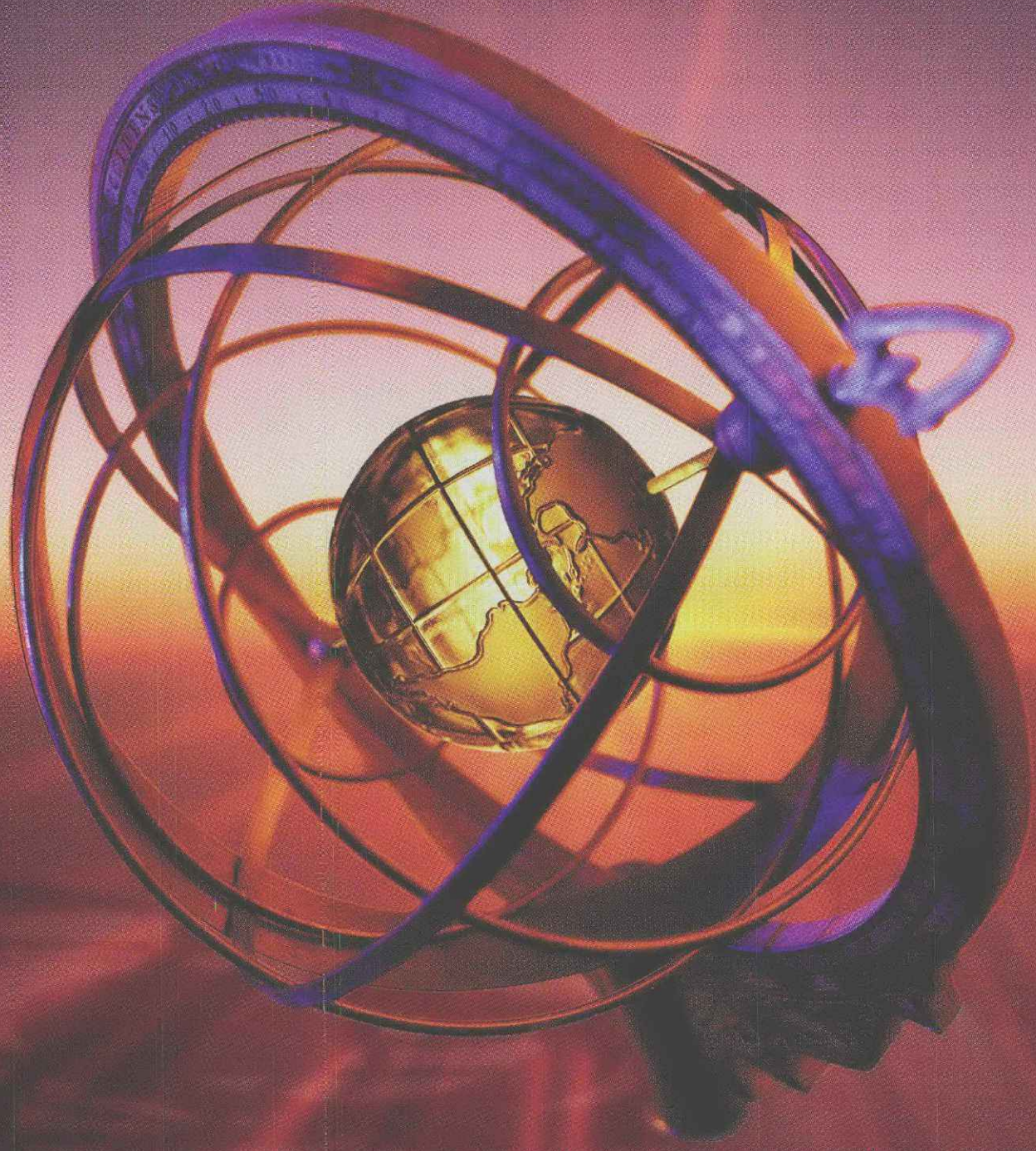
Is there anyone who stands out as one of your best friends in the industry? Anyone you were ever particularly close to?

I'll tell you, Ed Lloyd was a heck of a guy. You could just sit around his place shooting the breeze with him all day. But, and this might surprise you, he couldn't make a decent cup of coffee to save his life.

I used to tell him, 'Lloyd, don't think for a minute all these people are coming in here for your coffee. Now Starbuck down the street, he can make a cup of coffee. You'd better find another line of work before he puts you out of business.' BI



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ERISA changes benefit landscape forever

By JERRY GEISEL

There was a time when there were few laws and regulations governing voluntary employee benefits.

"Keeping up technically meant reading a few IRS regulations. And you didn't need a law degree to understand those regulations. It was a different world," recalled Ted Benna, a longtime benefits consultant.

That world is long gone, though. It was changed forever by the 1974 passage of the Employee Retirement Income Security Act and, since then, a quarter-century of persistent congressional legislating on employer-provided pension and welfare benefits.

Since the early 1970s, Congress has enacted about two-dozen benefit-related laws, putting on the books thousands of pages of rules that employers must follow in running their benefit plans.

Many of the laws have been broad in scope, such as those that require employers to fully vest employees in retirement plans after a certain number of years of service and that give employees the opportunity to stay in their company-provided health care plans after they leave employment.

While the laws often have been broad, the level of detail in some of the statutes and regulations has been almost mind-numbing.

The legacy of congressional macro- and micro-management of benefit plans is, experts concur, decidedly mixed.

To Congress' credit, the end of an era of unregulated benefits—described by Henry Saveth, an attorney with William M. Mercer Inc. in New York, as a kind of a "wild, wild West"—has resulted in greater security and protection for the pension benefits employees earn.

Employees no longer have to worry, as they once did, that they could lose their retirement benefits because their employers closed up and never put any money in the pension plans.

"The terrible loss of benefits and entitlement to benefits was halted," said Michael Gordon, a Washington attorney who, in the early 1970s as a Senate committee staff member, helped to draft what became ERISA.

The Pension Benefit Guaranty Corp., created by ERISA to administer a federal insurance program for participants' benefits, has taken over more than 2,600 pension plans that have failed in the past 25 years. To date, the PBGC also has paid benefits to those plans' 216,000 retirees and will pay benefits to 472,000 additional participants in insolvent plans when they reach retirement age.

Through the enactment of ERISA, as well as many other participant protection measures that came in ERISA's aftermath, federal lawmakers may have prevented a complete loss of public confidence in the employer-based benefit system and encouraged an expansion of public benefit programs, some say.

"Things had gotten pretty ugly. Perhaps the private system would have collapsed, and there would been calls for an expansion of Social Security," said Mr. Benna, who is now president of the 401(k) Assn. in Bellefonte, Pa.

Benefits complexity

But there has been a price—too high a price, some say—for the federal government's ever-expanding role in the regulation of employee benefit plans.

Laws heaped upon laws have added to the complexity of running benefit plans, especially defined benefit pension plans. Still other laws have made the plans less valuable to higher-paid employees. Those factors, at least in part, are leading to the disappearance of the very retirement plans Congress sought to protect.

Today, employers sponsor roughly 40,000 defined benefit plans, almost one-third the number they offered in the early-1980s. While the growing number of laws and regulations are not entirely to blame, they certainly have played a role, many say.

"The complexity of rules has driven employers away," said Theresa Stuchiner, a veteran benefits attorney and a consultant with PwC Kwasha in Teaneck, N.J.

The most extreme and, some would say, misguided legislative efforts led to huge expenditures of employer resources with no public gain.

For example, Section 89, was a provision added to the U.S. Tax Code as part of a broader 1986 tax law. Section 89 laid down extremely complex and, ultimately, unworkable health and non-discrimination tests.

Following employer protests, the law was repealed, but not before employers had spent small fortunes collecting the required data to see if their plans passed the tests.

"Think of all the time and money that was wasted on Section 89. So much money was spent on consultants and others that could have been used to provide benefits," said Robin Miklatek, director of U.S. benefits at Avon Products Inc. in New York.



One unintended consequence of these complex benefits laws has been an increase in the number of employers seeking help from outside advisers. That, in turn, has led to the huge growth of employee benefit consulting companies.

Benefit consulting—once largely limited to the provision of pension actuarial services—has grown into a huge, broad-based industry. This year, the 10 largest firms alone will take in more than $6 billion in revenues. In the 1960s, many of the largest consultants were but 1% of the size they are today.

"Consulting has grown by leaps and bounds," said Dennis Coleman, a principal with PwC Kwasha in Teaneck, N.J.

"Things are so complex, you have to outsource," said Avon's Ms. Miklatek

Still, while employers may groan about the weight of all those laws and what it costs them to comply, Washington also has given employers the tools to design new benefit plans.

Take Section 401(k), for example, which was added to the Tax Code in 1978 as part of a broader law and later endorsed by the Internal Revenue Service through regulations. This provision has revolutionized the employee benefit plan system.

Today, there are more than 200,000 401(k) retirement savings plans, more than five times as many employer-sponsored defined benefit plans. If present trends continue, there soon could be more 401(k) plan participants than defined benefit plan participants.

Numbers aside, the boom in 401(k) plans has changed the role of retirement plans. No longer are plans solely dependent upon employer contributions; the structure of 401(k) plans encourages employees to contribute to their retirement accounts to earn matching contributions from employers.

"We have given employees tremendous control over their own destiny," said Sylvester Schieber, director of Watson Wyatt Worldwide's Research & Information Center in Bethesda, Md.

'Playground for scoundrels'

How and why government got so involved in employee benefit plans goes back a decade before the passage of ERISA.

While pension plan coverage had expanded tremendously with the economic prosperity of the 1950s and 1960s, regulation of these plans hardly existed.

Pension plans, observed Mr. Gordon, the former Senate staffer, was "a playground for scoundrels. Pension plans were treated as a gratuity to be taken away as an employer saw fit."

Some plan provisions that were not uncommon prior to ERISA had the effect of making it impossible for all but a handful of employees to ever earn benefits. Some plans, for example, required employees to work until reaching retirement age before they could qualify for benefits, while others required decades of continuous service to vest in plans.

In one infamous case, which went to the U.S. Supreme Court, John Daniel, a Chicago-area truck driver, was denied a pension even though he had been a participant in his union pension plan for 23 years. The reason for the denial was that the plan required 20 years of continuous service, which Mr. Daniel did not meet due to a seven-month involuntary layoff.

"You could work decades, have a short break in service and lose everything," recalled Michael Pikelny, corporate benefits actuary at Chicago-based Hartmarx Corp.

While many of the worst pension abuses occurred in plans sponsored by small employers and some unions, not all large employers kept their pension promises, either.

For example, when automaker Studebaker Co. shut down in 1963, thousands of its employees and retirees lost most of their pension benefits. Even though collective bargaining agreements had boosted benefits, Studebaker had not adequately funded the increased benefits. Because there were no rules governing pension funding at the time, such a failure to meet benefit obligations was not illegal.

"Things went on and on. I was astounded by the constant flow of mail from people who lost out. There were no benefit laws to stop these sorts of things," Mr. Gordon said.

ERISA

Eventually, the complaints over pension abuses reached a crescendo, and Congress responded in 1974 with the passage of ERISA.

The comprehensive benefits law was a "crowning achievement," said Frank Cummings, a former Senate staffer and of counsel to LeBoeuf, Lamb, Greene & McRae in Washington.

ERISA's reforms may seem modest compared with some of the laws that have followed in its aftermath. But they were revolutionary, considering they were introduced into what was, in effect, a regulatory vacuum. Furthermore, such reforms have been implemented despite the fact that employers are not legally obliged to provide any benefits at all.

A key tenet of ERISA is that benefit plans must be operated for the exclusive benefit of employees, and not simply as an employer saw fit. Generally, employees' pension benefits had to vest after no more than 10 years of service; after that, the benefits could not be taken away.

Benefits had to be funded over a 30-year period, and the PBGC was created to guarantee participants' basic benefits if an employer were to go out of business without having fully funded the benefits it promised.

"ERISA was a well-crafted law drawing on a recognition that a voluntary system needed standards," said Ms. Stuchiner of PwC Kwasha.

"ERISA enormously increased the number of people eligible for benefits and protected those benefits," noted Mr. Gordon.

Indeed, the rules for pension benefits established by ERISA and several other federal laws have since helped to more than double the percentage of pension plan participants who have vested in retirement benefits.

Looking back, however, some of ERISA's shortcomings seem glaring, Mr. Gordon said. Pre-emption of state rules relating to benefit plans—a demand made by business groups—went too far, he said. States became unable to establish rules for self-funded plans, even though there are few federal rules, Mr. Gordon said.

"There is a vacuum there," he said.

Other shortcomings, Mr. Gordon said, include Congress' failure to create any type of pension clearinghouse, to which those employees terminating employment could transfer their benefits, which would be invested by professional managers.

Post-ERISA

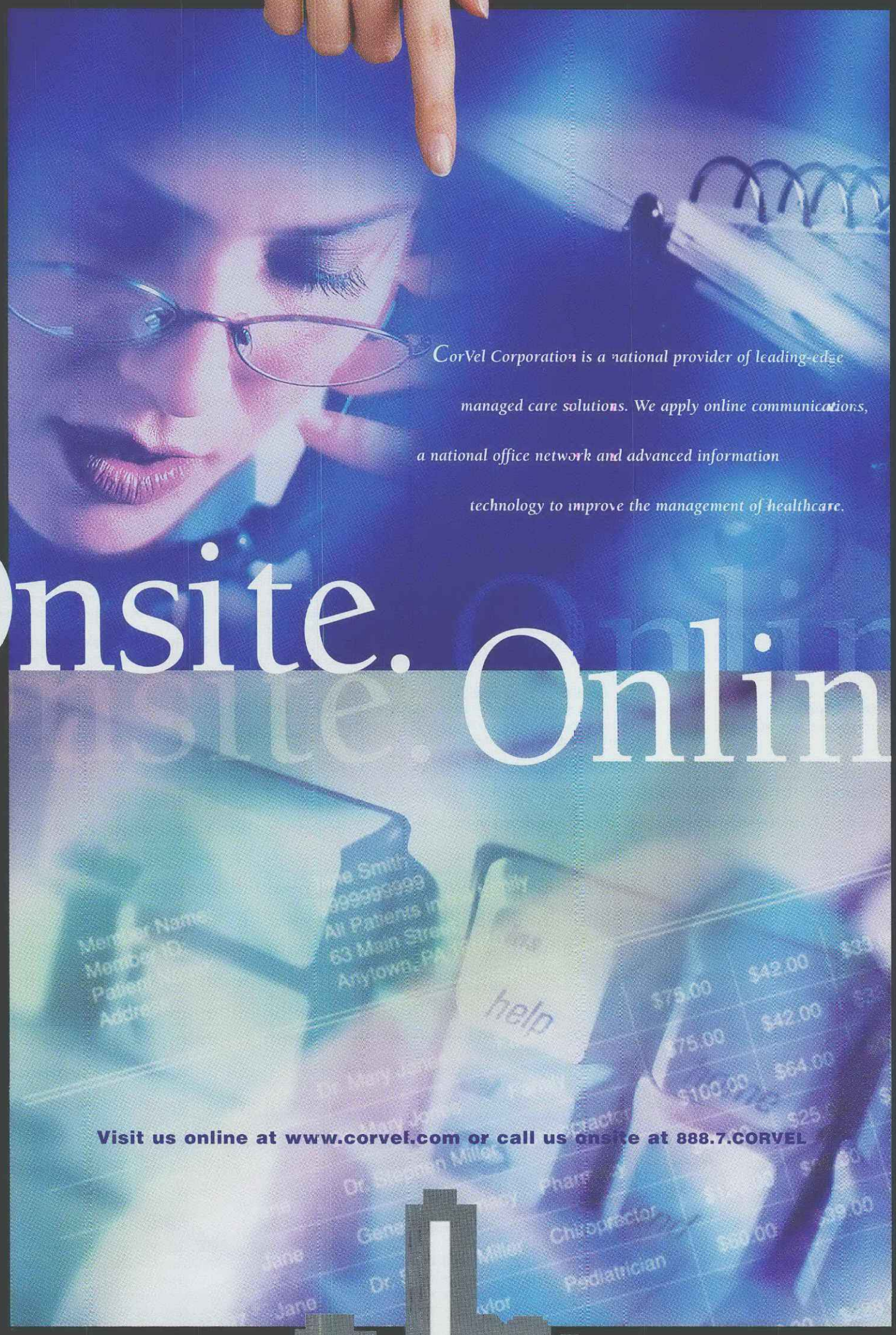
Just as the drive to pass ERISA was triggered by congressional interest in protecting employees' benefits, so were many measures that have followed in ERISA's wake.

Consider the 1978 Pregnancy Discrimination Act, which came at a time when many employers skimped on the amount of health care coverage they provided for pregnancy and childbirth.

Before the law, $500 caps on reimbursement for pregnancy-related expenses were common. Some companies went even further and refused to provide any benefits for pregnancy. General Electric Co., for example, excluded pregnant women from the company's disability plan and forced them to take unpaid maternity leave at the end of their sixth month of pregnancy.

When this practice was challenged, the U.S. Supreme Court ruled that GE had acted legally. An enraged Congress reacted to the Supreme Court ruling and the resultant outcry with a 1978 law that requires employers to cover pregnancy in their

See **Legislation** *on page 10*



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Legislation

Continued from page 8

health and disability plans on the same basis as they cover other medical conditions.

While the costs for many employers were minor, the passage of the pregnancy legislation was significant far beyond a dollar figure. The pregnancy law marked the first time Congress had required that employers cover a specific benefit in their health care plans.

"That was the first piece of mandated benefits legislation. That was the beginning," said Kathy Dupree, a human resources executive in Travis County, Texas.

And legislators haven't stopped since. Other congressional mandates include: the 1986 COBRA health care continuation statute; the 1993 Family and Medical Leave Act, which requires employers to offer employees up to 12 weeks of unpaid job-protected leave to take care of a variety of family situations or their own medical problems; the 1996 Health Insurance Portability and Accountability Act, which curbed pre-existing medical condition exclusions; and a 1996 law that requires employers to provide insured women with at least 48 hours of inpatient coverage after normal vaginal childbirth and 96 hours of coverage after a Caesarean section.

Other mandates include a 1996 law that banned the use of discriminatory annual and lifetime dollar caps in health plans for the treatment of mental disorders and legislation passed last year that requires employers that cover mastectomy to also cover reconstructive surgery on the same basis as other treatments.

"It has been legislation by body part," said Suzanne Mercure, a former benefit manager at Southern California Edison Co. and now a principal with health care consultant Barrington & Chappell in Falls Church, Va.

Helen Darling, practice leader-group benefits and health care for Watson Wyatt Worldwide in Stamford, Conn., said that, in the aggregate, benefit mandates have been a "kind of tinkering around the edges."

Few, however, would refer to those measures Congress passed regarding pensions, beginning in the early 1980s, as mere "tinkering."

Unlike ERISA, which is a participant-oriented law, many of the pension-related laws that followed in its wake were intended to gain revenue for the federal government. The government, because of a big tax-cut package approved in 1981, had begun to run up huge budget deficits.

"The deficit was large, and benefits were squeezed for revenue, not policy reasons," said Frank McArdle, a consultant with Hewitt Associates L.L.C. in Washington.

"Pension plans were where the money was," said Hartmarx's Mr. Pikelny.

In fact, from the early 1980s to the early 1990s, it became a near-annual ritual for Congress to pass tax legislation that, in the view of employers, made offering pension plans less and less attractive.

A 1982 tax law, for example, slashed the maximum benefit that could be funded through pension plans. In yet another instance, a 1986 tax simplification measure cut the amount of employee compensation that could be considered in calculating benefits, and a 1993 law further lowered the allowable level of compensation.

At the same time that some in Congress came to see pension plans as sources of revenue, some staffers also viewed the plans as vehicles largely intended to provide benefits to top-paid employees at the expense of the rank and file. To combat this situation, several laws were passed that created extremely complex non-discrimination tests for pension plans, particularly for defined benefit plans.

"There was a real witches' brew. First, there was a need for revenue. Then, there was some congressional staff arrogance and a perception that employers weren't to be trusted. Out of that came a real devilish mix," said Kyle Brown, an attorney with Watson Wyatt Worldwide in Bethesda, Md.

Many employers reacted to that unwelcome mix by dumping their defined benefit plans. In 1982, just before the big congressional attack on pension plans commenced, employers sponsored about 100,000 defined benefit plans. Today, the number has fallen to about 40,000.

With ever-more complex rules and a reduced ability to fund larger benefits, "companies say it isn't worth it. That has led to a decline in defined benefit plans," said Avon's Ms. Miklatek.

But it is possible that the pendulum may be swinging back. In 1996 and 1997, Congress passed measures that cut, to a limited degree, the red tape associated with running both defined benefit and defined contribution plans.

Congress also passed legislation this year to further simplify plan administration and boost the level of benefits that can be funded through the plans. President Clinton, though, for reasons largely unrelated to the pension provisions, vetoed the bill.

Still, those pension reform proposals are certain to come back, and some are optimistic that a more friendly attitude toward employee benefits is emerging in Congress.

"There is now a much greater recognition of how important these plans are and the need to improve retirement savings," Mr. Saveth said. BI

Milestones in U.S. benefits legislation from ERISA to the present

1974: Employee Retirement Income Security Act
- Establishes participation, vesting and funding standards for pension plans.
- Establishes the Pension Benefit Guaranty Corp.
- Establishes fiduciary standards for pension plan sponsors.
- Pre-empts state laws and regulations that relate to employee benefit plans.

1976: Tax Reform Act
- Gives tax-favorable status to prepaid legal plans.

1978: Age Discrimination in Employment Act
- Increases to 70 from 65 the age at which employees can be forced to retire.

Revenue Act
- Sets the legal basis for 401(k) plans.
- Allows employers to offer non-taxable benefits through flexible benefit plans.
- Gives employer-provided educational assistance benefits tax-favored status.

Pregnancy Discrimination Act
- Requires coverage of pregnancy/childbirth to be same as other medical conditions.

1980: Multiemployer Pension Plan Amendments Act
- Requires employers withdrawing from underfunded multiemployer pension plans to pay for a share of the plan's unfunded liabilities.

1981: Economic Recovery Tax Act
- Allows employees in pension plans to make up to $2,000 in annual IRA contributions.
- Gives tax-favorable status to dependent care benefits.

1982: Tax Equity and Fiscal Responsibility Act
- Drastically reduces maximum benefits that can be funded through retirement plans.
- Makes employer health plans primary payer of medical bills for workers age 65-69.
- Sets new rules for "top-heavy" pension plans.

1983: Social Security Amendments Act
- Imposes Social Security payroll taxes on 401(k) salary deferrals.
- Requires non-profit employers that withdrew from Social Security to return.
- Bars state/local governments from leaving Social Security, but doesn't force a return.
- Increases to 67 from 65 the age at which retirees can get full Social Security benefits.
- Accelerates Social Security payroll tax hike and partially taxes Social Security benefits.

1984: Deficit Reduction Act
- Subjects to federal taxes the investment income earned on assets held by Voluntary Employee Beneficiary Assns. for retiree health care liabilities.
- Imposes limits on tax-deductible contributions made to VEBAs.
- Makes employer health plans primary payer of medical bills to spouses 65 and older.

Retirement Equity Act
- Lowers to 18 from 22 the age at which employers must give vesting credit to employees.
- Cuts to 21 from 25 the minimum age at which a worker can join a pension plan.
- Employees waiving joint/survivor benefits must obtain written consent from spouse.

1986: Consolidated Omnibus Budget Reconciliation Act
- Requires employers with at least 20 employees to offer health care continuation coverage to former employees and their dependents.

Single Employer Pension Plan Amendments Act
- Closes certain loopholes that enabled employers to terminate underfunded pension plans and shift liabilities to the Pension Benefit Guaranty Corp.
- Raises to $8.50 per participant from $2.60 the annual PBGC employer premium.

Tax Reform Act
- Cuts to $7,000 from $30,000 maximum annual employee deferrals to 401(k) plans.
- Sets tougher non-discrimination tests for 401(k) plans.
- Establishes new non-discrimination, vesting and integration rules for pension plans.
- Sets non-discrimination rules—Section 89—for group health and other welfare plans.
- Imposes additional taxes on retirement distributions taken before age 59½.
- Sets income limits for tax-deductible IRA contributions by employees in pension plans.

Omnibus Budget Reconciliation Act
- Requires pension benefit accruals for employees who work after retirement age.
- Makes employer health plans primary payer of medical bills for disabled employees and dependents eligible for Medicare.

1987: Pension Protection Act
- Raises PBGC premium to $16 per participant and establishes a variable-rate premium structure for underfunded plans.
- Strengthens pension funding requirements.

1988: Family Support Act
- Directly offsets employees' dependent care expenses eligible for federal tax credits by the amount an employee contributes to a dependent care flexible spending account.

Health Maintenance Organization Amendments
- Repeals rule that employers must offer an HMO if properly approached by plan.
- Grants federally qualified HMOs new flexibility in setting rates.
- Liberalizes rules governing employer premium payments to federally qualified HMOs.

Technical and Miscellaneous Revenue Act
- Reduces penalties for COBRA continuation coverage errors.
- Imposes 15% excise tax on pension plan reversions.

Medicare Catastrophic Coverage Act
- Expands Medicare benefits to cut participants' exposure to out-of-pocket expenses.
- Adds new prescription drug benefit.
- Imposes new taxes on retirees to pay for the expanded Medicare benefits.
- Requires employers to return savings from cutting benefits that duplicate Medicare.

1989: Joint Resolution Increasing Statutory Limit on Public Debt
- Repeals Section 89 non-discrimination rules.

Medicare Catastrophic Coverage Repeal Act
- Repeals 1988 Medicare expansion law.

Omnibus Budget Reconciliation Act
- Allows disabled employees to purchase COBRA continuation coverage for 29 months.
- Allows workers in a new health plan to retain COBRA cover for pre-existing conditions.

1990: Omnibus Budget Reconciliation Act
- Raises PBGC flat and variable-rate premiums.
- Raises to as much as 50% the excise tax on pension plan reversions.
- Allows transfer of some surplus pension assets to special retiree health care accounts.

Older Workers Benefits Protection Act
- Employees accepting early retirement incentives must waive right to sue for age bias.

Americans with Disabilities Act
- Bars employment discrimination on the basis of disability.
- Employers must provide reasonable accommodation for employees with disabilities.

1991: Civil Rights Act
- Allows employees to seek punitive and compensatory damages for job discrimination.

1992: Unemployment Compensation Amendments Act
- Allows a terminating employee to directly transfer lump-sum pension distributions to a new employer's pension plan, if the new employer permits such transfers.
- Levies 20% tax on distributions not directly transferred to IRA or new employer plan.

1993: Family and Medical Leave Act
- Requires employers with at least 50 employees to offer employees up to 12 weeks of job-protected unpaid leave to take care of family medical situations.
- Requires employers to continue health coverage during FMLA leave.

Omnibus Budget Reconciliation Act
- Cuts to $150,000 compensation than can be used to calculate pension benefits.
- Increases to 85% from 50% amount of retiree Social Security benefits subject to tax.
- Requires employers to provide government with data on all health plan participants.

1994: Uniformed Services Employment and Reemployment Rights Act
- Requires employers to allow employees called up for military duty to make retroactive contributions to 401(k) and other savings plans when they return.

Retirement Protection Act
- Significantly raises premiums employers with severely underfunded plans pay PBGC.
- Sets new interest rate and mortality assumptions for valuing pension plan liabilities.
- Tightens pension funding rules.

1996: Health Insurance Portability and Accountability Act
- Curbs use of pre-existing medical condition exclusions in group health plans.
- Establishes pilot programs for tax-favored medical savings accounts.
- Provides limited tax breaks for long-term care insurance premiums.

Medicare and Medicaid Coverage Data Bank Repeal Act
- Repeals 1993 law requiring employers to provide data on all health plan participants.

Mental Health Parity Act
- Bars health plans from offering lower limits for mental illness than physical disorders, but exempts employers if mandate boosts their health care costs by at least 1%.

Newborns' and Mothers' Health Protection Act
- Requires health plans to offer at least 48 hours of inpatient coverage after a normal vaginal delivery and 96 hours of coverage after a Caesarean section.

Small Business Job Protection Act
- Eases definition of highly compensated employees for 401(k) non-discrimination test.
- Allows employers to use prior-year 401(k) deferrals by non-highly compensated employees in non-discrimination testing.
- Allows tax-exempt employers to offer 401(k) plans.
- Eliminates five-year income averaging for pension plan lump-sum distributions.

State Source Taxation
- Bars states from taxing pension benefits of former state residents.

1997: Balanced Budget Act
- Allows private health plans to offer coverage to beneficiaries opting out of Medicare.
- Sets new rate schedule for health plans providing coverage to Medicare beneficiaries.
- Makes employer plan primary payer of end-stage renal disease claims for 30 months.

Taxpayer Relief Act
- Allows employers to cash out terminating employees whose pension benefits have a present value of $5,000 or less.
- Eliminates requirement that employers distribute summary plan descriptions and summaries of material modifications to employees.
- Requires government to issue rules to expand paperless administration of benefits.

1998: Internal Revenue Service Restructuring and Reform Act
- Bars rollovers of hardship distributions from 401(k) plans to IRAs.

Women's Health and Cancer Rights Act
- Requires health plans that cover mastectomy to provide coverage for reconstructive surgery and to notify participants in writing of the coverage. BI



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Workers comp system has benefited employers

By MEG FLETCHER and JOANNE WOJCIK KOCHANIEC

After nearly nine decades, employers fare better under the state-based workers compensation system than do workers, industry sources say.

According to these national experts, if a report card were issued to grade how well states' workers compensation programs met employers' fundamental goals, the state system would earn a "B+."

Conversely, if the individual members of the group were to grade how well the state programs met workers' goals, these same experts would give the state system a wide range of grades from "A" to "F."

The varying assessments give some indication of the tensions that exist between employers and workers in regard to the workers comp system.

Areas of disagreement between the two groups range from recent issues, such as the newly proposed federal guidelines for ergonomics programs, to the responses of workers comp programs to economic, medical and social developments. since the system started.

The nation's first workers comp program began in 1911. At that time, the U.S. economy was in transition; declining numbers of people were farming or creating handcrafted goods, and more were employed in manufacturing.



Crowded, unsafe factories created conditions in which many workers were maimed or killed. Sometimes these tragedies led to reforms. In 1911, a fire at the Triangle Shirtwaist Co. factory in New York killed 146 workers, mostly immigrant girls, and prompted the passage of improved worker protection and fire safety laws.

While several states considered legislation to create workers comp programs, Wisconsin was the first state to implement such a program in 1911. Most other states, including New York, put workers comp programs into effect soon afterward, though Mississippi waited to do so until 1949.

The state-based origin of the workers comp system is no accident. A national program had been precluded until the U.S. Supreme Court changed its interpretation of the Commerce Clause of the Constitution in the 1930s, said John F. Burton Jr., dean of the School of Management and Labor Relations at Rutgers University in New Brunswick, N.J.

Initial exceptions to that rule included somewhat similar national compensation programs that were established in 1906 for railroad workers, in 1908 for some federal employees and in 1927 for longshoremen.

Later national efforts included the 1969 creation of federal compensation programs for coal miners with black lung ailments and, in 1972, voluntary national standards for the state workers compensation programs themselves.

The state-based workers comp system was designed as a no-fault trade-off between employers' and workers' rights.

A primary goal of state-based workers comp "was to get the litigation out of the system," said Lucille "Lucky" Gallagher. Ms. Gallagher, a former risk manager who served as a president of the Risk & Insurance Management Society Inc., is now an independent risk management consultant.

Workers comp's creators sought "a system that would take care of the medical and rehabilitative needs of the worker and get the person back to productive work whenever possible, and to pay a reasonable wage loss during that recovery period and then fairly compensate for a true disability or an inability to perform gainful employment," Ms. Gallagher said.

The system was designed to make workers comp the exclusive remedy for most job-related accidents and illnesses that were not intentional torts. As such, it gave employers immunity from tort suit liability, as well as immunity from non-economic and punitive damages.

The underlying economic principle was that employers, with the help of insurance purchased at a predictable cost, would meet their ethical and moral obligations to workers who were injured at their jobs. Employers' costs would then be passed on to society through the price of goods and services sold to consumers.

From employers' perspective, the system has worked well, as they have generally been immune from tort suit liability through the state laws that make workers comp the exclusive remedy for workers' job-related accidents or illnesses, said Eric Oxfeld, president of UWC Inc., a Washington-based national business coalition that lobbies on workers comp and unemployment issues.

Employers also have typically been able to find affordable and predictable coverage, except for a short insurance crisis about a decade ago, pointed out Nancy Schroeder, assistant vp-workers comp for the National Assn. of Independent Insurers in Des Plaines, Ill.

In return for most workers losing the right to seek potentially broader compensation through the courts, employers agreed to generally pay the costs associated with job-related injuries and illnesses, without regard to fault. Costs covered by an employer include full medical expenses and a substantial portion of a worker's wage if he or she is recuperating from a short-term injury. If an injury is permanent, workers receive an award based on the percentage of disability they experience as a result of the injury.

A secondary goal was to encourage workers to return to their jobs, which might then result in the termination of most types of wage-loss payments.

But when it comes to compensating injured workers, state workers comp programs typically have not worked as well for employees as they have for employers, national experts agree. Several studies, including one by the California-based Rand Institute, have raised questions about the adequacy of benefits for many injured workers, especially those with permanent partial impairments.

In addition, the lobbying by employers and insurers of some state legislators has tended to hold down benefit increases and to narrow the definition of compensable injuries, said James Ellenberger, assistant director for the AFL-CIO's department of occupational safety and health in Washington.

Several experts give states mixed reviews in addressing the problem of occupational illnesses. Some states have tightened compensation eligibility criteria by recognizing pre-existing conditions.

The fundamental concepts behind the workers comp system have endured for nearly 90 years, but the system has experienced significant changes.

In the early 1970s, there was general agreement in the workers comp community that benefits had to be improved, especially to avoid the explicit threat of mandatory federal standards for state-based comp programs.

The 1970 Occupational Safety and Health Act, which established the federal oversight agency, also established the National Commission on State Workmen's Compensation Laws. The commission's 1972 report encouraged states to improve benefits and operational procedures by adopting 19 essential recommendations, according to Rutgers' Mr. Burton, who chaired that group. The recommendations included benefit increases, extending the statute of limitations for injury compensation and interest payments for delayed benefits.

Adoption of the recommendations resulted in higher claim costs, which exacerbated the difficulties employers had finding affordable coverage in the mid-1980s and early 1990s.

Several factors led to the imbalance, said Peter Burton, senior division executive for state relations at the National Council on Compensation Insurance branch office in Wayne, Pa.

Among them were excessive system costs caused by "a combination of very high medical costs, the fact that fraud statutes were not in place and there were a lot of claims filed that perhaps shouldn't have been," he said. In addition, "the administration of the state systems probably didn't have the right amount of money or talent or infrastructure to appropriately handle workers compensation claims, and there was excessive attorney involvement."

Since then, the imposition of legislative changes that have controlled compensability and, generally, have reduced both benefits and the incidence of fraud have helped state workers comp programs reduce costs.

Today, as a result of the numerous workers comp laws enacted around the country earlier this decade, workers compensation loss costs are, on average and adjusted for inflation, 25% lower than those of the early 1990s, when costs were at their peak, the NCCI's Mr. Burton said.

Now, however, the market for workers comp coverage is being unsettled by fierce competition among insurers, despite the rising loss ratios for employers.

Perhaps one of the most successful movements in workers comp is directed toward changing society's laissez-faire attitudes about insurance fraud, according to Gary Countryman, president of Liberty Mutual Group in Boston.

Overall, "I think, on balance, today the system is meeting its goals fantastically," Mr. Countryman said.



Other observers are not so satisfied.

"Our concern is that those three primary groups—the employer, the employee and the consumer—aren't benefiting from the system today," said Steve Bent, executive director of the Texas Assn. of Responsible Nonsubscribers. "We hear estimates of the $70 billion to $100 billion dollar-plus industry, and the workers still are not getting adequate benefits, in many cases, and employers are paying very high premiums."

"We need to go back and realize the comp system was created to address problems that occurred at the turn of the last century. We ought to not look at the system per se, but look at the goal—protecting workers and providing benefits," Mr. Bent said.

"The system has been forced to do more than it was originally designed to do," said Mark DeLillo, a former president of the Risk & Insurance Management Society Inc. and vp-risk management at Celotex, a building material manufacturer in Tampa, Fla.

In seeking solutions to the system's problems, policymakers and state workers comp administrators are increasingly relying on research data.

The Cambridge, Mass.-based Workers Compensation Research Institute has been researching several workers comp-related issues for the past several years in an effort to provide objective data that can be used to compare systems and educate policymakers about the consequences of proposed changes.

And the International Assn. of Industrial Accident Boards & Commissions plans to establish a repository of international data about workers comp programs that can be used for benchmarking and making comparisons.

The goal of state workers comp administrators is to keep the playing field level for all workers comp shareholders—employers, workers, insurers and attorneys, said Jamie Beletz, executive director of the IAIABC in Lawrence, Kan. The administrators also strive to see that benefits and services are provided within the framework of individual states' laws, Mr. Beletz said.

While employers and workers can be expected to have different perspectives regarding the performance of states' workers compensation programs, they do have some common views.

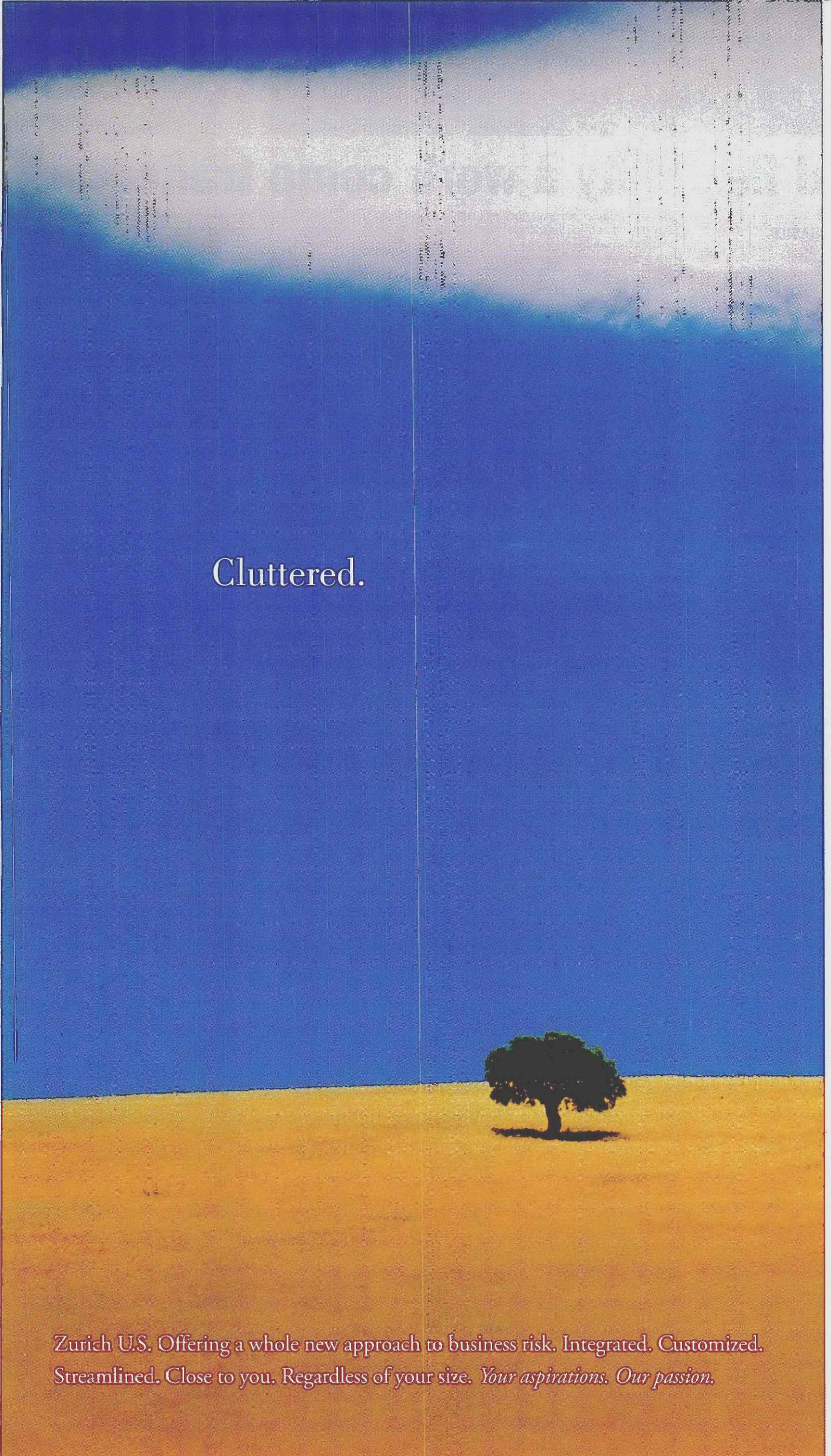
To begin with, "the great bulk of injured workers get compensation pretty readily," said Rutgers' Mr. Burton. Typically, such cases are not controversial and are of a short duration.

When controversial claims do emerge, employers and workers both would like to see the workers comp system return—theoretically, at least—to its no-fault roots. That would reduce the amount of litigation that drives up costs for employers and workers alike.

And both employers and workers are pleased that workplaces are getting safer, according to federal statistics.

For example, the number of fatal work injuries fell 3.5% to 6,026 during 1998, the last year for which complete statistics were available from the U.S. Department of Labor's Bureau of Labor Statistics.

That is the lowest count since the bureau began counting fatal occupational injuries in 1992. BI



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States find flexibility a work comp trademark

By MEG FLETCHER and JOANNE WOJCIK KOCHANIEC

The workers compensation system in the United States has always allowed for diversity and experimentation when it comes to the ways employers finance their liability for workers' job-related medical and wage-loss claims.

One state even lets employers opt out of the workers comp system entirely, though some critics claim that situation is unfair to workers.

Nationwide, nearly all states require employers to have workers comp coverage for most of their workers, although agricultural workers frequently are excluded. Texas is the only state to permit employers to operate with neither workers comp coverage nor any other insurance coverages that could be tapped on behalf of a worker who has been killed or injured.

Workers comp premiums are typically based on experience-rating calculations that take into account an employer's type of work, as well as the company's previous loss history.

Depending on the state involved, employers may fund their workers comp liabilities by:

- Buying insurance coverage from private insurers or competitive state funds.

During the last century, workers comp markets have become increasingly competitive, as state insurance regulators, attempting to hold down employer costs, have shifted their emphasis to competitive rating from administered pricing. The growing trend among employers toward purchasing policies with large deductibles has also helped control costs.

Some states also have competitive state funds, which compete with private insurers and help keep rates low. Such competitive state funds also may act as residual markets for their states, writing coverage for those employers whose businesses are too new, too risky or too unsafe to obtain coverage from private insurers. In other instances, states operate separate residual markets.

- Buying insurance coverage from exclusive state funds, such as those that operate in Ohio, North Dakota, Washington, West Virginia and Wyoming.

Nevada had an exclusive fund until the fund changed its status, becoming a competitive state fund in July 1999. The fund is scheduled to become a private mutual insurer in the future.

- Negotiating alternative workers comp systems, often with construction-related unions. Under such a carve-out program, an employer may, for example, cover benefits above a legal minimum in exchange for requiring its workers to use an approved network of doctors or to accept alternative dispute resolution.
- Self-insuring their workers comp exposure, either individually or in groups. Nationally, about one-third of all employers are self-insured. Typically, state officials require a self-insured employer to demonstrate its future financial ability to pay the claims of injured or ill workers.

In addition, more than half the states have established guaranty funds to help ensure that workers are not left stranded when self-insuring employers go bankrupt.

A few states, however, do not require employers to have workers comp coverage for most employees.

Currently, Texas is the only state that permits employers to voluntarily participate in the system, according to a spokesperson for the International Assn. of Industrial Accident Boards & Commissions in Lawrence Kan.

Because employer members of the Texas Assn. of Responsible Nonsubscribers do not participate in the workers comp system, they are subject to civil liability when their employees are injured on the job, according to Steve Bent, executive director of the association.

The Texas opt-out program, which has existed since 1913, hasn't been very beneficial to workers, contends Margaret Maisel, former chairwoman of the Texas Industrial Commission and a plaintiffs attorney based in San Antonio.

"In the past, if an employee could show the employer was negligent, he or she would have some recovery," Ms. Maisel said.

Without a workers comp exclusive-remedy system, employees in Texas now must sue for damages when injured. Damage awards resemble those granted in regular tort cases; they include awards for medical expenses, lost wages and pain and suffering.

But under a case currently before the Texas Supreme Court, that situation may change. In *Kroger vs. Keng*, the court may rule that a standard of comparative negligence should be used to allocate the responsibility for an injury between the worker and the employer, Ms. Maisel said.

Further exacerbating the situation for injured workers in Texas is that many small employers that don't carry workers comp insurance simply file for bankruptcy when hit with big lawsuits for injuries, she said.

And large corporations often place their various assets in numerous holding corporations, making it harder for workers to pierce the corporate veil, she added.

The system also is a deterrent to those small employers that try to be responsible by buying workers comp insurance; in effect, such employers pay twice, Ms. Maisel said.

"First they pay their work comp insurance premiums, and then they pay through their taxes the welfare benefits for the injured employees of the employers that don't buy comp," she said.

Other states have implemented or have considered opt-out programs similar to that in Texas, according to the IAIABC.

New Jersey also allows employers to opt out of the workers comp system, although those employers that do are required to have other forms of insurance, an IAIABC spokeswoman said.

Initially, workers comp insurance also had been optional for employers in South Carolina, although that option was eliminated by a change in the law in mid-1996, according to the IAIABC spokeswoman. BI

Workers comp system has been a work in progress

1884: Germany passes first legislation to provide compensation to workers injured on the job, followed shortly thereafter by similar measures in Austria, Finland and Norway.

1897: Great Britain enacts legislation that becomes the prototype for U.S. workers compensation statutes.

1906: Congress enacts the Federal Employers' Liability Act for railroad employees, which is based on comparative negligence and reflects the transition from common law remedies to those based on workers comp no-fault laws. FELA does not require overcoming the defenses of contributory negligence, assumption of risk or fellow-servant liability.

1908: Congress establishes the Federal Employees' Compensation Act which provides workers comp coverage to all federal civilian employees in unusually risky jobs; the act is subsequently expanded to benefit most federal civilian employees.

1911: Wisconsin becomes the first state in United States to establish a state workers compensation system to protect most of the state's workers.

New Jersey and Washington put into effect similar workers comp legislation later in the year. As part of its measure, New Jersey introduces the first schedule of benefits for permanent partial disability claims.

New York's Legislature approves workers comp legislation in early 1911, but it is overturned by a state court one day before the March 25 fire at the Triangle Shirtwaist Co. The blaze results in the deaths of 146, primarily immigrant girls, many of whom jump to their deaths to escape the fire. Family members of many victims of the fire receive no benefits; other families sue the employers and receive about $75 each.



1912: Workers comp legislation becomes effective in Massachusetts, Michigan, New Hampshire, Ohio and Rhode Island.

1913: Workers comp legislation becomes effective in Illinois, Minnesota, Nevada, Texas and West Virginia. Texas law allows employers to opt out of the system; the opt-out program remains in effect today.

1914: The International Assn. of Industrial Accident Boards and Commissions is established to represent the administrators of workers compensation systems.
Workers comp legislation becomes effective in Connecticut, Iowa, Maryland, Nebraska, New York and Oregon.

1915: Workers comp legislation becomes effective in Alaska, Hawaii, Indiana, Louisiana, Montana, Oklahoma, Vermont and Wyoming.

1916: Workers comp legislation becomes effective in Kentucky, Maine and Pennsylvania.

1917: The U.S. Supreme Court rules in *New York Central R.R. vs. White* that states can legally require employers to provide compensation to injured workers. In the wake of this ruling, nearly all states revise their laws to make workers compensation mandatory.
Workers comp legislation becomes effective in South Dakota and Utah.

1918 - 1919: Workers comp legislation becomes effective in California (1918), Delaware (1918), Idaho (1918), Colorado (1919), North Dakota (1919), Tennessee (1919) and Virginia (1919).

1920-1930: Workers comp legislation becomes effective in Alabama (1920), Georgia (1921), Arizona (1925), Missouri (1926), Kansas (1927), the District of Columbia (1928), New Mexico (1929) and North Carolina (1929).

1927: Congress enacts a compulsory federal compensation law for longshoremen and harbor workers after the Supreme Court rules such workers are governed by admiralty law and, therefore, are not subject to state workers comp statutes.

1930-1950: Workers comp legislation becomes effective in Florida (1930), South Carolina (1935), Arkansas (1940) and Mississippi (1949)

1952: Duke University professor Arthur Larson's award-winning treatise "Laws of Workmen's Compensation," is published. In it Mr. Larson creates the first comprehensive framework for analyzing and understanding workers comp cases and laws, which all parties to the system still use today.

1968: A coal mine explosion on Nov. 20 in Farmington, W.Va., kills 78 miners. The tragedy prompts the creation of the federal Coal Mine Health & Safety Act the following year. The act strengthens mine safety standards and establishes a federal program to compensate victims of pneumoconiosis, or black lung disease.

1970: Congress passes the Occupational Safety and Health Act which creates dozens of new workplace health and safety regulations that pre-empt state safety programs. The legislation also forms a federal agency--the Occupational Safety and Health Administration--to enforce those rules and creates a national commission to study workers comp programs and recommend improvements.

1972: The National Commission on State Workmen's Compensation Laws issues its report. The commission, appointed by President Nixon, finds state comp systems "inadequate and inequitable," and makes 84 recommendations concerning the coverage of employees and diseases, income protection, medical care, worker safety and program administration.

1979: Florida adopts a wage-loss approach as the primary basis for compensating injured permanent partial disabilities, in lieu of scheduled and non-scheduled payments for permanent partial disability injuries, though the state later enacts further changes to its compensation system.

1983: The Workers Compensation Research Institute is organized primarily by employers and insurers to conduct research in a broad range of areas that affect the workers comp community.

1989: Florida passes legislation that makes it the first state to allow employers to implement pilot programs providing 24-hour coverage. Several states grant similar authorization, but employers are slow to adopt the programs.

1990: Federal lawmakers approve the Americans with Disabilities Act which, when implemented, raises many new issues concerning treatment of pre-existing conditions and disabilities in the workers comp system.

1991: A blaze at the Imperial Food Products Co. a chicken processing plant in Hamlet, N.C., kills 25 and injures 55, because, in part, of locked doors and a lack of fire alarms and sprinklers. Five years later, as part of the commemoration of its 25th anniversary, OSHA gives to the Smithsonian Institute one of the plant's exit doors, which bears the footprints of workers who tried to kick it open to escape the fire.

1999: OSHA issues proposed ergonomics safety standards.

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Lloyd's history intertwined with America's

By CAROLYN ALDRED
and EDWIN UNSWORTH

Lloyd's of London's long relationship with American businesses has been marked by more than 150 years of growth and innovation.

While Lloyd's has been doing business in America for less than half of its 311-year existence, the U.S. market today is the largest overseas source of business for Lloyd's, accounting for nearly one-third of its total premiums.

Premiums, losses and capital from U.S. entities have helped make Lloyd's the institution it is today. Early in the 20th century, payment of claims from the San Francisco earthquake and fire boosted the market's reputation. Huge losses from industrial liabilities in the 1980s led to a radical restructuring of Lloyd's, but the influx of U.S. corporate capital in the late 1990s has helped revive the market.

The history of Lloyd's in America is dotted with achievements that have helped shape the insurance market—as well as U.S. businesses—and that continue to do so, according to underwriters.



Beginnings

In the late 1600s, as the British colonies were busy cultivating their economies, clients at Edward Lloyd's coffee house on London's Tower Street were exchanging news of shipping and shipping-related services. These wealthy individuals who grouped together to cover the potential loss of ships and cargo were laying the foundation of Lloyd's. As each signed his name one beneath the other on the policies, they became known as "underwriters."

The coffee house continued to be a center for marine insurance, and by the end of the 18th century, the underwriters had elected a committee and moved to their own premises in the Royal Exchange.

By 1840, the United States and Canada had become important sources of marine business for Lloyd's underwriters. Indeed, then-Chairman George Robinson spent five months visiting the United States and Canada that year, traveling up and down the eastern seaboard, according to Lloyd's.

The Society of Lloyd's was incorporated by Lloyd's Act 1871, and by the turn of the next century, Lloyd's had become a major force in non-marine insurance as well.

Early in the 20th century, Lloyd's aided U.S. economic development through underwriting support for a wide variety of risks, both directly and as a reinsurer.

And Lloyd's provided coverage to more than just the new manufacturing companies and expanding U.S. insurance industry. In addition, a growing number of art collectors, many of them leading U.S. industrialists, also turned to Lloyd's to insure their collections. Even saloon keepers bought Lloyd's coverage against claims arising from rowdy customers, according to Lloyd's.



A history of innovation

From these early developments have come some lasting results.

From developing vital excess-of-loss catastrophe coverage for earthquakes and hurricanes; to reinsuring medical malpractice mutuals; supplying satellite, aviation and marine insurance; insuring against rogue traders in Wall Street; and even covering actress Betty Grable's legs—prompting her nickname as "the girl with the million-dollar legs"—Lloyd's

successful economy.

Underwriters and market executives agree that innovation, stemming in part from its history in North America, remains one of the Lloyd's market's chief strengths today.

It is only during the past few decades that Lloyd's has kept records of the geographic source of its funds, but in those early years the United States would have represented only a relatively small source of income for Lloyd's syndicates. Today, the United States represents approximately a third of the market's annual premiums of £7 billion ($11.37 billion), lagging only slightly behind its principal market, the United Kingdom.

"The U.S. is, without any question and without any real competition from any other country, the largest overseas territory," according to Darragh Gray, London-based regional executive at Lloyd's for North America.

Lloyd's annually underwrites more than $4 billion of U.S. direct insurance—mainly on a surplus lines basis, including offshore energy and pollution liability—and reinsurance business. In surplus lines, it writes more premium annually than any single domestic U.S. company. And in certain surplus lines, such as pollution insurance for offshore production and exploration facilities, Lloyd's is the U.S. market leader. In addition, Lloyd's is a leading provider of reinsurance for U.S. risks.

Lloyd's underwrites 19% of U.S. surplus lines business, 5% of U.S. reinsurance, and 11% of U.S. directors and officers liability coverage, according to Mr. Gray.

Although Lloyd's began writing U.S.-originating marine risks more than 150 years ago, it was during the 1880s that Lloyd's began covering a wide range of risks beyond marine insurance.

An early innovator

The individual most closely associated with making Lloyd's a major name in the U.S. insurance community is Cuthbert Eden Heath.

He was born in 1859 into a prosperous family—his father became an admiral and earlier members of the family had been members of the Royal Academy and lawyers. When a hearing impairment prevented Mr. Heath from entering the navy or the civil service, he went to work at Lloyd's.

At age 17, Mr. Heath started as a junior clerk at Messrs. Henry Head & Co., a firm of Lloyd's underwriters and brokers. By 1880, when he was 21—the minimum age for becoming an underwriting member of Lloyd's—Mr. Heath became a member with the help of a £7,000 ($11,370 at the current exchange rate) loan from his father.

His subsequent rise was rapid. The next year he began underwriting for himself on a syndicate of three financial backers, known as names. By 1883, he had founded the brokerage company that still bears his name, Heath Group P.L.C.

Heath recently announced an agreement to merge with Lambert Fenchurch Group P.L.C. to become HLF Insurance Holdings Ltd., which will be one of the world's five largest brokerages based on gross revenues.

Mr. Heath's success resulted from his innovation, and it was this brand of originality as an insurer and broker that helped make Lloyd's so successful in the United States, according to Lloyd's and a 1980 biography, "Cuthbert Heath: Maker of the Modern Lloyd's of London," by Anthony Brown.

It was largely Mr. Heath's doings that led Parliament to pass a new Lloyd's Act in 1911, expanding the scope of the insurance market from merely "the business of marine

Mr. Heath's firsts at Lloyd's include non-marine reinsurance treaty, a loss-of-profits element in fire policies, contents insurance, an all-risk policy for jewelry, jewelers' block insurance, workers compensation insurance and bankers blanket bonds. Cuthbert Heath also underwrote the first risk based on American soil at Lloyd's, when, in the late 1880s, he arranged a reinsurance treaty for the U.S. branch of an English company, according to Lloyd's.

Mr. Heath was also responsible for singlehandedly boosting Lloyd's reputation in the United States through his handling of claims from what was one of the country's most costly insurance disasters, the San Francisco earthquake and fire.

The Heath syndicate was a leader in earthquake insurance at Lloyd's and so had heavy exposure to the disaster. One of the problems at the time was that there were some policies covering fire only, others earthquake only, and others still covering fire if caused by earthquake. Many insurers disputed claims on the grounds that they originated from causes not covered.

Mr. Heath dispensed with any such excuses. According to his biography, he simply cabled his agent in San Francisco: "Pay all our policyholders in full irrespective of the terms of their policies."

One of Mr. Heath's most important contributions to the market was his introduction of the notion of excess-of-loss coverage. Shortly after the San Francisco earthquake, The Hartford Fire Insurance Co. sent representatives to London from Connecticut to see whether Mr. Heath could help protect the insurer against losses from a recurrence of the quake. Mr. Heath's solution was excess-of-loss cover, whereby the direct insurer would pay reinsurance premiums only for losses above an agreed figure, up to an upper limit. Thus the loss was spread both "horizontally" among different underwriters and "vertically" so that neither the direct insurer nor any reinsurer was exposed to too great a loss.



Growth in the U.S. market

Helped by a boost to its reputation and by a booming U.S. economy, the next forty or so years proved mainly a boom time in America for Lloyd's. That time also gave rise to imitators, as well as others trying to cash in on the good reputation of Lloyd's. In 1892, New York state passed a new law making it difficult for companies to fraudulently use the Lloyd's name. The day before the law was enacted, 30 companies registered under the Lloyd's name in New York, said Mr. Gray of Lloyd's.

Lloyd's makes little of the fact that, in the United States, it is licensed only in Illinois and Kentucky and the U.S. Virgin Islands. Lloyd's is an eligible surplus lines insurer in all other states. Mr. Gray explained that this is "largely for historical reasons, rather than for any particular commercial purpose."

Historically, only approved brokers have had access to Lloyd's, and U.S. brokers wanting to place risks in the market have had to do so through an arrangement with such a broker. In October, however, Lloyd's proposed widening access to the market by foreign brokers.

Ties between Lloyd's and the United States were further strengthened when, in 1994, Lloyd's opened its doors to corporate membership, expanding its source of backing beyond the wealthy names who had supported the market since its inception. The market opened its doors to U.S. individual investors in 1968.

Corporate members now provide the lion's share of the market's capacity, and today more than 16% of that capacity

See Lloyd's, next page



Lloyd's

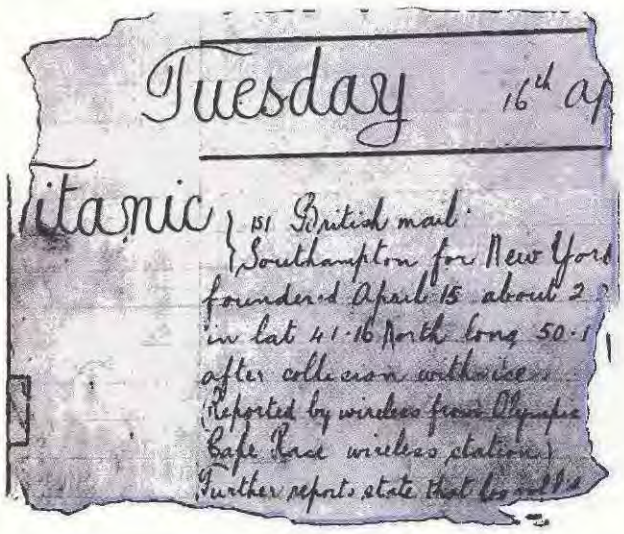
Continued from previous page
comes from the U.S. insurance industry. Another 13% of capacity comes from Bermuda.

"We expect this trend to continue and to see familiar names setting up shop at Lloyd's," says Mr. Gray. Among those already doing business at Lloyd's are State Farm Insurance Group, Chubb Corp. and Chubb Re.

Coverage when needed

Innovation, flexibility and continuity are cited by underwriters as the main strengths of Lloyd's, and its more than 150-year history with the U.S. market demonstrates these qualities.

"Lloyd's has always been innovative and has been very popular


Tuesday 16th ap
itanic 1st British mail:
Southampton for New York
foundered April 15 about 2
in lat 41·16 North long 50·1
after collision with ice
(Reported by wireless from Olympic
Cape Race wireless station)
Further reports state that

with U.S. risk managers who found flexible solutions to their problems at Lloyd's that they couldn't with their domestic insurers," said David Palmer, who was chairman and chief executive of Willis Faber P.L.C. before the 1990 merger that created Willis Corroon Group.

Mr. Palmer, who worked in the Lloyd's market from the 1950s to the 1990s, points to innovations made by Lloyd's underwriters in areas such as umbrella liability policies, professional indemnity, and D&O liability insurance.

"Lloyd's has always been seen as an innovative, solutions-driven marketplace," said James Weatherstone, deputy underwriter specializing in D&O for syndicate 861, which is managed by Brockbank Syndicate Management Ltd.

"Lloyd's has a very good history of writing D&O, which is a very sophisticated product. Lloyd's still has the third-biggest market share in the U.S. for D&O," he said.

Throughout most of the 20th century, Lloyd's has been one of the foremost markets for excess-of-loss reinsurance, surplus lines, and marine and aviation business, said Mr. Palmer.

Although competition from U.S. insurers and reinsurers in some of these areas has affected the Lloyd's market over the years, Lloyd's has remained willing to provide coverage at times when others are reluctant to do so, he noted.

Anthony Taylor, underwriting director for Wellington Underwriting Agencies Ltd., agreed that one of the Lloyd's market's great strengths is its ability to provide coverage when other underwriters shy away.

"The qualities of Lloyd's were demonstrated after the problems of Hurricane Andrew, when U.S. reinsurers were no longer keen to write catastrophe excess-of-loss reinsurance," said Mr. Taylor.

Lloyd's provided excess-of-loss capacity for the Florida windstorm pools and the California Earthquake Authority at a time when most others balked, he noted.

Lloyd's "generally is at the forefront of dealing with special problems as they arise," said Mr. Taylor, noting that the market's tradition of autonomous underwriters working in a market allows underwriters to respond quickly to situations and provide new solutions, wordings and policies.

Reinsurance is one area where Lloyd's has "always embraced product development," said Neil Maidment, treaty underwriter for syndicate 623, managed by Beazley Furlonge Ltd.

Lloyd's' response in the mid-1970s to the medical malpractice crisis in the U.S. is another example of the market's willingness to provide cover when others won't, according to Wellington's Mr. Taylor.

By 1975, increasing litigation by patients had led to doctors facing huge insurance costs. U.S. insurers began raising rates dramatically, with some even pulling out of the business. The doctors' response was to form their own medical malpractice mutuals.

But with no loss record and dire claims experienced by direct writers of medical malpractice liability insurance, the mutuals faced a major hurdle in buying reinsurance, according to Lloyd's.

By underwriting on a claims-made basis, however, the mutuals impressed Lloyd's underwriters, who agreed to reinsure them, according to Lloyd's.

Lloyd's remains an important reinsurance market for the doctors' mutual companies, particularly as the mutuals expand to offer new forms of liability coverage, such as errors and omissions, D&O, and employment practices liability insurance.

In another sector of health care coverage, Lloyd's, unlike many other reinsurers, is prepared to offer coverage for U.S. HMOs, according to a leading health care underwriter in the market.

"Many, many U.S. companies have pulled out of the HMO market because of losses over the last few years," said Merna Merrett, an underwriter with syndicate 2001, managed by Amlin Underwriting Ltd.

Lloyd's underwriters have a partnership with Centre Re in New York, part of the Zurich Financial Services Group, to provide cover for HMOs, explained Ms. Merrett, who specializes in writing international health care business.

Because Lloyd's underwriters did not write huge amounts of the business when it was rated poorly, they now are able to provide capacity that is desperately needed by clients, she pointed out, estimating that the majority of HMO accounts have been seen by Lloyd's during the last year.

Apart from its long tradition of providing cover when others won't, Ms. Merrett points to the market's flexibility in tailoring coverage as another of its assets.

A willingness to insure virtually anything—for the right price—has made the Lloyd's name famous throughout the world. Risks ranging from a circus elephant to a massive and complex oil platform have found coverage in the market.

In 1997, Lloyd's underwriters led the underwriting of the world's largest marine risk, assuming in total $1.19 billion of the $3.06 billion coverage program for the 600,000 ton Hibernia oil platform on its journey through Iceberg Alley, 200 miles off St. Johns, Newfoundland.

Most of the direct insurance business placed at Lloyd's for U.S. clients is written on a surplus lines basis, and varies from the disability coverage for an entire football team, to key man life insurance to kidnap insurance for a corporate executive.

In recent years, Lloyd's has developed "unauthorized trading" insurance to protect financial institutions against losses generated by rogue traders as well as, more recently, insurance for airlines to cover the costs and compensation incurred following an "air rage" incident.

"Lloyd's is unique in terms of underwriting and claims payment. Individuals have a tremendous amount of authority to



make decisions—they can put together a million-dollar contract on an envelope," according to Jeffrey Green, chairman of Aon Corp. subsidiary Asset Security Managers in London, which recently launched ASM Corporate Protection policy to cover the total costs of kidnap, ransom and extortion, including the loss of ransom in transit.

Longtime relationships

The unique position of Lloyd's underwriters, most of whom have a large financial stake as well as a management role in their syndicates, also allows for the development of long-term relationships with cedents, underwriters note.

Several dozen U.S. corporate property/casualty accounts have been in the Lloyd's market for 40 or 50 years, including major retail, manufacturing and heavy industrial companies, according to Jonathan Gray, global property underwriter for Beazley Furlonge syndicate 623.

These companies "have bought continuity in terms of pricing and underwriters," he said, pointing out that individual underwriters at Lloyd's often will handle an account, regularly meeting the client, for many, many years.

"There is much more continuity of people" at Lloyd's than policyholders would find with a conventional insurance or reinsurance company, agreed Mr. Taylor.

"U.S. clients will have seen the same underwriters for many years," said Mr. Taylor, adding that the U.S. market is Wellington's largest market, representing 40% of its total business. The agency owns a managing general agency in San Francisco, as well as five offices throughout the United States that hold binding authority for Wellington's combined 2020 syndicate.

"U.S. clients like the way Lloyd's underwriters do business. It is well tried and tested, and the relationships have stood the test of time," said Stephen Catlin, chairman of Catlin Underwriting Agencies Ltd.

In the reinsurance market, "a long-term relationship has developed between the London market and U.S. insurance companies which has proved valuable to both parties," said underwriter Mr. Maidment.

Many reinsurance accounts have been in the Lloyd's market for decades, he said, noting that the authority of Lloyd's underwriters



allows them to do business on a one-to-one basis with senior insurance executives and build up long-term relationships with client companies.

Reconstruction and renewal

Those relationships helped the Lloyd's market survive during the years of losses in the early 1990s, ensuing litigation by U.S. and other names and the market's Reconstruction and Renewal program.

"During R&R, there were very few clients who walked away from the Lloyd's market because of the strength of this relationship," said Mr. Maidment.

R&R, led by then-Chairman David Rowland, saved the market from potential ruin in the face of billions of dollars of losses, many stemming from the United States. Queen Elizabeth II knighted Mr. Rowland in 1997 for his role in rescuing Lloyd's.

The solution included transferring all pre-1993 liabilities into a new reinsurance vehicle, Equitas, which continues to pay legitimate claims. In addition, the program permitted—for the first time—corporate members of Lloyd's. As a result, many of the world's most prominent insurers and reinsurers, including many U.S. and Bermuda companies, now own stakes in Lloyd's syndicates.

Lloyd's reputation has increased since R&R, and more business now is being placed here, said Mr. Maidment.

"The restructuring of the Lloyd's market has been extraordinarily skillful and, as a result, Lloyd's continues and will always be a very important market," said Mr. Palmer.

R&R clearly demonstrated Lloyd's ability to "come up with creative solutions," said Wellington's Mr. Taylor.

Mr. Catlin agreed that Lloyd's has performed very well under pressure. Its R&R was a very significant and important restructuring that will be studied by business students for many years, he said. "It demonstrated what an extremely robust and resilient brand name Lloyd's has."

Looking ahead to the 21st century, underwriters predict that the United States will continue to be an important market for Lloyd's.

"In the future, I see the U.S. as a principal driver of our business. It will remain the principal economy of the world and have a high exposure to natural hazards," said Mr. Maidment.

Lloyd's Chairman Max Taylor summed up Lloyd's close links with the United States: "The U.S. is, by far, Lloyd's major overseas market, and I've no doubt that it will remain so.

"Over the years, we've built up many excellent relationships with U.S. brokers and clients. Our aim is to strengthen these relationships, to make it easier for U.S. producers to do business with Lloyd's, and to offer the diversity and choice that we know our U.S. producers want," he said.

"Predicting the future is always a risky business—but then Lloyd's is all about risk. As long as the U.S. needs access to our underwriting expertise and our unique structure, Lloyd's will have a major role to play," he said. BI

Iceman



There's nothing like a nice mild winter to cool an energy company's income. Which is why one of America's largest suppliers of natural gas asked Stuart Mercer how to insulate revenues from the effects of abnormally warm winters.

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Raging storms and devastating hurricanes. Early snow-melts and rising waters. Ever-changing weather patterns are making it harder for anyone to say, "A flood can't happen to me."

And those who think they won't suffer flood damage because they don't live near water or live on a hill could be in for a big surprise.

It's time for a serious conversation about the weather.

No one knows better than you do that beliefs and attitudes are slow to change. So the more you know the latest facts about floods, the sooner you can help your customers protect themselves before it's too late.

In the last few years, floods have hit all 50 states, making floods the Number One natural disaster in America.

In fact, last year, two out of three federally declared disasters were flood related, and almost 25% of all flood claims were in areas no one considered high risk.

National Flood Insurance. Smart for you. Right for your customers.

Offering National Flood Insurance not only protects you from Errors and Omissions exposure, but it also can keep you from losing the customer trust you've built up through the years. Do you really want to be the one to break the news to flood victims that the homeowner's policy you sold them doesn't cover flood damage?

And thanks to the Preferred Risk Policy for homeowners in low and moderate risk areas, flood insurance is easy for you to write and for your customers to afford.

Becoming a flood insurance expert is easy. Just call the NFIP.

The National Flood Insurance Program is ready to support you with everything from national and co-op advertising and lead programs to flood maps that help you determine flood risk zones and premium rates. Call today and get in on the fast-growing business of flood insurance.

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NFIP
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Worst catastrophes of the past 2000 years

Helping people and businesses cope with losses from natural disasters is a key reason for the existence of insurance.

Insurance played no role, however, in many of the worst disasters in history, while in other catastrophes, the high volume of claims ruined the fortunes of insurance companies and altered the course of the market.

Our list of the 50 worst natural disasters of all time displays total estimated losses, not just the insured toll from a disaster. To put this into perspective, consider 1992's Hurricane Andrew, which is the worst catastrophe in terms of insured losses at $17.95 billion. But in terms of overall losses, Andrew's estimated $30.48 billion in total losses comes in third behind the 1994 earthquake that rocked Northridge, Calif., and the quake that hammered Kobe, Japan, in 1995.

The earliest disaster on the list—the eruption of Mount Vesuvius—is included even though it is impossible to place a dollar figure on the damage caused when the Roman cities of Herculaneum and Pompeii were buried under as much as 100 feet of ash. Similarly, the New Madrid series of earthquakes is listed because of the massive damage caused by the powerful temblors, even though the area was not widely settled at the time.

This list is not limited to those disasters that created the most property damage; it also includes catastrophes that claimed the most lives. The worst of these are the 1931 and 1959 floods in China that each claimed millions of lives.

The following list does not attempt to rank these disasters relative to the others; however, readers will note the relative weighting toward disasters from the 20th century. This is partly because better information exists on more-recent catastrophes. But it also reflects the growth in property and people at risk from natural hazards, as well as what researchers say is an increased frequency and severity of natural disasters in recent decades.

•

Sources: Munich Reinsurance Co.'s Geoscience Research Group's World Map of Natural Hazards; Swiss Reinsurance Co.'s sigma reports; National Oceanic & Atmospheric Administration's National Hurricane Center; World Health Organization; Insurance Information Institute; World Almanac & Book of Facts; TIME Almanac 2000.



1999 Izmit, Turkey, earthquake

YEAR	DISASTER	WHERE	TOTAL DAMAGES	DEATH TOLL
1999	Hurricane Floyd	North Carolina	$6,000,000,000	75
	Earthquake	Izmit, Turkey	$5,000,000,000	15,814
	Cyclone	Orissa, India	$650,000,000	9,500
1998	Flood	Yangtze River, China	$30,000,000,000	3,656
	Hurricane Georges	Southeast U.S., Caribbean	$7,010,000,000	500
	Flood	India, Nepal, Bangladesh	$4,700,000,000	3,000
	Ice storm	Canada, Northeast U.S.	$2,000,000,000	46
1995	Earthquake	Kobe, Japan	$100,000,000,000	6,348
1994	Earthquake	Northridge, Calif.	$44,000,000,000	61
1993	Floods	Mississippi River, U.S.	$21,000,000,000	48
	Winter storm	20 U.S. states	$4,500,000,000	200
1992	Hurricane Andrew	Florida, Gulf Coast, U.S.	$30,475,000,000	58
1991	Typhoon Mireille	Japan	$6,000,000,000	62
	Cyclone Gorky	Bangladesh	$3,000,000,000	139,000
1990	Winter storm	Western Europe	$14,800,000,000	230
1989	Hurricane Hugo	Southeast U.S.	$9,705,000,000	504
	Earthquake	San Francisco	$7,000,000,000	67
1988	Earthquake	Armenia	$14,000,000,000	25,000
1987	Winter storm	France, Great Britain	$6,800,000,000	7
1985	Earthquake	Mexico City, Mexico	$4,000,000,000	10,000
1980	Earthquake	Irpinia, Italy	$11,800,000,000	2,735

Continued on next page



1995 Kobe, Japan, earthquake



1999 Hurricane Floyd



1992 Hurricane Andrew



1994 Northridge, Calif., earthquake



1998 Yangtze River, China, floods



1993 U.S. winter storm





79 Pompeii, Italy, buried by Vesuvius

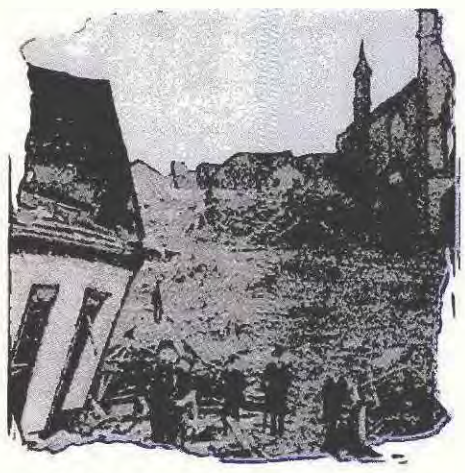
Continued from previous page

YEAR	DISASTER	WHERE	TOTAL DAMAGES	DEATH TOLL
1977	Cyclones	India	$1,000,000,000	20,000
1976	Earthquake	Tangshan, China	$5,600,000,000	290,000
	Earthquake	Central Guatemala	$1,100,000,000	22,778
1974	Tornadoes	13 U.S. states	$1,000,000,000	330
1972	Hurricane Agnes	East Coast, U.S.	$9,600,000,000	122
1970	Cyclone	Bangladesh	$63,000,000	300,000
1969	Hurricane Camille	Gulf Coast, U.S.	$6,096,000,000	323
1965	Hurricane Betsy	Florida	$7,425,000,000	299
1959	Flood	North China	NA	2,000,000
1931	Flood	Yangtze-Kiang, China	NA	1,400,000
1923	Earthquake	Yokohama, Japan	$2,800,000,000	104,619
1920	Earthquake	Gansu, China	$25,000,000	100,000
1906	Earthquake	San Francisco	$5,607,000,000	3,000
1900	Hurricane	Texas	$809,207,317	8,000
1887	Flood	Henan, China	NA	900,000
1883	Krakatau Volcano	Netherlands Antilles	NA	36,000
1881	Typhoon	Haifeng, China	NA	300,000
1876	Cyclone	Bakarganj, Bangladesh	NA	215,000
1850	Earthquake	Sichuan, China	NA	300,000
1811-12	Earthquakes	New Madrid, Missouri	NA	NA
1780	Hurricane	Caribbean	NA	24,000
1755	Earthquake	Lisbon, Portugal	NA	70,000
1737	Cyclone	Calcutta, India	NA	300,000
1662	Earthquake	Anwhei, China	NA	300,000
1556	Earthquake	Shensi, China	NA	830,000
1362	Storm surge	Germany	NA	100,000
1138	Earthquake	Aleppo, Syria	NA	230,000
856	Earthquake	Damghan, Iran	NA	200,000
79	Vesuvius Volcano	Pompeii, Italy	NA	3,500

NA - Not available



1976 Guatemala earthquake



1900 Galveston, Texas, hurricane



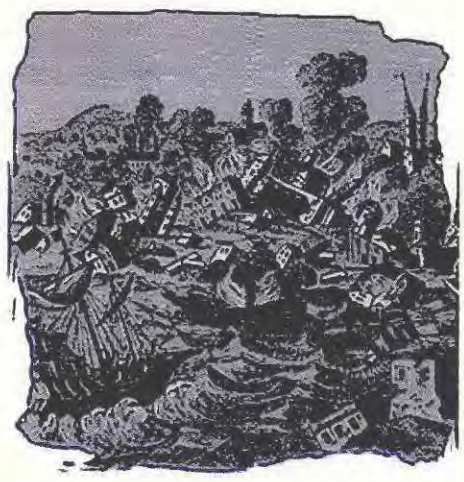
1965 Hurricane Betsy



1923 Yokohama, Japan, earthquake



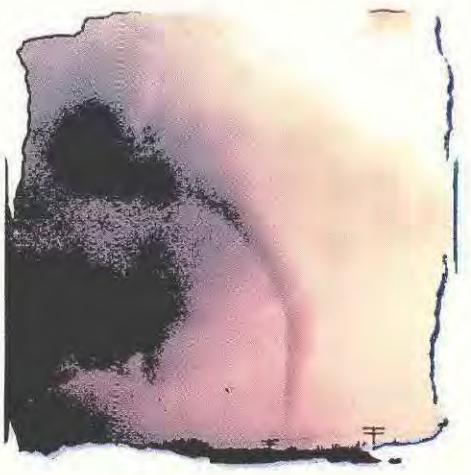
1811-1812 New Madrid earthquakes



1755 Lisbon, Portugal, earthquake



1906 San Francisco earthquake



1974 U.S. tornadoes

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Little brokers, bigger brokers, megabrokers

And then there were three.

Looking back over the past 28 years that *Business Insurance* has published its rankings of the U.S. and then the world's largest brokers, the same names dominate the charts for much of that time.

Marsh & McLennan Cos. Inc., Alexander & Alexander Services Inc., Johnson & Higgins, Frank B. Hall & Co. Inc., Fred S. James & Co. Inc. and Corroon & Black Corp. topped the charts in 1972, the first year that *Business Insurance* began publishing its rankings of the top 20 U.S. brokerages.

When *BI* separately began ranking the world's largest brokers in 1983, these six brokers together with London brokers Sedgwick Group P.L.C. and Willis Faber P.L.C. and Chicago broker Rollins Burdick Hunter Co., which would later become Aon Corp., represented nine of the 11 largest brokers in the world.

With the exception of Fred S. James, which Sedgwick acquired in 1985, M&M, A&A, Sedgwick, J&H, Corroon & Black, Willis Faber, Hall and RBH represented the top eight spots respectively in the 1990 worldwide rankings, which were featured for the first time on BI's cover.

Known simply as the "alphabet houses" throughout the industry, these top brokers, with few exceptions, fueled their growth over the years through numerous acquisitions.

It was not until 1990, however, spurred on by increasing global demands from clients, that the most significant acquisitions took place.

Over a span of eight years, there was consolidation among the alphabet houses themselves as well as acquisition of a number of other brokers that at various times ranked among the top 20 brokers in the world.

Three global powerhouses with 1998 brokerage revenues of more than $1 billion remain: Marsh, with $5.9 billion; Aon, with $4.4 billion; and Willis, with $1.2 billion.

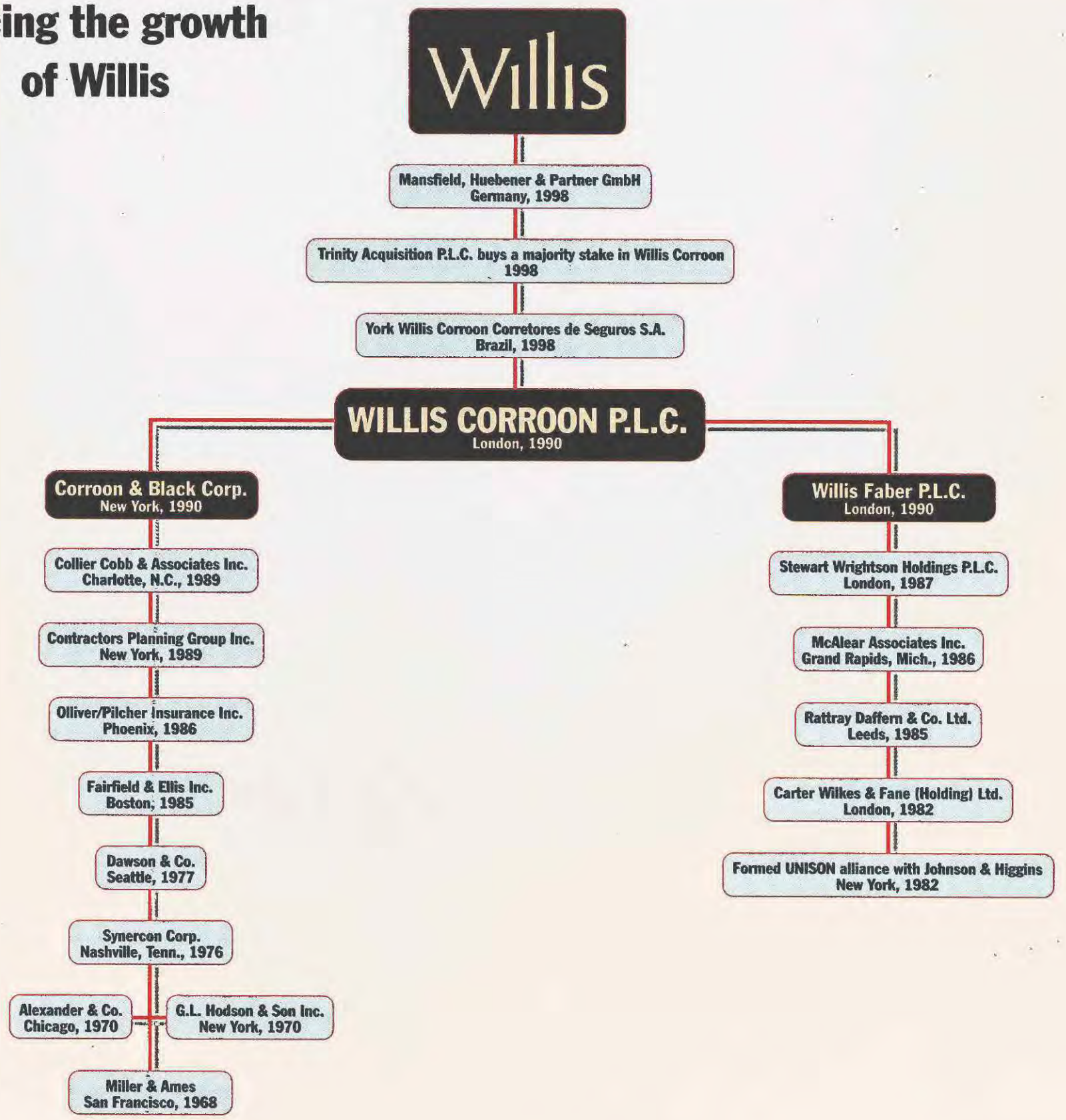
To put it into perspective, of the world's top 20 brokers that were featured in *BI*'s 1990 ranking, 11 have become part of either Marsh or Aon. That same year, Corroon & Black merged with Willis Faber to form Willis Corroon Group.

Combined, Marsh, Aon and Willis represented $11.5 billion, or 83.3%, of the $13.8 billion in total brokerage revenues reported by the world's 10 largest brokers in 1998.

The following charts—in order from smallest to largest—take a historical look at some of the more significant acquisitions made by these three brokers since *BI* began covering the commercial insurance industry in 1967 and illustrates their growth through acquisition and the birth of the megabroker.

—By Sally Roberts

Tracing the growth of Willis



Willis AON MMC Willis AON MMC Willis AON MMC Willi

Tracing the growth of Aon

AON

- Nikols Sedgwick Group, Milan, Italy, 1999
- Gil y Carvajal Group, Madrid, Spain, 1998
- Group Le Blanc de Nicolay, Levallois-Perret, France, 1998
- Grieg Insurance, Oslo, Norway, 1998
- Minet Group, London, 1997
- Sodarcan Inc., Montreal, 1997
- Jauch & Huebener KGaA, Hamburg, Germany, 1997

Alexander & Alexander — New York, 1997

- AIBA Holdings Pty. Ltd., Sydney, Australia, 1996
- Jardine Insurance Brokers Inc., 12 U.S. offices, 1995
- Reed Stenhouse Cos., Toronto, 1985
- O'Brion, Russell & Co., Boston, 1983
- Alexander Howden Group Ltd., London, 1982
- Nahm, Turner, Vaughan & Landrum Inc., Louisville, Ky., 1982
- R.B. Jones Corp., Kansas City, Mo. 1979
- Albert G. Ruben & Co. Inc., Beverly Hills, Calif., 1978
- Charles W. Sexton Co., Minneapolis, 1969

- Bain Hogg Group P.L.C., London, 1996
- Rollins Hudig Hall changes its name to Aon Group Inc., 1995
- Jenner Fenton Slade Group Ltd., London, 1994
- Nicholson Chamberlain Colls Ltd., London, 1993
- Rollins Burdick Hunter becomes known as Rollins Hudig Hall Group Inc., 1992
- Hudig-Langeveldt Group B.V., Rotterdam, The Netherlands, 1991
- Bayly, Martin & Fay International Inc., Fort Worth, Texas, 1989
- Ryan Insurance Group becomes known as Rollins Burdick Hunter Group Inc.
- Combined International Corp. acquires Ryan Insurance Group, 1982
- Rollins Burdick Hunter Co., Chicago, 1982
- James S. Kemper & Co., Chicago, 1981
- Youngberg-Carlson, Chicago, 1978
- Scarborough & Co., Chicago, 1978
- Yarchin & Co., Boston, 1978
- American Benefit Corp., Huntington, W.Va., 1978
- Ryan Insurance Group, Chicago, 1964

Frank B. Hall — Briarcliff Manor, N.Y., 1992

- Ansbacher Insurance Holdings Ltd., London, 1990
- Charles Lunsford Sons & Associates Inc., Roanoke, Va., 1983
- Leslie & Godwin (Holdings) Ltd., London, 1978
- Allen T. Archer, Los Angeles, 1972
- Boit, Dalton & Church, Boston, 1971
- Byrnes, McCaffrey Inc., Detroit, 1971
- Parker & Co., New York, 1970
- Olsen & Bartholomay Inc., Chicago, 1969

GRAPHIC BY ADAM DOI

Willis AON MMC Willis AON MMC Willis AON MMC Willi

Tracing the growth of Marsh & McLennan

MMC
New York

Cie. Europeenne de Courtage d'Assurances et de Reassurances
Paris, 1996

Johnson&Higgins
New York, 1996

Sibson & Co.
Princeton, N.J., 1982

InterOcean Management Co.
Bermuda, 1979

Thornton & Johnson Agency
Tulsa, Okla., 1979

Wilson McBride
Cleveland, 1972

Lipscomb & Ellis
Atlanta, 1968

The Frizzell Group Ltd.
United Kingdom, 1992

Faugere & Jutheau S.A.
Paris, 1992

Newstead & Porter Lda.
Lisbon, Portugal, 1992

EWI S.A.
Switzerland, 1991

Gradmann & Holler
West Germany, 1990

A.S. Hansen Inc.
Deerfield, Ill., 1987

Fenchurch Insurance Brokers Pty. Ltd.
Australia, 1987

R.A. Boyar Inc.
New York, 1987

ENCON Holdings Inc.
Canada, 1986

Lawton Byrne Bruner
St. Louis, 1986

Martin Hayes & Co. Inc.
Nashville, Tenn., 1986

Atkins Insurance Corp.
Little Rock, Ark., 1985

Hoag & Hoag Inc.
Columbus, Ohio, 1985

C.T. Bowring & Co. Ltd.
United Kingdom, 1980

Smith-Sternau Organization
Washington, 1972

George D. Clayton & Associates
Detroit, 1971

Balis & Co. Inc.
Philadelphia, 1967

Sedgwick Group
London, 1998

Muenchener Versicherungsmakler GmbH
Germany, 1994

Arvid Bergvall
Norway, 1993

Medisure Marketing & Management Ltd.
United Kingdom, 1993

Noble Lowndes & Partners Ltd.
United Kingdom, 1993

Arthur L. Owen Co. Inc.
Dallas, 1987

Armistead Group
Nashville, Tenn. 1986

The Crump Cos. Inc.
Memphis, 1986

Sedgwick Group P.L.C. acquired Fred S. James & Co. Inc.
New York, 1985

James
New York, 1985

Tomenson Inc.
Toronto, 1985

Dinner Levison
San Francisco, 1983

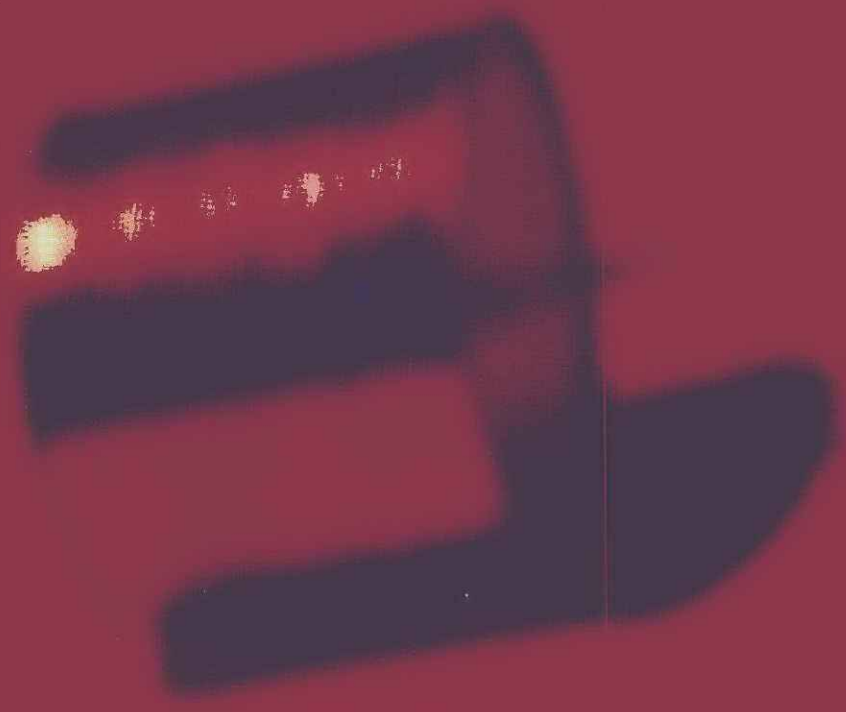
Wigham Poland Holdings
London, 1980

John F. Sullivan Co.
Seattle, 1972

John C. Paige Inc.
Boston, 1972

Despard International
New York, 1970

Rathbone & Co.
New York, 1969

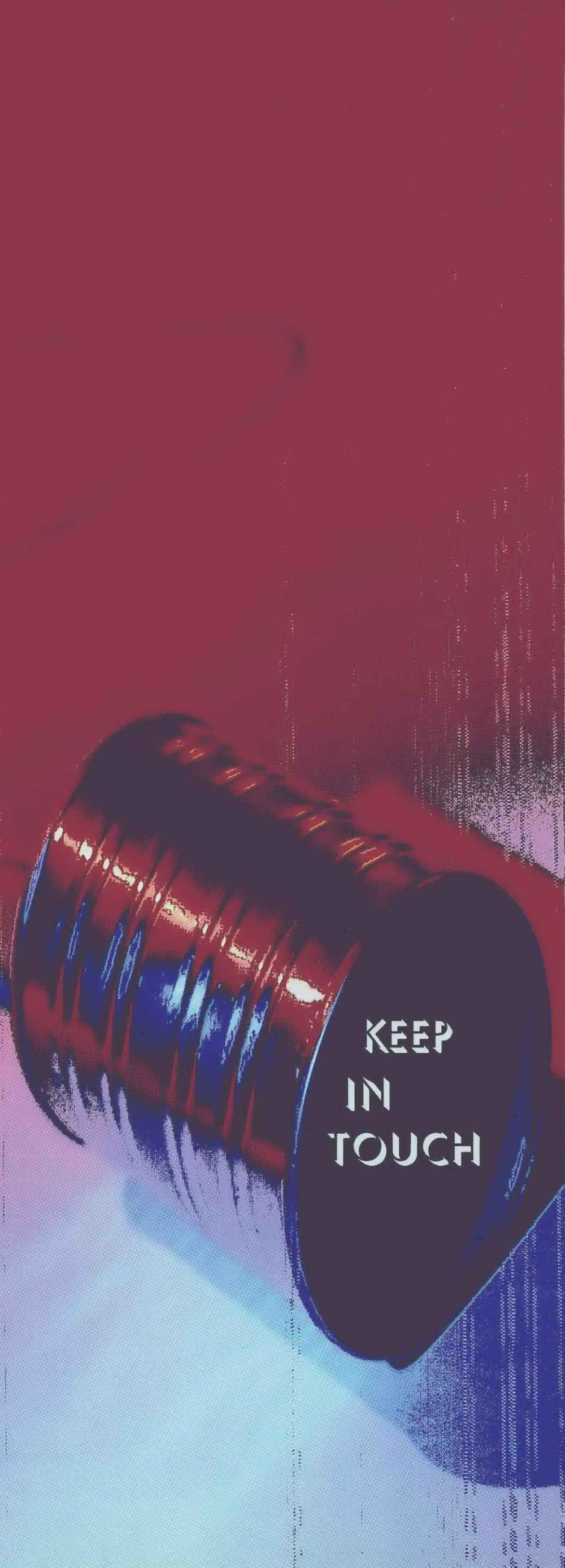


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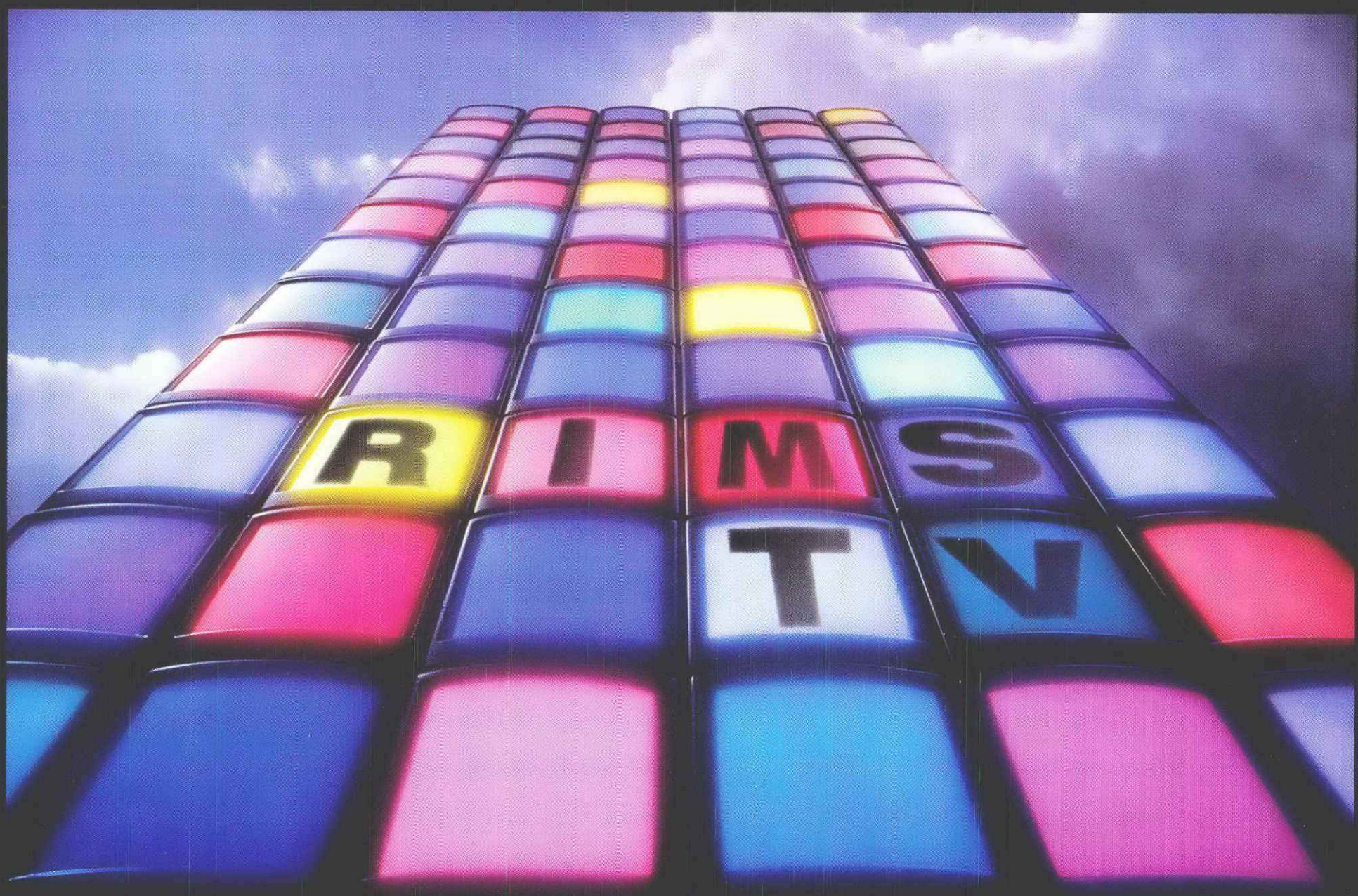
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Heirs to the industry look to the future

The senior insurance industry leaders of today are not likely to be the ones who will solve the challenges of tomorrow.

Rather, it is today's younger executives who will shepherd the insurance industry into the 21st century and beyond. Business Insurance *interviewed 15 young executives on what the future may hold for them and the industry.*

Washington Editor Mark A. Hofmann interviewed insurers; Associate Editor Sally Roberts interviewed brokers; and New York Bureau Chief Gavin Souter interviewed reinsurers.

Each of the 15 executives was asked the same 10 questions:

1. What do you expect will be the greatest issues in 2010?

2. What technological changes are likely to have the biggest impact on the way you will function?

3. What advice would you give people entering the industry today so that they can better meet the challenges ahead?

4. What will the commercial insurance distribution system look like 10 years from now?

5. Will online sales of commercial insurance become a reality?

6. Will you still be working for a company specializing in insurance 10 years from now, or will that operation be one unit of a financial services conglomerate?

7. Will capital markets instruments be a source of competition for conventional insurance?

8. Will state insurance regulation survive the next 10 years?

9. Will your customer continue to be the risk manager, or will it become the CFO?

10. What risk do you see today that is not being met by insurance?

Abbreviated versions of these questions, and their answers, follow:



Bret Ahnell

Bret Ahnell, 36, is vp and operations manager for FM Global in Dallas. He previously held the same positions with Protection Mutual Insurance Co., which merged this year with Allendale Mutual Insurance Co. and Arkwright Mutual Insurance Co. to form Factory Mutual Insurance Co., which does business as FM Global.

Greatest issues in 2010: "How is this industry going to attract and nurture the top-notch talent that will be necessary to fuel innovation, creativity and to support our customers over the next decade?

"What are insurers going to do to become more externally focused—getting closer and better understanding the customer? Will insurers start demanding more direct contact with our customers?

"What will the effect of the industry consolidation be? Looking at history, when things tend to get too concentrated, it creates opportunities for specialized organizations to emerge. What are our customers going to seek out—specialists, who have a clear focus on products and solutions, or are they going to be more lured to the raw capacity of larger organizations, whose primary value is large quantities of capital?"

Advice to today's new hires: "Some of the best contributions people can make in our industry are to listen to the customer, use good judgment and, probably above all else, demonstrate integrity day in and day out."

Specialist or conglomerate: "Being a mutual company, our policyholders, who are our owners, tell us what they want us to be. I would certainly think our policyholders will tell us 10 years from now that they still want us to be an HPR insurance company with an engineering focus."

Corporate client of the future: "I've never really viewed one individual as the sole customer. Our ultimate customers are the shareholders or owners of the organization that we insure. Our conduit to that group of people is a whole chain of people, from the plant manager to the risk manager to the CFO.

"It's going to become more of a board issue and, therefore, much more of an issue of corporate governance in terms of protecting the corporate assets and creating a safe work environment for the employees. If shareholders didn't care about these items, companies would simply elect to take the volatility on their balance sheet, which wouldn't be consistent with strong quarterly earnings."

Risks not being addressed: "Maybe try to develop a product that would try to protect the intellectual capacity or qualities of a company—what is that edge you have within your people that, if you lose that, you lose your edge?"

Joel Campanella

Joel Campanella, 39, in 1999 became vp and worldwide practice leader-professional and financial risks for Royal & SunAlliance in Charlotte, N.C.

Greatest issues in 2010: "The issues in terms of exposures will have to do with such things as cell phones allegedly causing cancer, and the aging baby boomer population will create issues that we haven't had to deal with involving health care and biotechnology."

Technological change: "Two years from now, it might not have changed as much as you might have thought. But 10 years from now, it will be so different from what you're used to. Ten years ago, did you ever send an e-mail to anyone outside your company? Essentially, everybody in the business has a cell phone. Already, you're having video conferences at your desktop. Ten years from now, it will all be voice commands.

"Technology will streamline dramatically processing work. It'll make companies that continue to have branch operations look totally different; their branches will look more like a sales office. Technology also will enable insurers to function electronically on a business-to-business basis, radically changing the business process and eliminating significant numbers of clerical positions."



Advice to today's new hires: "Be really flexible, don't forget to study organizational behavior, and be a power user of all technology. Study accounting and finance. And when you get into the job, be open to new and exciting challenges."

Online insurance sales: "First (it will happen) on the very small end of commercial. And it will happen anywhere where the product is perceived as a commodity, which could mean that, even within any segment, a portion of any product segment could be sold as a commodity online. You might end up with every product having an online side and every product having a value-added side."

Specialist or conglomerate: "I think companies will either become very focused or niche-oriented, or they'll become true worldwide global financial services business, and that could be driven by insurance, banking or asset management. There will be a lot of room for niche players. There will be room for 10 or 20 true worldwide property/casualty insurers, and the rest will probably get consolidated into more of a financial services conglomerate."

The future of state regulation: "It will survive, particularly for the individual customer and for the small-end commercial customer. But I think regulation for the medium to large commercial customer will come indirectly from the financial rating agencies like S&P and Moody's."



Robert C. Cox

Robert C. Cox, 41, is senior vp and managing director-department of financial institutions for Chubb & Son in Warren, N.J. He has held this position since 1996.

Greatest issues in 2010: "I see four or five big areas: distribution, globalization, non-traditional competition and technology. I think issues such as what I call 'regulatory risk' can have a huge impact on the industry. These are to be considered both challenges and opportunities."

Technological change: Technology "will have a huge impact on the way we communicate internally, as well as with customers, agents and brokers externally.

"As many of our customers embrace technology to do their business, it will present insurable risk. I think, in some ways, the industry has already identified them and is beginning to develop solutions. Advertising injury. . .infringement and, I think, the whole issue of intellectual property are areas in which the industry is currently developing solutions. I think the issue of fraud over the Internet is also an important emerging risk."

The distribution system of the future: "Even for larger commercial accounts, while the existing retail distribution system will continue to be dominant, we will see growth in other channels—wholesale, electronic, direct—so that buyers can purchase the product through any channel they want."

Online insurance sales: "I definitely think (online sales) will become a reality. But I also think there will still be a role for the agent or broker as adviser or counselor."

Capital markets inroads: "Yes, I think they will be (a source of competition), but I'd turn that around a little bit. Everything you read talks about capital markets making inroads into the insurance world. But for progressive insurers, there is an opportunity to both compete with the capital markets and to complement capital markets activities."

The future of state regulation: "I think it will be interesting, given the passage of S. 900, to see exactly what insurance regulation will look like. I think it probably will evolve more toward a national scheme, as opposed to state regulation. It will probably be more solvency-based."

Risks not being addressed: "There is an entire category of risk which we would call operational risk. For example, this would include theft of trade secrets; loss of key personnel, particularly during merger and acquisition periods; product obsolescence—any number of risks that are integral to the ongoing viability of an organization. As this whole concept of holistic risk begins to take form, I think you'll see insurers being willing to take on some of those operational risks. Over the next 10 years, I think we'll be able to develop quantitative and qualitative models to help analyze and quantify the risk."

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Will Dove



Will Dove, 33, is a vp at Centre Solutions, a New York unit of Zurich Financial Services Group, where he is responsible for pricing and building finite risk and structured finance programs.

Greatest issues in 2010: "Competition is going to be the greatest long-term challenge to anyone in this business—and trying to find a way to distinguish yourself from competitors. In a very basic sense, insurance—and reinsurance—is a form of contingent capital, and in that sense we will be competing with providers of equity and debt and other financial products."

Advice to today's new hires: "The reinsurance industry—and the financial services industry in general—is complex and a very technical business, and there will always be a need for people who have strong technical skills. You also need a solid base in general business and finance skills. Reinsurers will have to think about how reinsurance products will fit into the capital structures of customers, so you will need to understand not just insurance and reinsurance but general corporate finance and a whole range of products and alternatives."

Specialist or conglomerate: "Centre is a subsidiary of Zurich Financial Services, so we are already part of one (conglomerate). With Glass-Steagall being reformed, a lot of regulatory hurdles are disappearing, but there are still fundamental differences between what we do and what commercial banks and investment banks do.

"We take risks onto our own balance sheet, whereas banks are more like intermediaries between investors and the capital markets. I don't think that they will be comfortable taking on risks that they can't transfer."

The future of state regulation: "I really think that, within the next 10 years, we will see federal regulation of insurance. Glass-Steagall lasted close to 70 years, and it took a long time to remove those regulatory boundaries. But going forward, people are going to recognize that the cost of having 51 different regulatory mechanisms is expensive for the markets and for taxpayers. I don't think it's going to take another 70 years to change McCarran-Ferguson."

Corporate client of future: "For our company now, it depends on the type of transaction. For many of the transactions, our relationship is with the CFO or CEO. As companies start to manage financial and business risks together, the distinction at the company level between who's a risk manager or a financial manager will disappear. Some organizations already have a chief risk officer position. If you think of insurance as some form of contingent capital, that, logically, should be part of discussions about capital structure."

Doug Elliot



Doug Elliot, 39, became chief operating officer-commercial lines at Travelers Property Casualty Corp. in Hartford, Conn., this year.

Greatest challenges in 2010: "Five challenges of the past decade will still be with us. The rules of underwriting cannot be ignored, regardless of how much capital is available. Companies that apply new technology to our markets without a firm grasp of the fundamental principles of our business will fail. Simplifying insurance for consumers and improving service to both our commercial and personal lines customers will always be among the top challenges. Knowing what your expenses are, down to the smallest field operating unit, and keeping them under control, is the key to being the low-cost producer and, as a corollary to that, adapting the fast-changing technology to achieving all these ends.

"Said another way, the most fascinating aspect about questions about the future of our industry is not what will change but what will *not* change. Many companies have lost their way over the last decade—some even failed—because they ignored the fundamental principles of our business."

Technological change: "Among the various segments of the financial services industry, insurance is the least technologically advanced. By just about any measure—data storage, transaction speed and accuracy, to name a few—our industry is years behind both banking and securities. In fact, our lack of progress in the technological revolution is one reason why we have already begun seeing financial convergence. That is, we are seeing more-advanced enterprises both moving into the field of insurance and acquiring insurers.

Distribution system of the future: "I believe there will be fewer than 10,000 agents and brokers at the end of the next decade, down from 20,000 today and 35,000 just 10 years ago. The reasons are pretty straightforward, and they are the same forces at work on the carrier side: overcapacity and complacency. Those who survive will be those who do a good job of analyzing their business to determine where they should most profitably spend their time and financial resources."

Specialist or conglomerate: "You are talking to someone who is already working in what I believe to be the insurance company of the future. If that's in fact the case, let me tell you some of the lessons we've learned over the past five years.

"First, the acquisition of Travelers by a very savvy diversified financial services company brought us back into the world of financial reality. And that reality is that, in today's world, investors demand an adequate return on their capital. We've been tremendously successful, consistently producing among the highest returns in the industry, because of the financial discipline we've instilled in the company over the past five years. In the long term, I'm convinced that financial discipline will be brought to bear on the industry, which will ultimately lead to more-rational pricing.

"The second reason for our success as part of a diversified financial services company is the freedom we've been given to run our business. That may sound contradictory to the concept of financial discipline, but it is not. By granting us the freedom to act, we are also made accountable for our results. No diversified company will be successful if it is run centrally. That's part of the genius of Sandy Weill."

David L. Eslick



David L. Eslick, 40, is president and chief operating officer for USI Insurance Services Corp. in San Francisco.

Technological change: "That has to be evaluated in segments. For personal lines and small-business accounts, technology is going to be intrusive into the whole insurance process—from finding an insurance company, to developing the right coverage, to shopping for the most-effective price, to binding the policy.

"For the midmarket, technology will involve more service, administration and communications, rather than actual insurance purchasing. For the risk management accounts, technology will evolve so that it is almost as if we are sitting there, hand in hand with risk managers, assisting in the whole risk management process."

Distribution system of the future: "The commercial insurance distribution system is going to be much more linked to the financial services distribution system. There will be consolidation of those organizations, because clients are requiring total-solution capabilities."

Online insurance sales: "Online sales for commercial insurance will become a reality for small business owners—those with less than $1 million in sales and fewer than 10 employees. It's a very viable option for them. When you step up to the midmarket and risk management accounts, however, the sophistication is dramatically more significant, which does not lend itself to online sales."

Specialist or conglomerate: "The question is, what title it comes after. I will still be working for an organization that delivers financial and insurance capabilities. Whether it's under a title of a money management firm, a broker or a bank is a 20,000-foot distinction. What we do—the services, the resources, the capabilities—are still the same."

The future of state regulation: "The current system will have to change. We recently saw one of the biggest changes we've seen in over 50 years with the passage of (financial services modernization legislation) and the repeal of the Glass-Steagall Act.

"As we move forward with consolidation among financial service firms, we'll see more of a view to how to properly provide regulation over the total financial services capabilities. Investment firms are largely federally regulated, while insurance is state regulated and banks are state and federally regulated. Those regulations are going to have to consolidate, or at least they have to coordinate."

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Reina L. Gregorio

Reina L. Gregorio, 41, became president of Kemper Professional in New York in 1999.



Greatest issues in 2010: "A variety of issues, some of which we are already dealing with to some degree today, such as changing demographics. I think we're going to see continued growth in the small-business market, which may be fueled somewhat by an eventual slowdown in the economy. I think we're also likely to see major change evolving from technological change and the impact on business-to-business relations. Continued globalization will mean greater competition for insurers."

Advice to today's new hires: "An appreciation for technology is critical.

"One of the things I think is very important is to truly understand who your customer is; I don't think, in the future, we can survive as a world of generalists."

Online insurance sales: "We will continue to see multiple distribution channels in commercial insurance over time. There will always be opportunities for traditional distribution models, like agency platforms and brokers. I think that the Internet is enabling change principally in commoditization segments."

Specialist or conglomerate: "I think that many individuals will be working in financial conglomerates, but I do not think they will completely absorb the property/casualty business. I think we will see a blending of the operations. . . . We are likely to see certain large financial institutions moving into the insurance industry, but their success will be principally in personal lines and financial services. But the financial services industry is significantly ahead of the insurance industry in terms of its information technology capability."

Capital markets inroads: "We are going to see more opportunities for risk securitization. Reinsurance is still fairly abundant for the mainstream types of risk. I do think, however, that primary markets will begin to use capital markets more for more of the financial-oriented products associated with enterprise risks."

Risks not being addressed: "There is an enterprise risk that is not being met by traditional insurance products. As the financial services industry and insurance industry begin to find ways to offer more-blended programs, I think the whole financial protection issue—asset protection, earnings smoothing— non-traditional insurance products that have more balance-sheet implications will assume greater importance. I think it will be fueled somewhat by the blending."



Thomas A. Golub



Thomas A. Golub, 41, is president and chief executive officer of Hobbs Group L.L.C., an insurance broker based in Atlanta.

Technological change: "As I see it, our business, in general, is increasingly a business of intellectual capital. The impact of technology allows one to deploy intellectual capital more broadly, such as financially modeling risk at an enterprise level.

"Also, the technological ability to converge loss-frequency, loss-type and loss-severity data from around the world will have an enormous impact on the way brokers target loss control efforts for clients going forward."

Advice to new hires: "My advice, in general, is to put yourself in a position to aggressively learn—to work with people that are intelligent and willing to share information with you. Work in an environment that provides you an opportunity to fail. Look for complex tasks and challenge yourself in those situations.

"The key to this business and being successful is driven by intellectual capital."

Online insurance sales: "I think online sales of commercial insurance will become a reality and a major influence in the small commercial account world over the next 24 to 36 months. As accounts get larger, they require more advice. Assessing risk from a customer's point of view is hard to do online."

Capital markets inroads: "It's not a source of competition at all for us; it's another arrow in the quiver to offer clients. We're excited about the development of capital market instruments because it does bring competition to insurance companies. And when we're trying to find the best and most cost-efficient product for clients, competition is a good thing."

Corporate client of the future: "In reality, it depends on the size and structure of the company. Risk managers and CFOs are both already our customers. The point person for us is the risk manager, when one exists. I don't see that changing much."

Specialist or conglomerate?:

"Is it logical that a financial services conglomerate might be interested in purchasing an insurance broker? Sure. How much consolidation will take place? There will be some.

"In 10 years, I will work for a company that specializes in risk management. The shape of it will be a little bit different, but not from a sales standpoint, more from a product-offering standpoint."

Gregory S. Hendrick

Gregory S. Hendrick, 34, is a vp and underwriter at XL Mid Ocean Re, a unit of XL Capital Ltd. in Bermuda. He is responsible for U.S. property underwriting.

Greatest issues in 2010: "The biggest impact will be the reduced number of customers that you can go to as we continue to see consolidation in the insurance industry. Fewer clients and ensuring that you have a good-enough spread of risk across a good number of customers will be one of the big issues. Also, the role of capital markets and alternative forms of capital, and how will reinsurers compete with them or work with them."

Technological change: "I doubt that it's very different from someone making widgets—computing power available. There are theoretical analytics of risk that we can't do due to the lack of affordable computing power but, as that diminishes, there will be much-improved risk analysis."

Distribution system of the future: "For some parts of the market, things will look radically different, as the Internet will have a big impact. Whether independent agents will be disintermediated or not, I'm not sure, but the Internet will play a big role. For the more-difficult and larger commercial risks, the intermediary's role will not be fundamentally changed. People will want to deal with someone in between who will facilitate the best structure for them."

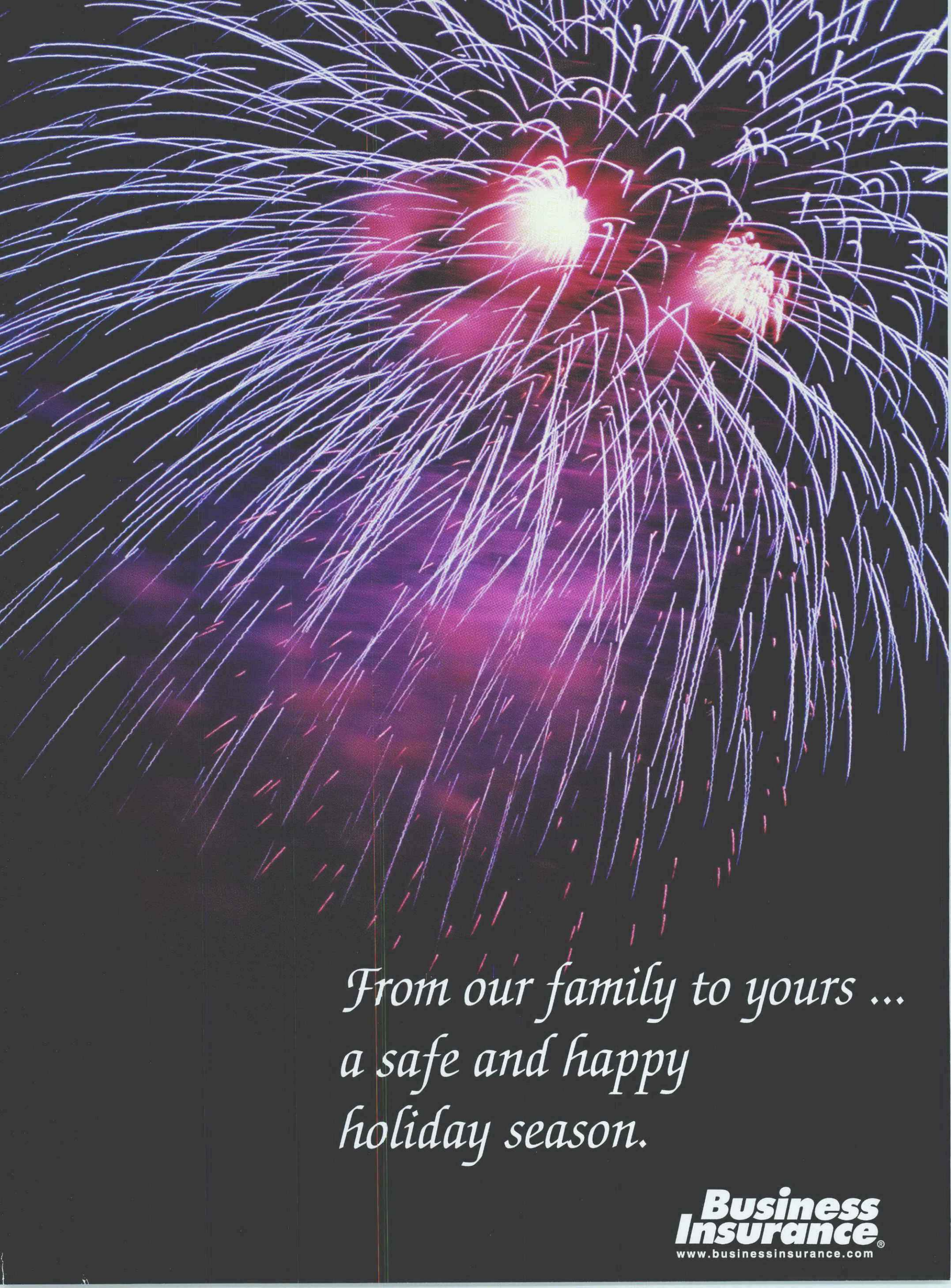
Specialist or conglomerate: "I like to think that I'm already part of a financial services boutique. I'll still be working for a reinsurer, but the tools that we bring to the table will not be traditional. We'll be assuming risk, repackaging it, keeping the risk we want and ceding the rest into the capital markets."

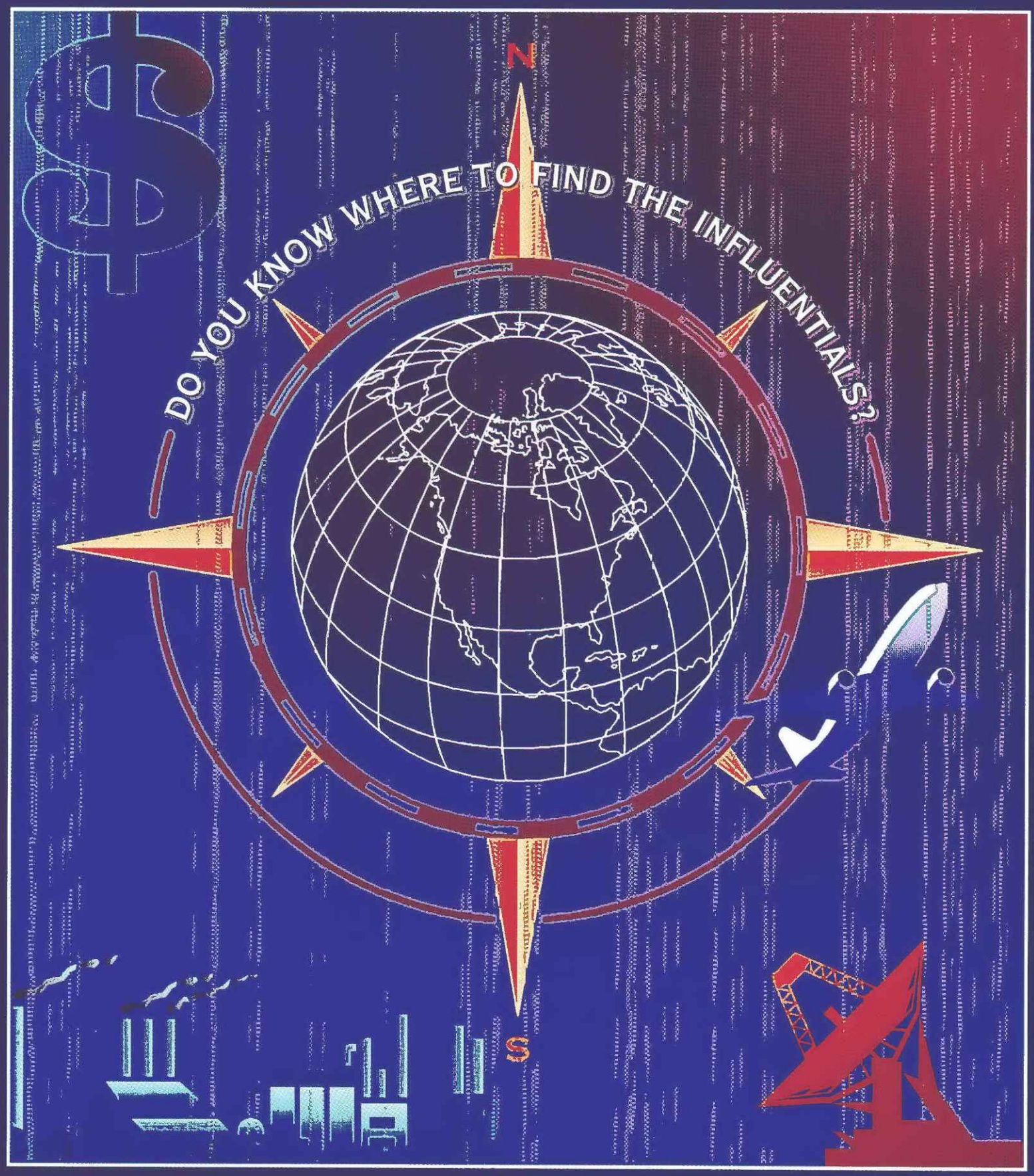
Corporate client of the future: "If everything comes to pass as we see it, we'll be dealing with the CFO. The reinsurance buyer or risk manager will not be eliminated, but they will be part of an equation that involves the CFO. The CFO will take more of a driving role in dealing with enterprise risks."

Risks not being addressed: "I think we are in the infant stages of being able to provide coverage to Internet companies, but we are a long way from dealing with risk needs that they have in terms of Internet downtime and system failures.

"We also are still not able to meet all the earthquake needs due to the appetite for the risk and the ability to price it at the proper level."

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Thomas Huerlimann

Thomas Huerlimann, 36, is a director of Swiss Re New Markets in Zurich, where he works on a wide range of financial products, including securitization issues and contingent capital solutions for Swiss Re's largest ceding clients.

Greatest issues in 2010: "For me, the question depends on how you define a reinsurer. The role of the reinsurer has changed significantly and will most likely change dramatically over the next 10 years.

"A more-appropriate definition is a manager of capital and risk rather than being a reinsurer. If you are talking about a broader definition of that industry of capital and risk, then reinsurers are in that industry along with insurers, brokers, capital markets and banks, and the borders are blurring between these traditional definitions. If you look at that industry today, it is rather inefficient, because only about 50 cents of the original premium dollar is paid back to the insured. The greatest issue will be structural changes ahead of us and how we all fit in the food chain.

"As far as new risks are concerned, the biggest one will probably be something that we are not yet talking about. But if I had to guess, I would say that it will probably be something in the area of genetic engineering of food."

Advice to today's new hires: "Don't think that you are entering the reinsurance industry; you are entering the capital and risk industry. That means bringing corporate finance and insurance know-how together. It is not good enough anymore to know how to write a proportional or non-proportional treaty, because companies buy protection to optimize their capital base to achieve their ultimate goal of creating shareholder value."

Capital markets inroads: "For me, it is a certainty because of the inefficiencies in the industry at the moment. There will be more-efficient ways to absorb risk, and one of those will clearly be by using the capital markets. At the moment, the capital markets themselves are not efficient as a means for taking on insurance risk because prices for traditional insurance are so low, but that is changing. When prices reach a certain level, it will be more efficient to use capital markets, and then capital markets will take off because of economies of scale."

Corporate client of the future: "My customer already is the CFO. I provide him with different types of capital solutions for rating, regulatory and risk purposes."

Risks not being addressed: "There are still many risks that insurers and reinsurers are not willing to cover, although the number is decreasing and there are a lot of innovative new ways to deal with the risks. But there is a natural limit where risk transfer does not make sense anymore. For example, from an economic point of view, it doesn't make sense to pass on entrepreneurial risk."

Brian K. Lineberger

Brian K. Lineberger, 34, is assistant vp and Western territory facultative casualty manager at Employers Reinsurance Corp. in Los Angeles.

Technological changes: "The Internet is going to allow us to accept more opportunities from customers. We can already accept facultative submissions, and we are headed in the direction of offering quotes online for smaller pieces of business. Larger pieces of business may be submitted over the Internet, but I can't see all the underwriting being done online."

Advice to today's new hires: "Everyone has to be computer savvy. You have to know how to use a computer and its different software applications when you walk through the door. You also need to know how to surf the 'Net.

"You also have to be sharp financially and know how to address financial information and have an understanding of



contracts. You can learn the underwriting on the job, but if you can come in with a good number of skills, it's got to give you a leg up."

The future of state regulation: "I think it will definitely change over time. As long as you have elected insurance commissioners, you will have some form of state regulation, because consumers need protection. But smaller insurers are merging or not surviving, and the need for regulation decreases with the bigger companies. We are already regulated by our customers and the rating agencies."

Risks not being addressed: "There are so many products popping up all the time that it seems that products are being developed before the exposures are there. But on the technology side. . .the industry is struggling, because it is not sure how much coverage it should be giving. The contract language has to be strict, but you have to offer coverage. All the players in the technology realm are struggling with whether they are setting up the right contracts but not giving away too much."



H. Elizabeth Mitchell

H. Elizabeth Mitchell, 37, is executive vp-North American casualty treaty at St. Paul Re, a New York unit of The St. Paul Cos. Inc.

Advice to today's new hires: "People need to develop a technical specialty. By that, I mean things like loss control, technical underwriting and claims adjusting. The reason I think that is important is that business is becoming much more technical and more defined, so you need to have some areas of expertise that you know in depth.

"Secondly, you need a wide spectrum of business experience. So take assignments in different departments, deal with different types of companies and work in different regions. Expose yourself to as wide a segment of experience as possible. Sometimes, that may mean a lateral move."

Online insurance sales: "I see the Internet right now as a tremendous source of information and research on companies that we do business with and (a marketing tool for) the types of products we offer. Also, it's a source of communication for pushing information out to clients about things like how claims are being paid and informational items.

"But the tough question is, how will we actually use the Internet as a sales vehicle? We are exploring how to use our Web site to sell facultative products, but we have long way to go on other products, because they are too individualized and complicated to make them vanilla enough to transact over the Internet. The jury is still out on whether you will be able to click a button and have a reinsurance contract."

The future of state regulation: Will the current regulatory system survive the next 10 years?

"I hope not. There is no other place in the world where rates and forms are regulated in the same way. Regulation for commercial entities should focus on solvency. They are sophisticated and understand their risks and should be able to contract with insurers to protect themselves.

"The current regulation system is costly and limiting, and if it isn't relaxed, the states risk losing their authority over insurance to the federal government."

Corporate client of the future: "We already see our customers as CFOs in many cases (rather than risk managers). More and more clients are rationalizing how they buy their reinsurance. That's an opportunity, because we deal with a more-sophisticated buyer and find out their real needs and design products that meet those needs, rather than give them cookie-cutter products off the shelf. Underwriting managers are only interested in protecting their own books. A CFO looks at how much risk the company can bear."

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Teresa L. Pahl

Teresa L. Pahl, 40, is an executive vp at Aon Corp. in Chicago, where she is responsible for Aon University as well as a new product development unit called Aon Growth Works.

Distribution system of future: "I think it will look very different from now. It's going to be very integrated with all kinds of financial products generated to businesses. This will be driven by Internet communities where, for instance, a mid-market or large-account buyer can go to a community on the Internet and find all the information and buying options needed to make decisions. For the brokerage distribution system to survive, it needs to engender that to happen, not stall it."

Online insurance sales: "Definitely, it will become a reality, but I don't think it will lead to insurance sales for large, complex risks. Buyers will be able to get support, information and be able to look at products and providers on the Internet, but for large, complex risks and other middle-market accounts, I think there is still going to be a real role and real need for risk managers and brokers to talk."

Specialist or conglomerate: "It's probably going to be inside a financial services conglomerate. I'm kind of already there now because Aon offers those financial services."

Future of state regulation: Will the current system of insurance regulation survive the next 10 years?

"I certainly hope not. The current system is very detrimental to the industry and puts us at a tremendous disadvantage. The system needs to be either federally regulated or put into a much more streamlined state-regulated mechanism that makes us competitive with financial service companies."

Corporate client of future: "I think it will be the risk manager, but the risk manager will take on a more financial role and will become more involved in the total risk of a corporation.

"The CFO will be a customer as well, to the extent he or she supports the decision the risk manager makes or gives the final authority to a decision."

Risks not being addressed: "Intellectual property needs to be addressed. Increasingly in our economy and with what's happened with a few cases, intellectual property is really critical. Catastrophic product recall insurance also is an area that needs to be better addressed.

"There are risks that we don't really know of and won't know of until the economy evolves into more of a business-to-business e-commerce. There are going to be risks associated with that that will be important."

Sean K. Smith

Sean K. Smith, 40, is president of the schools division for Keenan & Associates in Torrance, Calif.

Greatest issues in 2010: "I think some of the biggest issues brokers will face in the next decade will focus on the integration of technology into the business and how to provide value back to the customer. Brokers will have to take an even more interventionist approach and provide a variety of services that currently are not being provided, including merger and acquisition advice, financial advice, strategic planning—all things associated with one-stop shopping.

"Brokers also need to become far more efficient than they are currently. This will be achieved through the application of technology. The survivors will be the ones that provide the most value, the most efficiency and recognize and apply technology."

Advice to today's new hires: "Adopt a specialty in a niche, have a passion for it, be creative and demonstrate a high degree of integrity."

Distribution system of future: "I think it will be much smaller. The recent passage of financial services modernization legislation will drive even more consolidation within the industry. Brokers, financial service companies and banks will all converge to form large financial service companies, which will clearly reduce the number of choices in the distribution system. Companies that have never thought of themselves as acquisition targets before have become them."



Online insurance sales: Will online sales of commercial insurance become a reality? "Absolutely. People will be purchasing commercial insurance online; they'll be purchasing every type of insurance online. There will, however, still be a need for brokers to provide a servicing arm to clients, and complex commercial transactions will still require broker services. Commercial insurance will really be part of an e-business to e-business transaction, and the most successful companies will integrate their e-business strategy with traditional bricks and mortar to effectively tailor their service to customers."

Risks not being addressed: "I think one area that's not being met today is e-business and business interruption as it relates to the Internet. It's a huge area, and I think as it becomes more defined and the economy changes, there will be a tremendous need there."



Christopher M. Treanor

Christopher M. Treanor, 36, is managing director at Marsh Inc. in Morristown, N.J.

Advice to new today's hires: "I would give young people four things to keep in mind. One, it's still a relationship business. Clients do business with people they like and trust. Integrity is key, and your reputation is your strongest asset.

"Two, now more than ever, strong finance and business skills are fundamental to our business. If you don't have this background, get it.

"Three, training and education are career-long endeavors. You need to continue to learn new things and improve your skills if you expect to provide value in our rapidly changing industry.

"And fourth, understand and use technology. Although this is typically not an issue for the Nintendo generation, young people need to keep their technology knowledge and computer skills sharp."

Capital markets inroads: Will capital markets become a source of competition for conventional insurance?

"Absolutely, but perhaps the better question is whether insurance products will be competition for capital markets instruments? From what I've seen so far, the insurance industry has been more aggressive and creative in coming up with new solutions and infringing on turf traditionally reserved for the capital markets.

"For example, through credit wraps and credit enhancements, the industry has been able to supply risk cover that many lending institutions would not take, allowing deals to go through that might not otherwise.

"I think that, as an industry, we understand many areas of risk better and are more flexible than the capital markets."

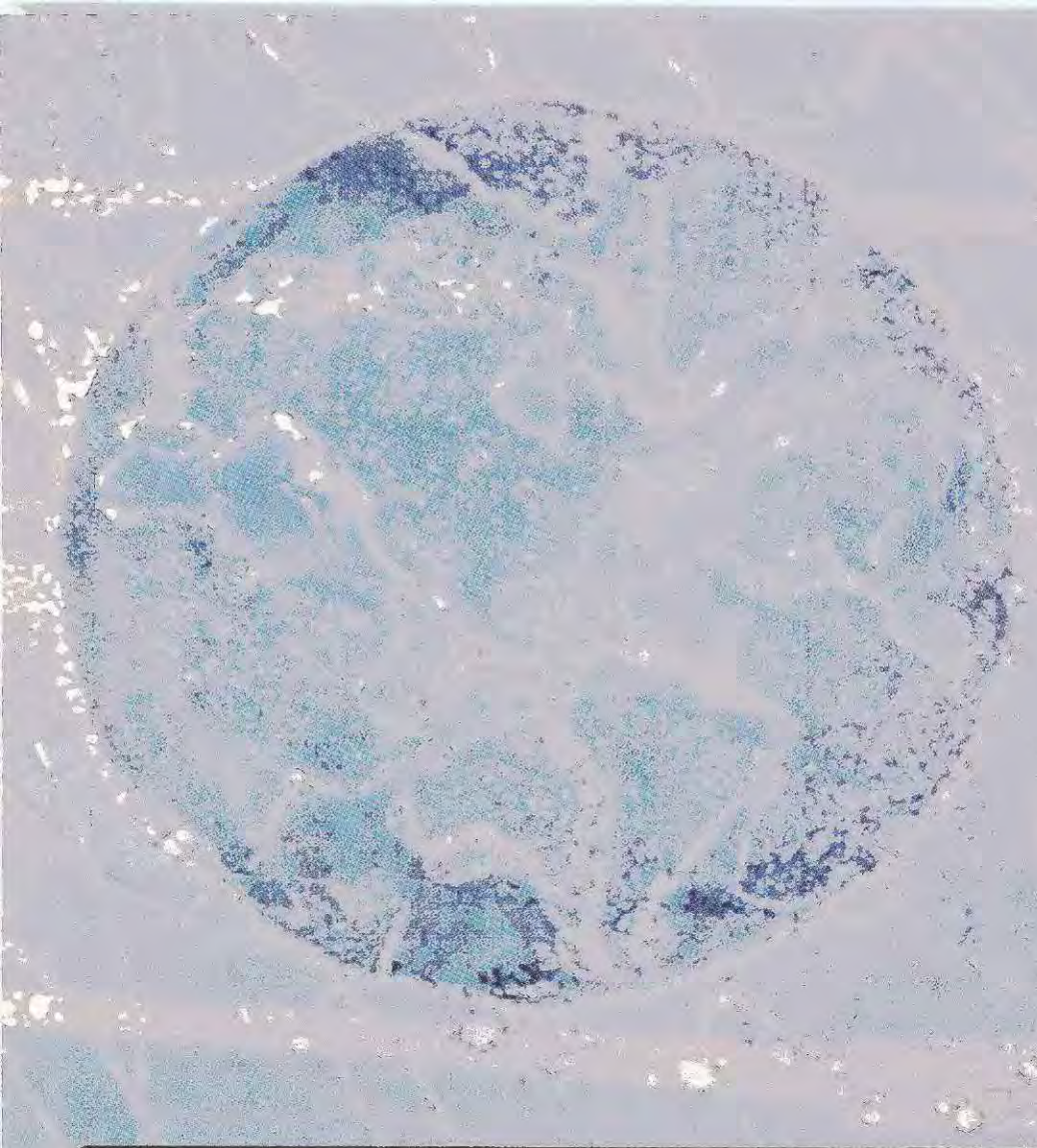
Corporate client of future: "I believe our primary contact will continue to be the risk manager. What will evolve is the role the risk manager will play within the organization.

"Just as we need to continue to tackle more complex issues and get involved in new and different areas of risk, so, too, will risk managers be charged with overseeing and integrating different risks of their organizations."

Future of state regulation: Will the current system of insurance regulation survive the next 10 years?

"I hope not. Regulation certainly serves a purpose, particularly in protecting smaller, less-sophisticated consumers. For the larger, more-sophisticated customer with multistate and country exposures, regulation can be a substantial impediment and create inefficiency.

"I think most commercial buyers would say 'buyer beware' and trade off additional risk for greater efficiency. One area that may continue to require regulation for all buyers would be insurer solvency."



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Insurance, alternatives will join to transfer risks

By RODD ZOLKOS and GAVIN SOUTER

The shape of risk financing in the coming century will definitely include integrated risk programs, enterprise risk management and financial products, but not at the expense of traditional insurance.

The alternative risk financing products in their infancy today will mature as the new century begins, according to risk financing experts. But rather than replacing traditional coverage, these products will provide other options for insurance buyers, allowing them to craft programs that best fit their companies' needs.

But if the many insurers lining up to offer integrated programs for enterprise risks are to be successful, they must be prepared to cover a wider range of risks than they currently do, risk managers say.

While many insurers claim to offer integrated programs, few are prepared—or able—to embrace the wide range of catastrophe risks that some risk managers wish to cover, risk managers say.

And, they say, to meet fully the growing needs of corporations. insurers will likely need to work with investment and commercial banks to develop solutions that make use of capital markets.

"I think we're in a world where people want more options, more tools," said Prakash Shimpi, principal at Swiss Re New Markets Corp. in New York.

"There are things that you want that are very basic. And there are other things that you want that, while you would like them to be standardized, situations don't allow them to be. So you have to have a lot of customization," Mr. Shimpi said.

"Convergence is here to stay," said Martin H. Scherzer, a managing director in Marsh Inc.'s Marsh Risk Finance group in New York. "Convergence is a force that is absolutely shaping the way products are designed and are going to be offered to clients."

"Really, when you think about it, risk management is about how you manage capital," said Carl Groth, senior vp and director of alternative risk transfer at Willis Corroon Corp. of New York.

"There are all kinds of pockets in a company that contain risk," Mr. Groth said. "And a company has to make sure that it's not overexposing its capital to risk. One of the ways to get a handle on that, from an overall corporate perspective, is to implement an enterprise risk management approach."

But, Mr. Groth said, "I don't think there's a company out there that can do this overnight. It's something you have to grow into."

To do so, a company must to develop a new way of looking at risk and take a more-comprehensive view of the exposures it faces throughout the organization, many experts say.

The demand for new risk transfer products then will arise from an increased recognition of the risks a company faces, as well as a common view of risk from department to department within an enterprise.

"As that recognition becomes more commonplace, then the tools and the instruments that people will use will also undergo this cross-fertilization," Mr. Shimpi said. "That's not to say the one solution will be the integrated solution."

The change in approach will be to look at all the organization's risks "with one set of optics," he said, allowing companies to draw together insurance, derivatives and corporate equity to evaluate those elements as a whole.

As yet, "I'm not able to put all of those on the same page and evaluate them consistently," Mr. Shimpi said. "That's the breakthrough, and we still haven't got there."

The movement toward integrated programs is partially dependent on the further development of risk management itself, said John Degnan, president of Chubb Corp. in Warren, N.J.

In order to benefit from the integrated products, risk managers need to begin viewing their companies' business risks as a whole, rather than as individual exposures, he said.

"It takes a fairly creative and sophisticated risk manager" to put together an integrated risk program, Mr. Degnan said.

Some risk managers interested in integrated and enterprise risk programs have found that insurers currently offer few coverage options, said Susan R. Meltzer, assistant vp-insurance and risk management at Sun Life Assurance Co. of Canada in Toronto and president of the Risk & Insurance Management Society Inc.

Insurers are willing to offer property coverage on buildings that, because of sophisticated fire suppression systems, effectively cannot burn down, but they are unwilling to cover the real catastrophe risks of businesses, such as changes in interest rates converging with significant regulatory changes, Ms. Meltzer said.

"Insurers talk about what can be insured and what can't be insured, but anything can be insured. You just have to figure out the price," she said.

Those insurers eager to offer some integrated risk policies and insurance coverage for business risks often limit that coverage to certain risks, and they usually are unwilling to consider other groups of risks put forward by risk managers, Ms. Meltzer said.

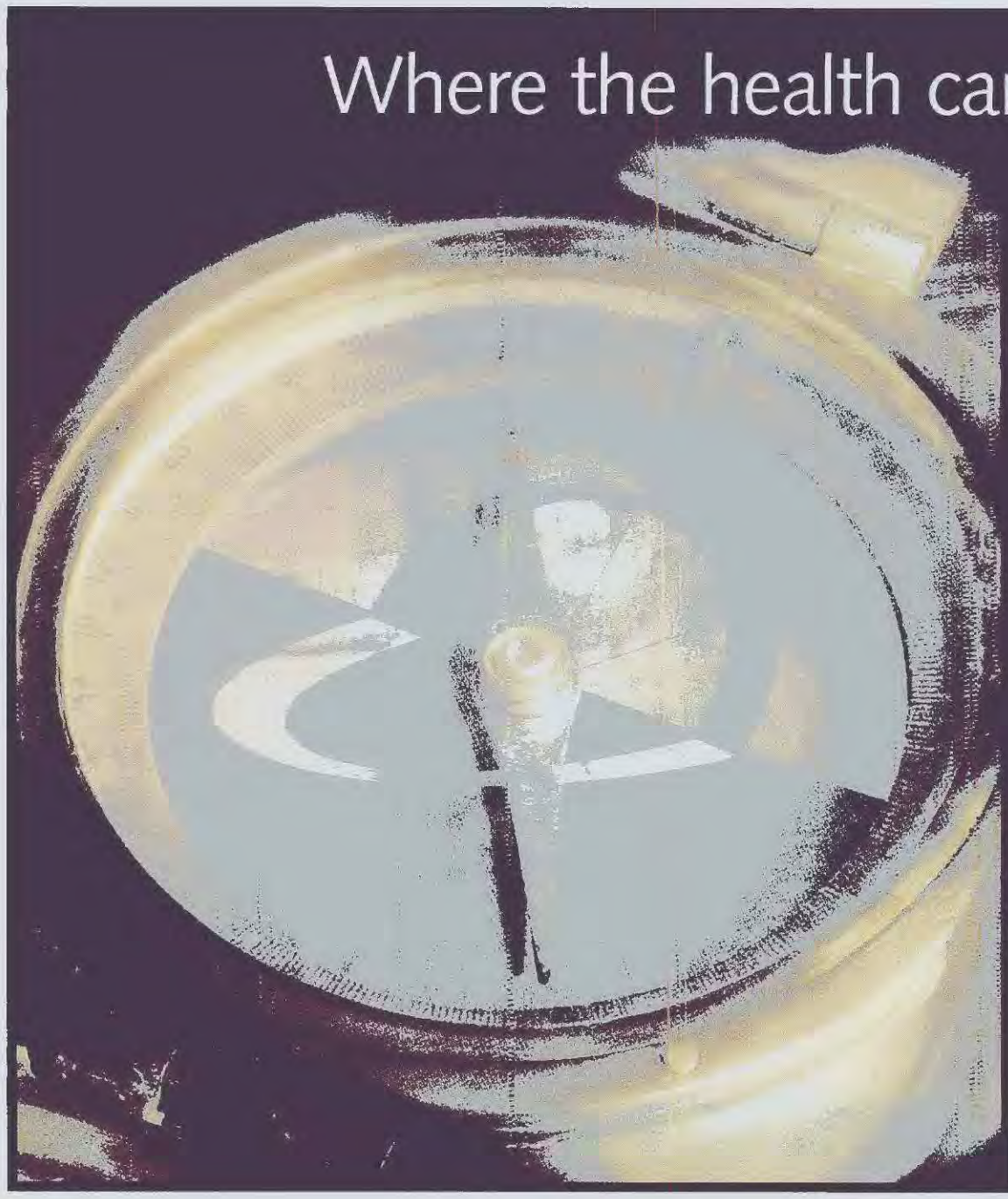
"Insurance companies still sell only what they want to sell you," she said.

Furthermore, investment banks entering the insurance market with securitized products are also unwilling to cover risks outside of the narrow band of coverages they currently offer, Ms. Meltzer said.

More-extensive coverage may develop out of investment banks and insurers coming together to offer coverage, as each will bring a fresh perspective to the process, she said.

The current crop of business risk products generally provides only traditional amounts of capacity for risks that already can be efficiently

See **Alternatives** *on next page*



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hedged by other means, said William J. Kelly, a managing director at J.P. Morgan & Co. Inc. in New York.

"Some of them are saying, 'We'll cover your foreign-exchange risk.' Well, that's very nice, but there's always been mechanisms to cover those risks. What is not addressed are operational risks," he said.

For a financial institution, for example, uncovered operational risks would include a widespread systems crash and losses caused by a rogue trader, Mr. Kelly said.

Conventional insurance is a cheap and efficient means of covering traditional risks, but it does not provide sufficient capacity to cover "life-threatening" operational risks, he said. "Those types of risks are in the billions of dollars, not the hundreds of millions."

The capacity for covering operational risks could develop out of a combination of traditional insurance, finite risk and securitized coverage, he said.

Improved information technology could enhance the ability of insurers and risk managers to handle integrated and enterprise risks. And the new technology could increase banks' participation in the programs, several executives said.

"Now we have very sophisticated modeling technology and really sophisticated systems for handling data in a way that makes managing enterprise risk possible," Mr. Groth said.

"Information is key," SRNM's Mr. Shimpi said. "It's empowerment of the risk manager."

"What we will probably evolve to is a situation where corporate CFOs will have within their organization, maybe, a corporate risk manager who will have at their fingertips the tools that a corporate treasurer takes for granted today," he said.

Those tools will allow a risk manager to analyze an organization's risks in order to craft the most-efficient portfolio of risk financing solutions.

And, Mr. Shimpi asked, "if they're then able to do their own analysis, what does it mean for my firm?"

With that analytical power, "it's possible for the corporate risk manager to say exactly what he wants and then to go out and find the cover," he said. The risk manager might choose to sell that risk directly into the capital markets, perhaps directly to a reinsurer.

"Every step you take out in the process is value added to the client," Mr. Shimpi said.

"I see a strong possibility of on-balance-sheet securitization of corporate risks," he said. Rather than going to an insurer or using a special-purpose vehicle to transfer risk, "what's to prevent a number of these steps from getting cut out?" he asked. "What's to prevent corporations from going straight to the capital markets?"

"It doesn't mean that the insurance industry's out of the picture or the investment banks are out of the picture," Mr. Shimpi said. "What it means is the questions become, does this approach satisfactorily address the risk, and what does the overall risk management program look like, and how does this approach fit in?"

The removal of the barriers among investment banks, commercial banks and insurers will have a significant effect on the insurance industry, said David L. Wasserman, president and chief executive officer of Centre Solutions, a New York-based unit of the Zurich Financial Services Group.

Financial institutions already have demonstrated their keen appetite to enter the insurance market by developing securitized products, such as catastrophe bonds; by establishing insurance agencies; and by setting up captives in anticipation of taking on underwriting risks, Mr. Wasserman said. In addition, he noted that investment banks assembled the investment capital that was used to establish the Bermuda catastrophe reinsurers in 1992 and 1993.

"They got in and made a market that the insurance market was not prepared to make and then got out through initial public offerings," Mr. Wasserman said.

In the future, investment and commercial banks will likely be just as aggressive in making inroads into the insurance market, he said.

"The banks that now provide lending capacity to commercial customers will want to provide them with everything else they can," he said.

But insurers will still be able to work with the banks, Mr. Wasserman said.

Investment banks have traditionally avoided taking financial risks themselves, he said. While changing regulations may increase their willingness to do so, investment banks still likely won't want to take on those risks that are covered by primary insurance policies, he said.

"We don't have to fight with the banks; we can cooperate with them. There will be some banks that want to take risks, but there will be others that want insurance companies to come forward," Mr. Wasserman said.

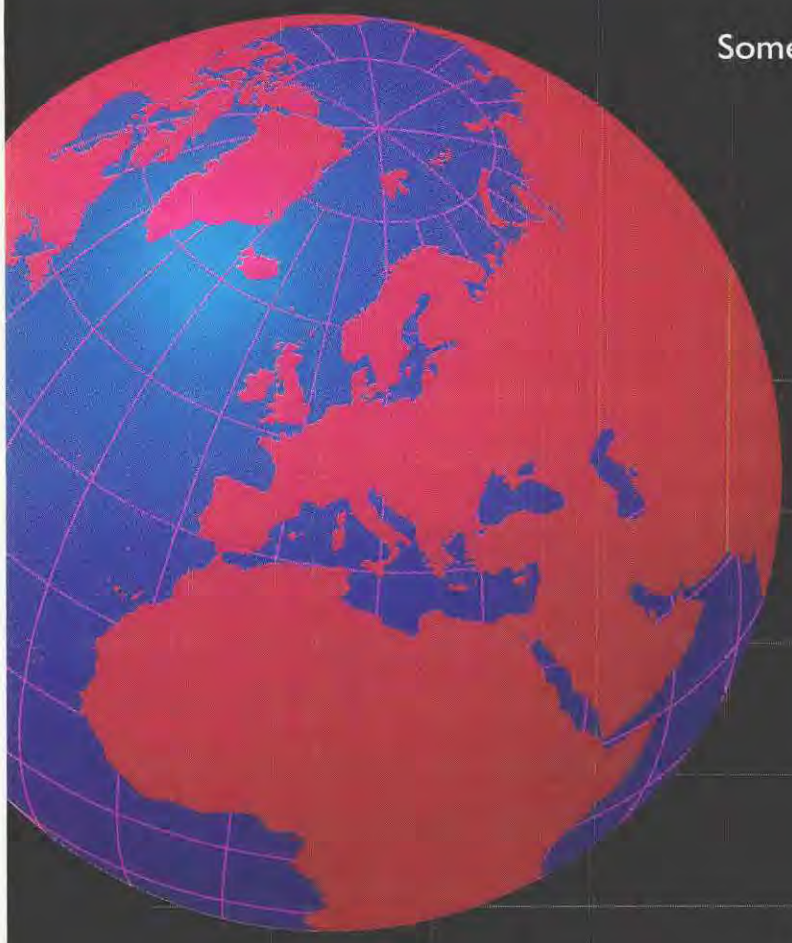
Insurers that do cooperate with the banks will have to produce new coverages to complement the deal structures designed by banks, he said.

For example, insurers could provide coverage for the riskier properties in a real estate portfolio that is being sold by a bank, he said.

The analytical underwriting skills needed to assess risks and the ability to gain access to capital markets are not normally found in one company, said Chubb's Mr. Degnan.

"We're better at sizing up risks, analyzing the degree of exposure and pricing it right, but (capital markets) have more capital, so there are going

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to be far more alignments between the capital markets and insurers," he said.

Marsh's Mr. Scherzer offered a similar view. "The insurance concept of transferring risk for a fixed price—if you will, guaranteed cost insurance—will absolutely be a core concept of whatever (the shape of risk financing) is going forward," he said.

While buyers' decisions about whether to use traditional insurance, derivatives, or other approaches to transferring risk will be made on a case-by-case basis, "insurance companies will be very active in this field," Mr. Scherzer said. "They have the unique ability of all the different financial institutions where their core business design is to take on risk and hold it on their balance sheets."

Even in their traditional risk transfers, businesses are likely to see the effects of the increased role of the capital markets.

Michael R. Levin, senior manager of business risk strategy consulting at Arthur Andersen L.L.P. in Chicago, sees strong similarities between the risk financing scene that is developing as the new century begins and the home mortgage industry as it was 25 years ago.

A quarter-century ago, mortgages were "hand tailored" and very individualized, Mr. Levin said. But increased standardization of mortgages allowed mortgage lenders to become "mortgage originators," bundling the loans and selling them to entities such as the Federal National Mortgage Assn. and the Federal Home Loan Mortgage Corp.

Fannie Mae and Freddie Mac, in turn, securitized those bundles, selling them in the capital markets.

"There's a similar possibility that's available for insurance companies, in which they will be originators of insurance," Mr. Levin said.

In that scenario, insurers could provide standardized policies, bundle them and sell them to reinsurers, who could securitize them.

Reinsurers "better start acting more like Fannie Mae and Freddie Mac," Mr. Levin said. "The Fannie Mae/Freddie Mac model is highly standardized and very efficient."

Another possibility Mr. Levin envisions is that of a "liability manager," whose function would be similar to that of an asset manager.

Today, on the asset management side, a company hires an individual or firm to manage a portfolio, with certain goals for return on risk.

"There's no reason that, 10 years from now, there's not going to be a similar person or a firm called a liability manager, who, in exchange for a fee, will be handed a portfolio of liabilities" to manage, Mr. Levin said.

Mr. Levin said he wouldn't be surprised to see larger corporations take that approach. He added that he would expect to see such liability managers coming out of the asset management business, where managers are accustomed to being paid not by the transaction but for the management of an overall portfolio.

"Just like an asset manager gets paid for assets under management, you get paid for liabilities under management," Mr. Levin said.

And, he said, an enterprise risk management approach dovetails well with the notion of a liability manager.

"The liability management idea works best only if you have a client that wants to transfer pools of risk," he said. "If you want to just transfer one risk at a time, you hire a broker and go buy an insurance policy."

In the future, insurers and policyholders will forge broader relationships than those they now have, said Clive Tobin, president and CEO of XL Insurance Ltd., a unit of XL Capital in Bermuda.

"Corporate customers will be looking to insurers and reinsurers for a variety of programs to address a multitude of risks," he said.

For example, a shipowner who traditionally buys hull and machinery coverage from an insurer might also seek a specialized coverage from the insurer to enhance the shipowner's credit, enabling it to raise financing capital, Mr. Tobin said.

"We'll be able to go to investors and say, 'Will you raise the money based on our guarantee?' " he said.

An insurer could then offer traditional hull and machinery coverage and special-purpose coverage, as well as a whole range of other insurance and financial products to the shipowner, he said.

But insurers are still some way from developing such relationships, he said.

Several integrated property/casualty programs have been sold over the past two years, but there have been few programs that blend traditional risks with other financial risks, Mr. Tobin said. The growth of integrated programs has been slowed by the recent soft traditional market, he said.

"But now there is a sense that rates are beginning to tighten, and, if that happens, there will be a much greater movement to integrated risks in order to save money," Mr. Tobin said.

And larger businesses won't be alone in incorporating more financial approaches to risk transfer, many assert.

"The integrated program that has been sold to date has been for the very large companies, but now I think the trend might move down to the middle markets," said Barbara H. Monaco, vp at Atlantic Risk Services Inc. in Madison, N.J.

Atlantic, which works with many middle-market clients, sees some interest by those clients in integrated programs, she said.

"I do foresee captives moving down into the middle markets, too," she said, adding that "even smaller companies can now

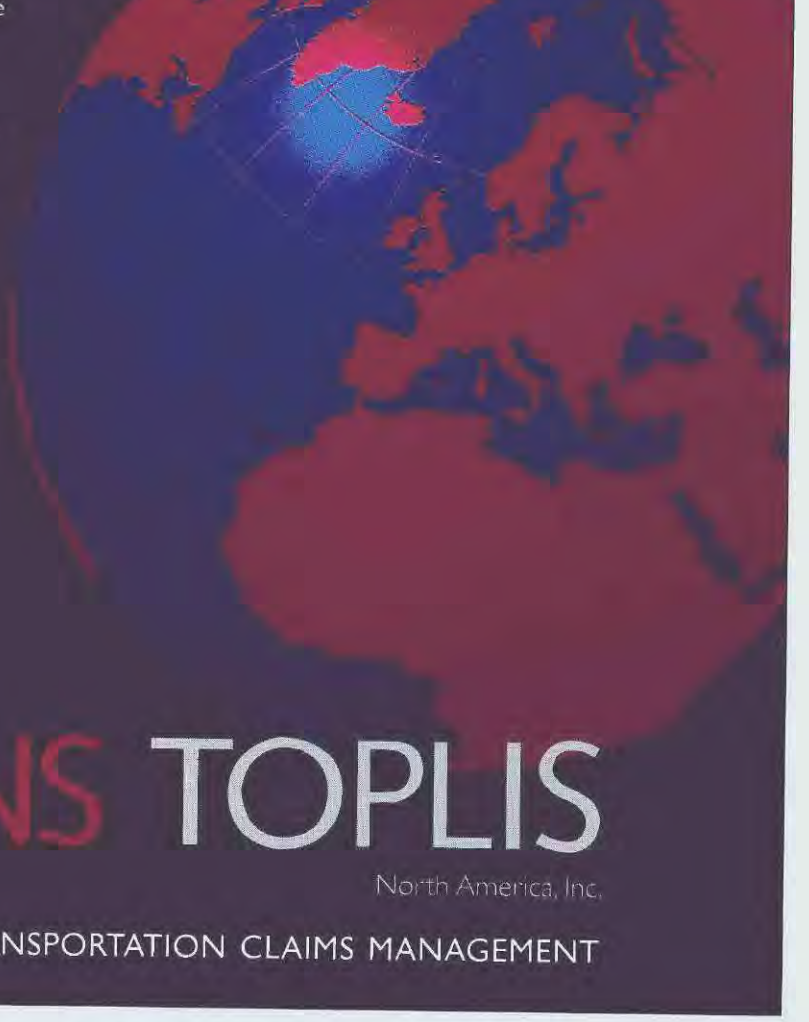
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Alternatives

Continued from previous page
participate in captives through groups and associations."

Mr. Scherzer also sees demand for the new risk financing techniques among middle-market companies, and he said he believes it's up to the insurance industry to craft approaches to allow those companies to evaluate and deal effectively with the new options available to them.

"It's up to us, in the industry, to try to craft something that meets what I think is a real pent-up market demand," he said.

Whatever risk financing alternatives develop in the future, they will be products that meet consumer needs, experts say.

Development of new commercial products will center on financial reinsurance and alternative risk transfer products, such as securitized coverages, because these products offer more flexibility than does conventional insurance, said Steven Bolland, senior vp at Gill & Roeser Inc., a reinsurance intermediary in New York.

Securitized coverages have not yet been sold in significant numbers, largely because conventional coverage has been plentiful and cheap. But that could soon change, he said.

"A couple of years ago, you could ask yourselves, 'Are the people that are providing the new coverage being greedy, or are the insurance guys giving their product away?' and you could answer, 'Fifty/fifty.' But now, with the financial results we are seeing, it's clear that insurers are not setting the right price, and maybe the capital markets are rating their products at the right level," Mr. Bolland said.

When insurance and reinsurance prices start to rise, capital markets-based products may gain an advantage, as insurers have failed to substantially reduce their expenses, he said.

Securitization will not become a popular risk transfer approach until insurance prices rise significantly, predicted Mr. Wasserman of Centre Solutions.

"Everybody in the insurance industry is hoping that the market hardens. But that is a mixed blessing, because, as soon as that happens, the investment banks will bring capital markets capacity to bear," he said.

If the traditional market should harden, that would only further promote the development of alternative risk financing options, rather than prompting the current insurers in the market to abandon their efforts and return to traditional products, Mr. Groth said.

"You've got the insurance companies like AIG and Swiss Re and XL and Munich-American Risk Partners. These companies are gearing up, and some of them are throwing a lot of capital at being able to write these types of programs," he said. "And some of these will begin to bear fruit. So I think we're going to see the insurance business gravitating to new types of risk exposures."

"I don't think the insurance companies are going to ditch all the stuff they put into their alternative risk areas if there's a big market correction up," Mr. Groth said. While the current soft market may be providing those companies with an incentive to be more creative in their coverage options, "as soon as the market gets a little harder, these insurance companies will still have a competitive advantage by being able to write these types of products," he said.

Beyond that, Mr. Groth said, the alternative products that are considered expensive by some in today's soft market will be priced more competitively in a hardening traditional market.

"The prices for the integrated programs may not follow the market up," he said. "Because, right now, if you go through the actuarial process of what a risk is worth, the (traditional) market is pricing beneath that level."

A harder market may well prompt demand for more-sophisticated risk financing in other ways.

"For the last five to seven years, at least, risk managers have been riding the wave of market softness," Mr. Groth said. "If there's a budget increase in the insurance side, then the next step is to say, 'If we're going to pay more money, how can we get more of our risks covered?' "

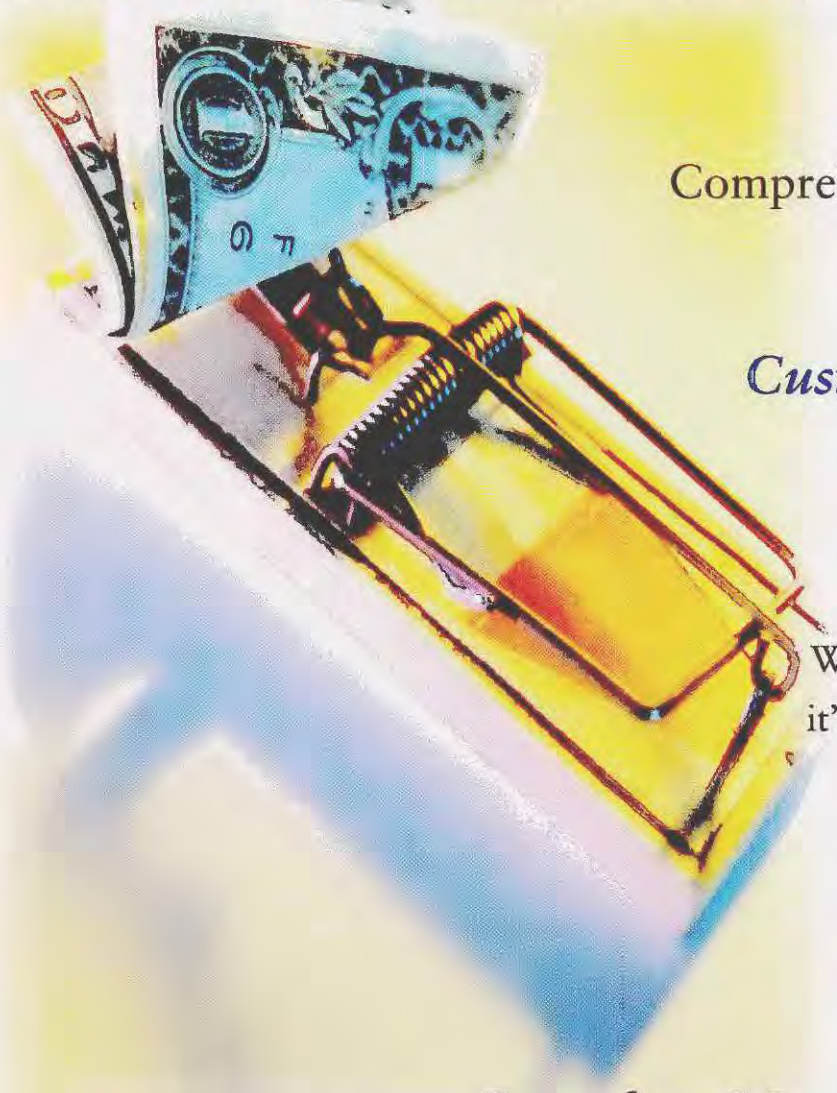
And from a seller's perspective, the view will be similar, according to Peter Gentile, president and CEO of Gerling Global Financial Products. This should promote a continued interest in providing alternative risk financing products, he said.

"The hope really is not necessarily in a hardening of the reinsurance or insurance market but in a convergence taking hold and the capital-providing process becoming more efficient and, as a result of it becoming more efficient, people making what they think they should make on their capital," Mr. Gentile said.

While there have been relatively few examples of enterprise risk management or integrated risk financing to date, "if you took a look at how many companies are looking at whether to try enterprise risk, you'd be surprised how many companies are looking at this," Mr. Groth said.

"I think the future for these products is tremendous," SRNM's Mr. Shimpi said. "And it's not the future of these products in isolation or as substitutes; it's the future of these tools as instruments for capital management." BI

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In 2100, rates respond to future schlock

By JUDY GREENWALD and ROBERTO CENICEROS

Just like that starship now slowly wending its way toward Alpha Centauri, insurance rates in 2100 are being pulled by competing gravitational forces.

Virtually all lines of life/health and property/casualty insurance continue to see sporadic shifts in pricing, depending on the latest news developments, risk and benefit managers say.

"And to think, 100 years ago some risk experts were predicting the end of insurance market cycles because the capital markets were moving into risk financing," recalled Victor Frisbee, chief risk and benefit officer for MedBot, a manufacturer of hospital operating room robots based in Armstrongville, the Moon.

"Now, risk rates behave like commodity prices, fluctuating daily, so we can never renew all our coverages at one time of year," he noted. " 'Buy low; renew lower' is my motto."

The latest example of the risks of rating volatility is pollution liability insurance.

Rates for pollution coverage declined throughout much of last year, insurers report, thanks to advances by new spinach-based biotechnology at cleaning up old Superfund sites and halting the threat of third-party damage.

Dubbed the "Popeye Solution," the Environmentally Benign Digestion Process safely eliminates the toxicity of pollutants by digesting their chemicals and then either transforming them into useful compounds or reducing them to a nutritious biomatter that tastes great on crackers.

However, while the apparent success of the Popeye Solution kept pollution liability rates down for much of 2099, rates began creeping upward again at year end. The cause: two new studies warning that corporations and their insurers now are likely to be on the hook for trillions of dollars more than expected from liabilities stemming from the failed application of pollution-eating microbes a decade earlier (*BI*, www.businessinsurance.com/archive/01-13-2088.html).

The microbes had to be destroyed after it was discovered they also had a fondness for pets and small children. The new studies contend that, owing to the difficulty of completely eradicating the microscopic bugs that were deployed at thousands of waste sites, claims of infestation continue to surface years later, driving many scrofulous claimants before sympathetic and overly generous juries.

"Just when rates were dropping and the market was convinced that the Popeye technology would succeed where the microbes had failed, these reports come out, showing our liabilities will be much greater than expected," complained Byron Dupert, chairman, president and chief operating officer of SPACE Ltd., the Bradbury, Mars-based excess liability insurer.

SPACE is among the reinsurers and excess liability insurers that have moved their base of operations to Mars in recent years, as they seek a less-onerous regulatory environment than Bermuda, where many of these same companies were founded over 100 years ago to avoid the restrictions placed on them in the United States.

The complete lack of regulation on the Red Planet gives insurers and reinsurers far more flexibility than does the regulation found in Bermuda, they contend.

But what really sealed Mars' future as a reinsurance center was the discovery that the multitude of below-surface water sources, paired with the latest in climate control technology, meant that golf courses could flourish there.

"The Martian greens are a little fast and the sand traps are murder, but boy, thin atmosphere is great for my drive!" said Mr. Dupert.

"It's like we have been saying for decades. The insurance industry is a solar-systemwide market anyway," said Roger Connors, head of BIG Insurance Group Inc., based in New Stamford, Mars.

Meanwhile, back on Earth, pollution liability is not the only headache for risk managers and their insurers.

Genetic engineering malpractice claims remain a nightmarish situation for insurers, causing liability rates to continue soaring. Several recent scandals, in particular, are driving the GE&O market higher, insurers say. One high-profile case involves a technician in a genetic engineering clinic who cloned his DNA and implanted it into 500 embryos. Five-hundred lawsuits were promptly filed against the clinic shortly after the technician was caught and jailed on criminal mischief charges.

"We've been charging 500% rate increases in some cases, and, in many cases, turning clinics away altogether," said Lawrence Jacobs of Amazon.com Mutual Liability Insurance Co. of Redmond, Wash.



Meanwhile, genetic engineering clinics also face rising liability exposures as the competitive marketplace forces them to guarantee children with ever-increasing I.Q.s, along with perfect health and whatever other features the client demands.

"Nobody's ever satisfied," says Dr. Robert Grivens, who heads a Tijuana clinic that is considering closing its doors in the wake of soaring malpractice claims and unaffordable GE&O insurance. "We had one couple sue us because their child's eyes were the wrong shade of blue. It's become impossible to get insurance for the business."

"It won't be long before these risks become totally uninsurable," agreed Dick Smithers, vp of EVI Insurance, a unit of Donaldson, Lufkin & Jenrette Securities Inc. in New York.

Other commercial liability coverages continue to experience sharp fluctuations in pricing.

Directors and officers liability rates, for example, had seemed to permanently plateau after several court rulings in the early 2090s held that corporate leaders with NYSE-approved embedded artificial governance chips could not be sued by investors. Since then, most shareholder lawsuits have been routinely dismissed, if the majority of a company's directors and officers had NYSE-approved implants to guide their decision-making.

But almost overnight, D&O rates last year more than tripled after trial attorneys proved in *Kramden vs. NYSE et al.* that the NYSE implants contained a flaw in their ability to calculate stockholder dividends to the 13th decimal place (*BI*, www.businessinsurance.com/archive/10-30-2099.html). The ruling opened the floodgates for thousands of retroactive lawsuits against publicly traded companies. In addition to raising D&O rates, underwriters are expected to subrogate against the chips' makers, which could spike product liability premiums for the artificial intelligence market.

As for the life/health business, the market for coverage of mechanically enhanced humans is humming along, though rates for policyholders with animal implants are soaring.

Rates continue to rise for human/animal coverage as a result of the U.S. Supreme Court's controversial decision in *Minotaur vs. Aetna U.S. Healthcare*, in which the court ruled that health plans cannot limit the number of animal internal organs replacements they will cover, in spite of the limited lifetime per organ (*BI*, www.businessinsurance.com/archive/05-01-2099.html). The ruling sparked controversy not only because employers question the fairness of paying for an unlimited number of procedures but also because Chief Justice Rehnquist, who voted with the majority, has been the recipient of multiple implants.

A typical pig-to-human heart transplant operation, for example, which must be redone every two years, runs about $2 million. And with the average employee requiring such an operation as early as age 95, costs for employers could run into billions.

Some employers may decide to drop their health care programs entirely, rather than shoulder the cost of such mandates, benefit experts say.

"Frankly, I don't know how (employers) are going to fund this," said Roger Cranberry, a consultant with PricecoopTouche, Perrin & Hewitt's Lifeform Advisory Services division in New York.

"The federally mandated coverage for face lifts and body shaping that President Madonna just pushed through Congress is already likely to cost employers billions of dollars. And now, with most employees needing transplants by age 95 and the average retirement age at 150, the cost is going to be prohibitive," he warned.

"It's going to cost us a fortune," said Michael Axelrod, benefits manager at The Giant Computer Co. in Baltimore. "Benefits are already eating up 50% of our profits. I don't know how we're going to fund all these expenses."

The implants have other implications as well, say some observers. With animal transplants extending the work life of people indefinitely and forced retirements long since forbidden, many companies—particularly the more-established ones—are becoming clogged with older workers.

"Companies need the younger workers to provide fresh perspectives," said Archie Smith of ABACDEFG&K Consulting in Atlanta. "They lose that when people spend decades in a company."

This adds to the existing retention problems caused by federal employment laws that bar employers from firing any employee unless a court has ruled that the employee is criminally insane.

Meanwhile, another case headed for the U.S. Supreme Court raises the question of whether employers are obligated to provide health insurance even for employees who choose to go the robotic route.

The case involves the 150-year old Dennis Wrightston, an employee of Sputnik P.L.C., whose heart, lung, left arm, eyes, voice box and two legs all have been mechanically replaced, in addition to the standard cyber memory addition.

Under the Insurance Services Office Inc.'s standard cybernetic organism exclusion, once more than 50% of a policyholder's body mass is artificial, existing policies no longer apply, and the employee is considered a machine for insurance purposes.

As a machine, it is covered by specialized group boiler & machinery policies that cover those employees with a majority of artificially engineered body parts. Typically, the premiums for these specialized b&m policies are far less expensive and generous than health insurance premiums.

The Wrightson case challenges the very notion of what employment law regards as human. The 13th U.S. Circuit Court of Appeals, based in Yeagertown, the Moon, ruled that, as long as there is any flesh and blood left in the policyholder at all, employers are obligated to provide full coverage as if the worker were 100% human.

If the case is upheld by the Supreme Court, it could dramatically increase the cost of health insurance premiums for employers.

This is especially so as a result of the increasing popularity of the so-called Borg implants—named after the cyborg characters in the long-running Broadway musical Star Trek. These implants augment or replace a majority of organic bodily functions with superior mechanical parts.

"If we lose, it's going to cost us a fortune in added benefits," says Axle Harmon, benefits manager with Sputnik in Yeagertown.

Complicating the issue is the question of whether these procedures are medically required or should be considered elective surgeries not covered under standard health policies.

"Everyone knows that, once people start being enhanced with mechanical parts, it's hard to stop, and they naturally desire to have more and more done," says Jerry Cooper, a vp at Roboto Insurance Co., a New York-based unit of the Jiffy Lube Co. "Under standard insurance policies, these procedures aren't covered unless there's a medical necessity. But you can always find some doctor to say one exists," he said.

In spite of the evolving nature of risks and the seemingly endless demand for new forms of financial protection, analysts are still undecided over the prospects for a new stand-alone insurance company.

Just Insurance P.L.C. was formed last year by an investment consortium led by Trident Partnership CXVII Ltd.

With the virtual disappearance of monoline financial services companies following 1999's financial services modernization legislation, it has been decades since a solo insurance company has been created.

"I don't see how they can make it," said stock analyst Roger Drysdale with Shearson in New York. "It seems to be me they totally lack the financial expertise, experience or capital backing to be successful."

But others say the revolutionary idea has a chance of success.

"A small, stand-alone insurance company will have the flexibility that the megacompanies lack," says John Smith, a partner with Acme Advisers in New York. "Who knows? This idea of starting up insurance companies might even become



Future brings challenges to risk manager

By MICHAEL BRADFORD and DAVE LENCKUS

Risk managers are standing at a crossroads as the new millennium opens, and the direction they choose will lead them either toward greater prominence within their organizations or into a career dead end.

The right path for risk managers, experts contend, is one laid with the hard work of educating themselves about the challenges posed by new risks and with a rapidly changing outlook on managing risk.

A relatively modern discipline, risk management is in the early stages of an evolution that is expected to lead to new ways of protecting organizations from a multitude of hazards. In recent years, there has been a shift toward "enterprise" risk management, which attempts to bring together the management of all risks—financial, operational, strategic and traditionally insured hazards—into a single portfolio.

Further prodding the evolution of risk management is a host of new exposures created by an explosion of technology. Suddenly faced with e-commerce and other risks that did not exist a decade ago, risk managers are finding their





responsibilities branching into uncharted territories.

Risk managers who choose not to dedicate themselves to learning about risks that fall outside their traditional purview likely will realize "you've come to the end of your career," said John Bugalla, managing director of the Advanced Risk Management Services Division of Willis North America Inc. in Nashville, Tenn.

What remains unclear is who will have ultimate responsibility for managing a company's enterprise risk portfolio as that concept takes hold.

Some experts say the job will evolve into one handled by a chief risk officer and that the risk manager is the person best suited for the job.

Others, including some risk managers, disagree. But while they would give CRO responsibilities to a finance or treasury officer, they maintain that risk managers still can expand their roles by becoming something akin to chief purchasing officers for their organizations.

What most observers do agree on is that the risk manager who is unprepared for the shift toward enterprise risk management will be on the outside looking in as the profession evolves.

"It's a fascinating time," observed Bob Williams, a New York-based executive vp at Aon Group Inc. "It's a very opportunistic time for risk managers and other senior executives."

No longer is senior management looking at risk as "separate towers" of traditionally insurable hazards, financial risks and other exposures, he said. Instead, top managers have taken an expanded view of risk and are considering ways to handle their exposures in a holistic fashion.

"Everybody is talking about enterprise risk management," Mr. Williams noted. "Whether they are on the same page or not, I rather doubt it. But it is my firm belief that enterprise risk management is very real and very necessary, because risk is becoming far more complex."

It is a slow evolution, experts say, but one that is gaining momentum.

"Enterprise risk management is not widespread at all," said Larry Ponemon, partner and global leader of compliance risk management at PricewaterhouseCoopers in New York. "There are companies in financial services that are doing it and doing it well. But it's still in the infancy state."

Still, "we predict that it will become an enormous opportunity," Mr. Ponemon said.

Enterprise risk "has been a hot topic out there," observed Lino Martin, a board member of the Bethesda, Md.-based Assn. of Financial Professionals, formerly the Treasury Management Assn. There has been "an expanding need and recognition" of the importance of managing a company's entire risk profile, said Mr. Martin, vp and North American treasurer for Ingram Micro Inc. in Santa Ana, Calif.

Enterprise risk management, though, "is still evolving," he said. Mr. Martin predicted that only a few very large companies will venture into this area in this early stage. If insurers and capital markets develop products that work, then many more large and even medium-sized companies will adopt a broader risk management approach, he said.

"It's kind of morphing from one level of sophistication to another," observed Jerry Belfiglio, director of risk and insurance management with Armstrong World Industries Inc. in Lancaster, Pa. During this transition, the risk management profession is gaining some stature, as senior management is calling on risk managers to manage the "upside" of corporate risk as well as the downside, he said.

For example, Mr. Belfiglio is involved in a project designed to ensure that Armstrong products are not among those delayed in getting onto store shelves because of Y2K-related transportation disruptions.

"If our competition hasn't done this, we've got a leg up on our competition," he said.

But, as the enterprise risk model matures, risk managers may find that their roles—and perhaps even their professional survival—depend on whether they can manage the financial and operational exposures that senior management is insisting must be considered alongside traditional risks.

Observers contend that, while the risk manager of tomorrow may not necessarily be a financial officer, it will, in most cases, be someone with a financial education.

"It's critical, in this modern age, that the risk manager has a role in finance," asserted George B. Flanigan, insurance industry professor at the Katie Insurance School of Illinois State University in Normal. "I can't emphasize that enough in my classroom."

Some experts say that a well-educated risk manager already is prepared for the challenges of financial risks.

"There's no reason why the person with responsibility over property/casualty can't take financial risk management," said Chris Mandel, director of risk management at Tricon Global Restaurants Inc. in Louisville, Ky. Financial issues should not be foreign to the well-educated risk manager, who "has to understand every aspect of the organization anyway," he said.

The risk manager who has handled traditional exposures has a broader view of risk than the financial risk manager who has concentrated on issues such as currency exchange and interest rate risk, Mr. Mandel contends. "How many people understand derivative risk? Can people learn it? I think they can. The well-educated risk manager has a financial background anyway," he said.

Susan R. Meltzer, president of the Risk & Insurance Management Society Inc., agreed that financial risk managers may not be the right people to handle a company's total risk management responsibility.

"I think financial risk managers have a more narrow view of the company and operations than the risk manager. I don't think their knowledge is broad enough to take over the whole thing," said Ms. Meltzer, assistant vp-insurance and risk management at Sun Life Assurance Co. of Canada in Toronto.

The AFP's Mr. Martin agreed that "traditional risk managers have the core competency skills to competently manage other areas" and to move into the role of a company's chief risk officer.

Mr. Martin envisions CROs overseeing the entire risk portfolios of their companies, but he notes that the precise role they take will "evolve over time," just as an individual company's approach to enterprise risk management will evolve.

Others, though, say that some of today's traditional risk managers are not well suited to handling a company's entire risk portfolio.

Risk managers who have been encouraged to help address their organizations' operational and financial risks can make valuable contributions to that process, said William J. Kelly, a managing director with responsibilities for corporate risk and insurance management at J.P. Morgan & Co. Inc. in New York.

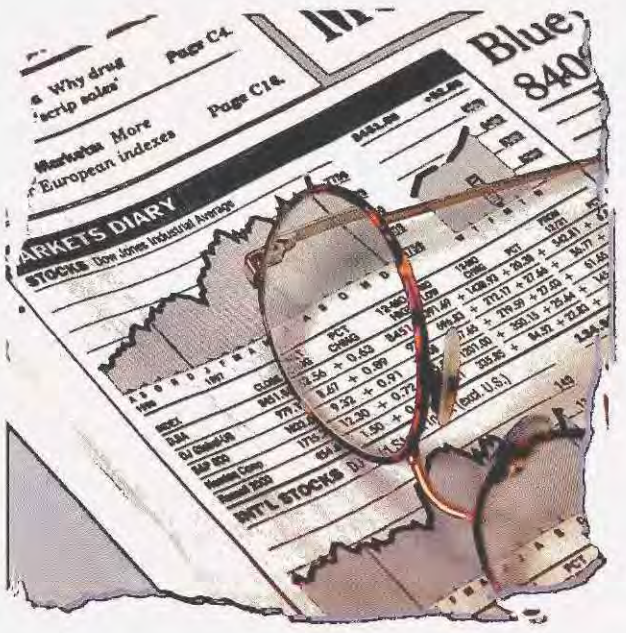
Risk managers, however, usually are not the most qualified individuals to lead that effort, he said.

Mr. Kelly explained at the Federation of European Risk Management Assns.' forum in October that enterprise risk programs offer safeguards against financial and operational risks, with technology being the major source of the latter.

Mr. Kelly noted that the focus of enterprise risk programs is moving toward providing coverage for operational risk rather than a company's entire risk portfolio with balance sheet losses typically the trigger for this coverage.

A new insurance program crafted by FMR Corp. with Swiss Re New Markets Corp., for example, provides FMR with large limits for a catastrophe program that includes coverage for the company's operational risks (*BI*, Nov. 6).

"The development of the role of enterprise risk manager may, depending upon the nature of the firm, favor individuals with extensive financial and/or technological backgrounds. In



my opinion, this does not describe most current practitioners of risk and insurance management," Mr. Kelly said.

Mr. Kelly said he sees a different role for risk managers, though he acknowledges that his idea amounts to "blasphemy" in most risk management circles.

He explained his concept at the American Bankers Assn. Insurance Risk Management Conference earlier this year: "After decades of attempting to distance themselves from purchasing in general and insurance buying in particular, the risk manager may well be the individual most naturally equipped, in terms of experience and skills, to address expense risk management by assuming responsibility for a broader spectrum of corporate procurement."

The procurement function, with its direct impact on corporate expense management, profit and loss and, ultimately, on share value, has "evolved into one of the most

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critical (functions) in the modern corporation," Mr. Kelly noted.

Risk managers are uniquely qualified to head corporate procurement, largely because of their experience managing vendor relationships to hold down insurance costs, Mr. Kelly explained.

Those same management skills are needed to minimize procurement expenses throughout the organization, Mr. Kelly said. The principles of vendor relationship management, he said, are that purchasing power should be fully leveraged under appropriate contract terms with the fewest financially sound vendors possible, without being overly dependent on any single vendor.



"All of this should sound very familiar to the risk and insurance manager," Mr. Kelly said.

Armstrong's Mr. Belfiglio said he does not believe the current crop of risk managers will be found in the CRO's chair.

With the insurance-industry training and the "old MBAs" that most 40- to 60-year-old risk managers have, they do not possess the skills to manage the enterprise risk products that will emerge from the capital markets, Mr. Belfiglio asserted.

"Some small portion"—around 10% to 15% of risk managers—can develop the necessary skill sets and "will rise to the top. The bell curve will tell you that," he said. "I don't think the rest are capable."

For different reasons, Ms. Meltzer also said she does not believe that career advancement for tomorrow's risk manager necessitates moving into the CRO position.

Indeed, "I don't believe in the theory of a chief risk officer," she said. In effect, as the head of the organization, a company's CEO holds that position, Ms. Meltzer argued.

In addition, she said, "there are a number of skill sets that no one person can have" but that are crucial to a company's efforts to manage risk. "I believe in a chief risk team," made up of several managers who handle risk management, compliance, auditing and other functions, Ms. Meltzer explained.

Walter S. Tomenson Jr., chairman, client development at Marsh in New York, stressed that risk managers must develop leadership skills if they are to hold the critical position that he believes to be the future of the profession.

"The person who has this job has to be a risk connector," he suggested. "They must be able to connect to various parts of the organization and to identify risks in all those areas, evaluate them and help in developing solutions."

The person handling the risk management function will be "dealing with very talented people in their own firm," Mr. Tomenson said. As such, that person will need skills that will enable him or her to communicate issues to and work closely with those senior managers on handling risks in various areas, he noted.

Larry Gaunt, professor of risk management and insurance at Georgia State University in Atlanta, agreed that tomorrow's risk manager will be a team leader. "The person with the title of risk manager will have the job of coordinating," he said.

Risk management "is more of a function than a job," Mr. Gaunt observed. "Many different people in an organization do risk management. What we see evolving bears that out," he said.

Winnipeg, Manitoba-based United Grain Growers Ltd. took that team approach when management reassessed UGG's total risk portfolio. The UGG board appointed a committee of several top corporate officers to identify all of the company's risks. The committee included CEO Brian Hayward, Chief Financial Officer Peter G.M. Cox and Michael J. McAndless, manager of corporate risk and insurance services.

UGG buys and sells grain on world markets and distributes livestock feed, fertilizer and crop protection products.

While UGG senior management understood the company's business operations risks, they did not have a "systematic evaluation of how big the risk was and its frequency," Mr. Cox said.

"That's where traditional risk management came in and applied a process" for identifying, analyzing, controlling, preventing, reducing and financing those risks and monitoring the results, Mr. McAndless said.

Beginning Jan. 1, a new integrated risk product will cover the company's exposure to downturns in its grain-handling business, as well as the company's traditional property/casualty risks (*BI*, Nov. 15).

While Mr. McAndless' position at UGG has not changed, his responsibilities are broader, as he identifies both the traditional and non-traditional risks the company faces. "I've assisted our risk management committee. That's where I've added value," he said.

Regardless of the title they ultimately assume, risk managers in the near future will have to offer additional skills, observers agree.

Georgia State's Mr. Gaunt said that risk managers need, among other things, good communication, analytical and finance skills. "The risk manager, to be successful, will have to have these tools and have a big-picture mentality" to coordinate the function among other managers.

Risk management consultant Mark Charron said that if a CRO is defined as an individual responsible for an organization's operations, treasury and insurable risks, then "that individual is going to need to have better management skills than any one functional skill."

Still, "the CRO will need a certain level of knowledge across multiple areas," said Mr. Charron, national partner in charge of insurance risk management consulting at Deloitte & Touche L.L.P. in Hartford, Conn.

Most notably, a CRO will need finance, accounting and legal skills, as well as common sense, to handle quality assurance and product liability issues, Mr. Charron said.

The CRO will have to rely on individuals with deep technical skills in each of those areas, while deciding with



senior management how much risk to transfer to another party, he said.

As for who will fill the role of CRO, Mr. Charron observed: "Ah, yes, the race is on."

The successful candidate will be the individual "who is bringing value to the organization" by identifying, managing and financing risk, he said.

That individual could come from risk management or treasury, or it could be a critical control person, Mr. Charron said. "No one has a lock on it, in my opinion."

Experts agree that the person who wins the job will have to let senior management know that he or she deserves it.

"The No. 1 issue is making sure that the people who are decisionmakers know what you do," Tricon's Mr. Mandel said. "I've seen too many people get hammered because they couldn't explain what they do. Selling yourself is No. 1."

Willis' Mr. Bugalla said that effective ways of communicating with senior management include keeping CFOs up to date on developments in major lines of coverage and preparing annual board presentations on the status of risk management at the organization.

"Be a marketer," he urged. "Market your own ideas in your firm."

He also strongly advised risk managers to get "involved in business deals." Whatever risk managers do to improve their stature will not matter much "if you're not in the room when



decisions are made" by top management, Mr. Bugalla said.

Maintaining a high visibility and becoming a facilitator are the keys to that room, he said. "If you have a CFO who doesn't know you, you'll find yourself in great difficulty." High visibility in a company "is important to your survival," Mr. Bugalla said.

Mr. Gaunt of Georgia State said high-profile risk managers are good communicators. "When I look at the people who are *Business Insurance*'s Risk Manager of the Year, one of the top skills these people have is communication. They have the ability to communicate effectively both above and below them."

Of course, they have to be communicating a cutting-edge risk management approach, experts say.

"The people I know as risk managers have a high stature if they're out on the cutting edge and doing new things," said Mr. Flanigan of the Katie Insurance School. "I think the risk manager who is on his last legs is the risk manager who doesn't add value. The risk manager has to demonstrate that he just doesn't go to lunch with his brokers and let the brokers handle the whole thing." Otherwise, top management will ask, "What the hell do I need a risk manager for if all he does is rely on the broker?" Mr. Flanigan observed.

As for education, Willis' Mr. Bugalla said a CRO candidate will need an MBA and must be proficient in statistical analysis.

Without that background, risk managers may see companies turning to the financial area for their chief risk officer, the AFP's Mr. Martin said. "A treasurer would have a lot of those skill sets, and the insurance function reports into the treasurer" at many companies, he observed.

Georgia State's Mr. Gaunt said a financial education is becoming vital for risk managers. Many traditional risk managers who want to survive in the coming years "better know more finance than they know now," he stressed.

RIMS' Ms. Meltzer said risk managers and their staffs need the broad business background that can be delivered through obtaining the Fellow in Risk Management designation, which is administered by the Global Risk Management Institute at RIMS. "I'm not hiring anybody in my department that doesn't have the FRM," she said.

Mr. Flanigan said he believes that earning an MBA is a great advantage. If that is not possible, then risk managers should investigate seminars or special courses on finance, written and verbal communication skills, marketing and management offered by colleges, RIMS and other organizations, he said. "Take whatever is convenient," he advised. "You can get immediate rewards from every course you take."

And if a risk manager has not already earned the Associate in Risk Management designation, Mr. Flanigan said, he or she "should get it."

Mr. Tomenson of Marsh said that while he is a "great believer in educational courses" that prepare risk managers for their work, he also thinks "those educational courses are going to have to include the soft courses of people skills, presentation skills and leadership skills."



Future benefit managers may be a new breed

By AMANDA MILLIGAN
and JOANNE WOJCIK KOCHANIEC

While there is some disagreement as to the role of the benefit manager in the future, industry observers do largely agree on one thing: the job will never be the same again.

A squeezed labor market, continual advances in technology, ballooning health care and drug costs, and a highly litigious environment are all at the forefront of benefit managers' minds as they peer into the new millennium. These are among the factors contributing to a change in the scope of benefit management jobs, as they move from an administrative role to a more strategic one.

"It really is an interesting time to be in this business, with all the changes going on," said Gary Laugham, a principal at Hewitt Associates L.L.C. in The Woodlands, Texas.

As companies compete for top talent, benefits as part of overall compensation packages are helping define the most progressive companies—and the most desirable ones—for which to work. Benefits are viewed by many corporate leaders as a critical part of the success of the overall business plan.

Rather than assuming that benefit managers have offered the best mix of benefits to meet recruiting and other corporate goals, however, company leaders often are asking benefit managers to quantify the cost, value and utilization of benefit offerings.

In addition to focusing on benefits, benefit managers should look at a larger picture that includes such issues as compensation and human resources, said Tony Miceli, director of sales and marketing for PricewaterhouseCoopers in Boston.

"You need benefits to play, but you don't need it to win," he said. "You will see a really smart approach to total rewards—a shift away from a look at benefits to a focus on total compensation."

"I've seen more change in the last five years than in the prior 30," observed Helen Darling, group benefits and health care practice leader at Watson Wyatt Worldwide in Stamford, Conn., and the former manager of international compensation and benefits at Xerox Corp.

Ms. Darling predicts the pace of benefit managers' jobs will accelerate.

She pointed to a current project she is working on involving benefits integration following a merger: "They're going to take over the whole company in four weeks, and they want the benefits integration done in four days," she said. "Because the big guys are doing things like taking over whole companies, they're not remotely tolerant of somebody saying, 'Wait a minute, I need six months for this,' like they might have done in the old days."

As a result, benefit managers and consultants are working more hours than ever before.



Changing role of managers

While there may be more demands placed on the benefit manager, the size of benefit departments in the future will likely shrink, said Mike Pikelny, corporate actuary and employee benefits consultant for Hartmarx Corp. in Chicago.

That reduction will stem from a shift in the role of the benefit manager. In the future, employees will become less reliant on discussing their benefit selections with company benefit advisers, he predicted.

As a result, benefit managers will likely focus their efforts on managing the outside vendors handling various areas of benefits administration, Mr. Pikelny said.

Because of outsourcing, "the benefit manager will have to be a more strategic and capable manager to keep up with lots of



things moving at the same time," Ms. Darling said. "So there will be this strategic vision about where benefits need to be and, at the same time, you'll be on the phone with United Healthcare one minute and your 401(k) vendor another minute and. . .dealing with employees in a hurricane, and you've got to get the EAP down there."

Failure to adequately monitor such operations could introduce liability due to mismanagement, said Tim Beck, principal and health and welfare practice leader in Buck Consultants Inc.'s Los Angeles office.

Benefit managers also are becoming more responsible for monitoring and controlling the cost of benefits and how it affects the company's total costs, said Mr. Beck. They are looking at the impact of benefits—from the advantages to the liabilities, he said.

"The benefit manager is finding their role to be more than the traditional personnel role," Mr. Beck said. "Now, they're having to look at all of the risks associated with offering an employee benefit program, be it health care or pension."

In addition to meeting employees' benefit needs, benefit managers should be making sure company needs are addressed: that offered benefits are yielding desired results, said Theawanna Sanders-White, manager of employee benefits for LEGO Systems Inc. in Enfield, Conn.

"We are currently making sure the benefits area is strategically aligned with the business," she said.

Rick Citron, corporate director of global benefits for Campbell Soup Co. in Camden, N.J., said, "To a large extent, the benefits department has already been viewed as an outsourced entity because of the way it crosses so many boundaries of the company." He noted that areas as far removed from benefits as public relations are now interested in the work of the benefits department.

Benefit managers, in turn, will also need to broaden their knowledge of company operations. An improved understanding "will cause them to think about how programs are designed, as it impacts the business with respect to the workforce," said Mr. Citron.

As benefit managers begin to take on a more strategic role, the clout they wield will grow, said Mr. Beck, particularly in progressive companies.

"As human resource/benefit managers continue to look at benefits in terms of the total cost impact to employers, it will increase their position within the corporate structure and the overall influence they have on operations," he said.

If the economy remains as good as it is today, employee benefits—and therefore the role of the benefit manager—will continue to be a high priority for companies seeking to attract and retain talented workers, predicts Ms. Darling of Watson Wyatt.

Benefit managers can improve their visibility "to the extent that we in benefits can make a business case that if we could enrich benefits and even enrich pay a little bit, the cost would be more than offset by the lower turnover" of employees, she said.

Needed skills

Benefit managers should demonstrate that "they're an investment with a high return, and not an expense," Ms. Darling pointed out. "We've got a golden opportunity with this economy."

A good foundation in management basics will help the benefit manager wield more influence in the company, she added.

"The highly educated benefit generalist is likely to be the best bet," said Dallas Salisbury, president of the Employee Benefit Research Institute in Washington. Benefit management "is not the sleepy field that it once was."

Benefit managers also will need more risk management and legal expertise to help shield their companies from liability, said Suzanne Mercure, principal of health care consultant Barrington & Chappell in Falls Church, Va.

Employers will be more concerned about liability issues and will exercise more due diligence in selecting benefits. This likely will include employers taking a more hands-off approach toward health care decisions, even when their plans are self-insured, she said.

Benefit managers will take on more of a risk management function and less of a human resources approach, agreed Thomas Emerick, vp of benefits for Wal-Mart Stores Inc. in Bentonville, Ark.

Insurance and finance experts will take the place of pure human resource professionals, he said, noting that at Wal-Mart, the benefits and risk management departments are in the same unit, and both report directly to the chief financial officer.

"So many benefit departments of today don't speak the language of business, which is accounting and finance," Mr. Emerick said. Cost justification of benefits, he said, is beginning to take precedence over the somewhat less-quantifiable notions of recruitment and retention.

Continuing global expansion also will play a significant role, some say.

Marjorie E. Neville, a principal with Towers Perrin in New York, said that, in five to 10 years, benefit management will become a global profession—and will demand a global strategic approach.

"It's going to become a 'need it to play' in the future," said Ms. Neville, noting that, in addition to being technology savvy, benefit managers will need to have a team scattered throughout the world. "Instead of having your team members two desks away, there's going to be someone sitting in London or Taiwan."

Mr. Citron of Campbell Soup expressed a similar view. "Benefit managers will be more global and more consultative," said Mr. Citron. "They will be dealing in a different milieu of technology."



Technology-driven change

Benefits administration in the future will be very "technology-driven," said Watson Wyatt's Ms. Darling.

Five years from now, "we'll all be walking around with these so-called personal assistance devices. We'll look at it and talk to it and we'll pull down our e-mail and we'll pick up our voicemail and we'll order the turkey for Thanksgiving—all this stuff using something as small as our watches," she said.

Ms. Darling also predicted that voice-activated software and cellular technology will be sufficiently fine-tuned to make hands-free benefits administration possible. Benefit managers will simply talk into their personal assistance devices from any location in the world, and the information will be automatically stored on computer hard drives back in their home offices. They also will be able to access information from vendors using the personal assistance devices, she said.

Benefit managers will have to be comfortable with Web-enabled software programs because this is how benefits will be communicated and administered in the future, according to Mr. Laugham of Hewitt.

"Technology will continue to revolutionize the way benefits are delivered and communicated and will make benefits more self-service," agreed Ralph Kimmich, director of benefits and compensation at Southwest Airlines Co. in Dallas.

Continued on next page



Continued from previous page

Ms. Mercure of Barrington & Chappell predicts benefit managers will use technology to measure more of the total cost of all benefits, not just that of health care.

"There will be a movement in the next few years to look at not just the cost of the health plan, but the cost of disability and lost worktime—all of that combined," which advances in technology will make possible, she said.

Plan design changes

Changes in plan designs could also have a tremendous impact on the role of the benefit manager.

Southwest's Mr. Kimmich discussed a new type of benefit program, dubbed "lifestyle accounts." In such programs, "over a period of years, you vest in a certain number of dollars that you can determine how you're going to use."

Such accounts would make possible new benefit options, such as funding mortgage payments or children's education, and these accounts also would be portable due to changing demographics, he said.

If such a scenario emerges—which is regarded as a likely development, given the needs of today's mobile workforce—the benefit manager will become more of an educator than a



manager, providing employees with information to aid in benefit purchasing decisions, said Ms. Mercure. "People will not want to be tied to a single employer," she said. "So benefits will have to be more portable."

And this focus on portability could effect even more radical changes.

"If this happens, there still is a need for a service that the employee can buy from, but it may not be sponsored by the employer." As a result, benefit managers may no longer be employed by individual employers; instead, they might work for the "mega-benefits" firms that provide benefits to employees on an individual basis, Ms. Mercure said.

John Murphy, vp of compensation and benefits for ARAMARK Corp., a Philadelphia-based diversified management service company, said that benefit strategies are no longer just about being competitive with other companies in one's industry.

"Now we have to focus on, 'Are the benefit plans we offer appropriate and competitive in the world where we're seeking employees?' " he said.

John Erb, area vp for Boca Raton, Fla.-based Gallagher Benefits Services, said "defined contribution" welfare plans are likely to surge in popularity due to their limited liability provision for employers. At the same time, though, employers may be compelled to offer a wider array of plan choices.

"There's a real sea change among large employers to define their contribution in dollar terms, as opposed to tying it to a percent of premium," said Mr. Erb. "We'll offer the Cadillac plans as well as the Chevrolet plans."

Hewitt's Mr. Laugharn predicts that employers in some markets will offer employees as many as 20 or 30 health plans, compared with the four or five offered today.

Future role of managers

As employees are given more and more choice, the role of the benefit manager will become that of information manager: arming employees with knowledge that will help them select the best health plan for their needs, Mr. Erb said.

If employers adopt a defined contribution approach to benefits, the benefit manager will be charged with making benefits more meaningful and attractive, said Mr. Laugharn. As a result, their jobs will emphasize communication and education.

Overseeing the benefit programs and empowering employees' decision making, rather than doing hands-on administration, is how benefit managers of the future will operate, said David Guilmette, managing principal for Towers Perrin's Parsippany, N.J., office.

For example, a benefit manager might collect information about health care product offerings using quality indicators and consumer and employee perceptions, and he or she would then package and share this information with employees, he explained.

"The theme that will prevail in the next decade will be employee self-service," Mr. Guilmette said.

"We'll want to really do a better job of communicating or explaining the value of benefits in terms of the kind of results



and outcomes they produce," Southwest's Mr. Kimmich said. "I've often said benefits have no value until you need them. So we need to tell people they're there to meet those needs when they arise. I think that's how we will have to weave the benefits into our overall reason for being at a company."

Mr. Kimmich added that benefit managers are likely to take on additional responsibilities in the future.

For example, benefit managers will be responsible for introducing "new types of benefits to address the population of the next 10 years, such as long-term care insurance and the new lifestyle accounts," he suggested.

Wealth-building will be the focus of retirement planning, as it has become in the last several years with the growing popularity of the defined contribution pension plan, said Mr. Laugharn.

Hartmarx's Mr. Pikelny fears that once the red-hot stock market begins rendering more-modest returns, employees funding retirement through 401(k) plans won't have enough saved to retire comfortably.

"A lot of employees have gotten spoiled seeing the stock markets perform and their 401K (plans) growing," Mr. Pikelny said. "When rates return back to normal, employees are going to be disappointed that they won't have enough to live on for the rest of their lives. There's going to be too many horror stories of people getting a large lump sum upon retirement and spending it on a boat or vacation home."

Employers, in turn, will feel pressure to increase the amount of matching funds, Mr. Pikelny said, or at least to offer adjustments for the swelling cost of living. BI

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State regulation trying to keep up with changes

By DOUGLAS McLEOD

State insurance regulation has survived its share of challenges during the 20th century, but how—or whether—it will survive the forces now bearing down on it is uncertain.

From the product liability crisis of the 1970s to the fallout that followed huge property/casualty insolvencies of the 1980s, state regulators have found ways to adapt and fend off federal encroachment on their turf.

More recent industry trends, though—globalization, consolidation and the rise of e-commerce among them—are again stirring debate about the costs and benefits of a regulatory system with roots in the 19th century.

More than ever, large insurers and commercial policyholders say they will be at a competitive disadvantage without deregulation and uniform requirements to replace the 50-state patchwork of rules.

Meanwhile, the recently enacted federal financial services reform law gives the states three years to adopt uniform agent licensing requirements or face ceding their authority to a national licensing entity.

State officials are feeling the pressure.

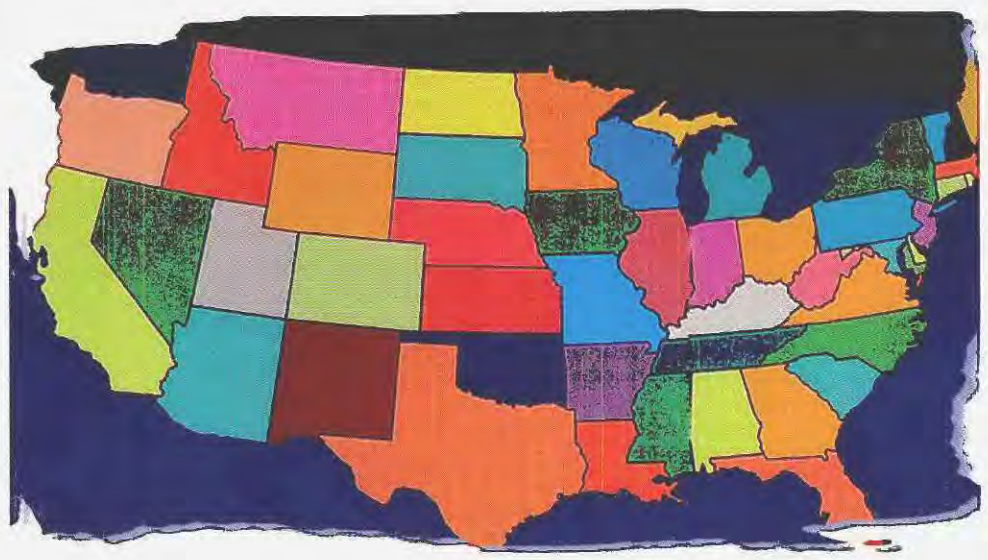
"If state regulators don't respond in terms of trying to be more uniform where it is appropriate to be uniform, then we will lose out," warned George Nichols III, Kentucky insurance commissioner and vp with the National Assn. of Insurance Commissioners.

"Everything right now is riding on the response in the next 12 months of the state regulators and the state legislatures," Mr. Nichols said.

"I think they've gotten the message that this 50-state network just will not work in the modern world," said Richard Heydinger, director of risk management services for Hallmark Cards Inc. in Kansas City, Mo. "They have to find a way to allow national companies to be efficient or they are just going to get in the way."

However frustrated industry officials may be with state regulation, though, most expect it to evolve rather than disappear.

"In the short term, state regulation is likely to stay pretty much the way it is today, but moving toward more coordination between the states" on rate and form, solvency and market conduct issues, predicted Linda Kaiser, a former Pennsylvania insurance commissioner who is now senior vp and general counsel with Reliance Insurance Co. in Philadelphia.



"I don't see it continuing in its present form, (but) it's also not going to go away," said Jon Harkavy, vp and general counsel with Risk Services L.L.C. in Arlington, Va., and a member of the National Risk Retention Assn.'s government affairs committee.

Even Mr. Nichols conceded that in the long run the federal government may take on some regulatory role that is still to be defined.

But "I do believe that state regulation will be around for a long time to come" he maintained.

Turf battles are nothing new for insurance commissioners.

Such a battle, following a 1944 U.S. Supreme Court ruling that insurance is interstate commerce subject to federal antitrust law, led to the passage of the McCarran-Ferguson Act reaffirming state regulators' primacy.

More fighting broke out in the early 1980s, when Congress passed the Risk Retention Act in response to a market crisis that had made product liability coverage scarce and expensive in the mid-1970s. The law, expanded in 1986, allows group self-insurance through risk retention groups that can operate nationwide after being licensed in one state, and overrides state laws against group sales of commercial insurance to industry purchasing groups.

From the beginning, though, insurance departments have skirmished with buyers over everything from whether states can impose minimum capital requirements on out-of-state risk retention groups to whether they can levy various fees. Those skirmishes continue, the latest as recently as last fall.

"It just shows how difficult it is even when there's a federal pre-emption," the NRRA's Mr. Harkavy observed.

The multibillion-dollar failures of Mission Insurance Co. and Transit Casualty Co. in the mid-1980s sparked another battle: Rep. John D. Dingell charged that the states had been lax in overseeing insurer solvency and introduced a bill to shift solvency regulation to a new federal agency and exempt large commercial business from rate and form regulation.

The NAIC adamantly opposed the measure, and countered it with a "solvency policing agenda" that featured a package of model laws and an accreditation program for certifying insurance departments in states that enacted the models.

The states also had luck on their side. When Republicans won a majority in the House in 1992, Rep. Dingell lost his Energy and Commerce Committee chairmanship, and with it any prospect of passing the bill.

No sooner had this threat receded, though, than another began to build. Throughout the 1990s, corporate policyholders, brokers and insurers have grown internationally and consolidated in a huge wave of mergers and acquisitions. The world's 10 largest brokers in 1990, for example, included eight companies that have since merged to become three; insurer and reinsurer mergers, including many between U.S. and overseas companies, have kept pace.

"The more (insurance) moves from a national to an international business, the more pressure it puts on state (efforts) to control anything," said J. Robert Hunter, insurance director for the Washington-based Consumer Federation of America and a former Texas insurance commissioner. "Controlling international commerce is something that almost has to be done at the federal level."

Complicating things even further is the rise of the Internet, a vehicle that allows buyers, sellers and brokers to transact business virtually instantaneously anywhere in the world.

On the World Wide Web, one might find "22 guys in Nebraska running an (insurance) company in Mali," Mr. Hunter said, only half-jokingly.

"What's going to drive uniform regulation is e-commerce," predicted William R. Berkley, chairman of W.R. Berkley Corp. in Greenwich, Conn. "You can get quoted and bound in 15 seconds on some sites. You don't want to wait 90 days (for approval) to get a new rate on.

"State regulation as a protector of consumers and of paying claims appropriately is important and valuable," Mr. Berkley allowed. But state control of "licensing and financial standards and rates and forms does not work well in the era of e-commerce."

The federal government also continues to push the states for more efficient oversight in at least one segment of the industry. The Financial Services Act signed into law by President Clinton in November gives states three years to adopt uniform agent licensing or reciprocity laws. If they fail to do so, the NAIC would then form a National Assn. of Registered Agents and Brokers, which would take over licensing duties if a majority of states do not adopt uniform laws after two more years.

Eventually, NARAB could be managed by a federal agency.

Few people, regulators included, disagree that the current system needs change.

"It's clearly becoming dysfunctional on large commercial risks," Mr. Harkavy said. "We're operating like we're still under the Articles of Confederation."

"The regulation of insurance companies has been a millstone around the necks of the public and the insurance industry ever since the South-Eastern Underwriters case" led to McCarran-Ferguson, said Robert Clements, a founder of ACE Ltd. and XL Capital Ltd. and now chairman of Greenwich-based Risk Capital Reinsurance.

"The result of that has been huge additional costs, the development of new products has been impeded, free entry of new competitors has been impeded and life for the customer has been outrageously difficult," he said.

"It's what created the Bermuda market," Mr. Clements added. "It would have taken 20

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or 25 years to (form ACE and XL) in the States."

And, once again, regulators are working to adapt to head off calls for more-radical change.

Roughly 10 states have enacted some form of commercial lines deregulation, freeing large commercial policyholders and their insurers from rate and form restrictions.

The NAIC is also pushing for more uniformity among state rules regarding insurance company licensing, rate and form regulation, market conduct, and oversight of e-commerce, Kentucky's Mr. Nichols said.

States should adopt standard versions of regulations in these areas or justify the need to depart from the standard, he explained.

Many observers, though, express doubts about these efforts.

Commercial lines deregulation, while a step in the right direction, has become reality in only a handful of states, and those states have different definitions of which large policyholders qualify for deregulation.

"Each state is going to try to put a twist on it for their own benefit," and fights may break out if and when one state refuses to accept another's definition, Mr. Harkavy observed.

The diverse laws will probably remain dissimilar until more states enact deregulation and a discussion begins about how to bring them into line, added Reliance's Ms. Kaiser.

Getting a majority of states to agree on uniform laws and regulations in other areas, meanwhile, may prove an impossible task, some say.

"I think it's pretty hopeless," said Mr. Hunter, explaining that state legislatures are too parochial to sacrifice local interests.

"There will be some states, and maybe even some major states, where we will not be able to get changes in local laws to achieve uniformity," Mr. Kaiser predicted. If the dissenters are large premium-volume-states such as New York or states where their legislatures meet only every other year, the push for uniformity could be slowed considerably, she suggested.

If this happens, insurance commissioners could still create "de facto law" themselves by issuing regulatory bulletins implementing changes, she said.

For his part, Mr. Nichols expressed optimism.

"Convincing state legislatures will be the most monumental task we have before us," he conceded. But the insurance industry itself could improve the odds by helping to draft legislation and lobby lawmakers, he said.

"Are we, as regulators, ready to do it? I believe we are," he said. "Can we convince state legislatures to do it and get buy-in from the insurance industry?" That, Mr. Nichols said, remains to be seen.

The states long ago managed to enact uniform insurer accounting and financial reporting standards, and "if we can agree on that, I don't see why that can't be extended in a lot of ways to ease the burden on the industry," said James W. Schact, a partner with PricewaterhouseCoopers in Chicago and a former Illinois insurance regulator.

"The easiest thing is to have the states stop ruminating about it and say, 'Look, this is going to happen with us or without us, so we should get some uniform standards,' " Mr. Berkley said.

If the states fail to streamline the system, meanwhile, the prospect of federal involvement in insurance regulation remains.

"It depends on who controls Congress," Mr. Hunter observed. "If John Dingell comes back, I think he still has an interest in that."

Mr. Nichols himself said he believes there will be federal regulation of some form in the long run, though what role a federal agency might play is unknown.

Many industry officials favor a federal license for commercial insurers, but the states could develop a national insurance charter of their own, Mr. Nichols noted. In addition, there is probably little support in Congress to pay for a new regulatory agency, he said.

Buyers and insurance industry officials offer differing views on what regulatory role best suits the states in the future.

Mr. Clements argues for a two-tiered regulatory system of the kind proposed by Rep. Dingell, with insurers able to opt for federal regulation.

"That's a simple, effective, efficient, easy-to-implement solution to the problem," he said. "The only reason I'm skeptical about it happening is that it's a concept that was first floated 30 or 40 years ago.

"The lobbyists who want to perpetuate the current travesty are able to marshal opposition to it because they portray it as another entry by the 'feds' " into an arena where they don't belong, Mr. Clements said.

"It's word games of the most dishonest kind," since the two-tiered system, rather than adding another layer of regulation, actually accomplishes deregulation, he said.

Hallmark's Mr. Heydinger said the only oversight large, sophisticated companies need from state insurance departments is insurer solvency regulation.

"Anything that they do beyond that probably gets in the way more than it helps," he said. "I want to go where the solutions are and where the best ideas are, unrestrained."

If the federal government does get into insurance regulation, it may divide responsibilities with the states, not along commercial vs. personal lines, but according to function, Mr. Hunter speculated.

Consumer complaints, for example, particularly in personal lines, are best handled by the states, he said.

The states' best course, he added, is to look beyond protecting their own turf and see the federal government as a partner that could help them retain maximum authority in the areas for which they're responsible.

"If they circle the wagons, I think then it becomes untenable" and could create support for a repeal of the McCarran-Ferguson Act, Mr. Hunter said.

Several observers say they would be surprised to see states give up much authority without a fight, though.

"State regulators do not naturally cede jurisdiction, be it to the federal government or to (other) states," Mr. Harkavy observed.

"The system as it exists is awfully entrenched," noted Robert A. Mulderig, chairman and chief executive officer of Mutual Risk Management Ltd. in Bermuda.

For this reason, if for no other, most observers expect the states to remain the primary regulators of insurance for the time being.

"It will survive at least into the immediate future, over the next 10 to 20 years," Mr. Schact predicted, adding that "there are good reasons for it to maintain its primacy."

While deregulation of commercial lines will continue and even spread to personal lines, Mr. Schact said the state system is the better regulator. As evidence, he pointed to the case of Martin Frankel, the financier who bought and, the FBI charged, looted a network of life insurers in several states. While Mr. Frankel's group was based in Tennessee, suspicions about his activities initially were raised in a Mississippi examination of three units located there.

"Forty-nine other states are looking over the domiciliary regulator's shoulder. . . . That sort of situation does not exist at the federal level," Mr. Schacht said. "It's just a very strong system from the standpoint of protecting policyholders." BI

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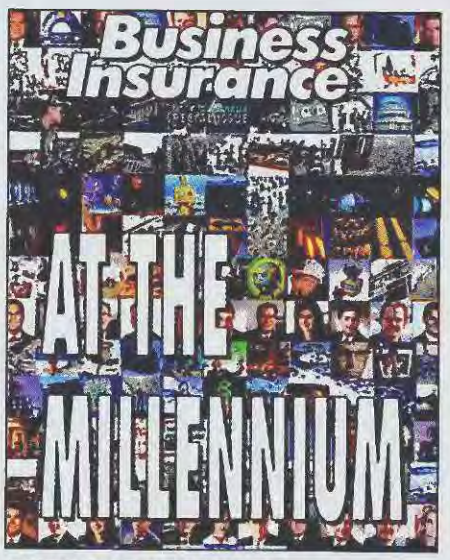
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A look back at the future

The inaugural address of Cal Ripken Junior Klinger, chief risk taker for Little Demon Candy Corp. and incoming president of the Risk & Insurance Management Society, during RIMS' 138th annual conference and exhibition, Post Memphis, Tenn., April 1, 2100.

Friends, mere words cannot express what an honor it is to stand before you to accept the presidency of the Risk & Insurance Management Society on this, the first year of the 22nd century—or the last year of the 21st, depending on how you measure things. One of the many things that make this particularly sweet for me is the very fact that I, born in the year 1999, stand before you.

A century ago, a man or woman my age most likely wouldn't have been here at all—he or she would have been long dead. At best, that centenarian would have been shunted off to a nursing home, rather than still sitting behind a desk dealing with the day-to-day crises that make our profession what it is.

Our profession is both a risky and a serious business, as we're reminded every day. But looking back, the past century could have been much worse. From the vantage point of a new century—rather than a new millennium—the weird emotions and outright fear that preceded the Year 2000 seem nearly incomprehensible to us.

Take the great Y2K computer problem. Its impact on North America was not as significant as many had feared as late as 1999. But much of the world plunged into recession or worse because businesses and governments had not brought their computers into compliance.

Despite the relatively mild effects of the bug on American businesses, lawsuits still proliferated as some in the insurance and legal professions had predicted. Insurance coverage disputes jammed the courts, and lost insurance records continued to plague some policyholders for two decades. Of course, the very constitutionality of the much-vaunted Y2K Act came under attack, although the Supreme Court ultimately upheld the law's limits on certain Y2K-related lawsuits. Congress passed a comprehensive national tort and product liability law in 2006, which President George Bush the Younger wasted no time in signing.

That was good news for the emerging biotechnology industries. With the threat of certain pre-emptive lawsuits gone, they have blossomed beyond the wildest dreams of their pioneers—extending life and the pursuit of happiness, if not always liberty, for billions of people. It has certainly meant the pursuit of profits for my employer—Little Demon Candy Corp.—for without the genetically enhanced cinnamon used in our Little Demons, how could we brag that we indeed have the hottest little demons on the planet?

But I digress, for I was talking about the Y2K bug—a senior moment, if you will. The global disruptions caused by a lack of preparation for the bug led some historians to dub the first decade of the new millennium "The 'zips." Economic uncertainty fueled nebulous yet vicious extreme nationalist and religious movements, which led to a redefinition of global risk.

The resultant surge of lawlessness led any corporation doing international business—and what corporation could survive without at least a nominal international presence, even if only an electronic one?—to view K&R insurance as vital as good old D&O.

Of course, given the growth of e-commerce, K&R itself took on new meanings. The artificial intelligences that we now regard as colleagues fell into a gray coverage area. Were they property, and if so, what kind? Or were they something else altogether and, if so, what?

Underwriters, of course, disagreed. Some tried to avoid coverage altogether, noting that almost daily advances in software could render even the most advanced artificial intelligence obsolete before it could be recovered.

But eventually, certainly by the mid-'20s, most underwriters began treating our ever-more sophisticated electronic colleagues as something akin to an employee. Just as traditional K&R responded to terrorists or bandits, the new non-traditional K&R responded when someone grabbed the laptop or briefcase that contained the true brains of the operation and threatened to sell it to the highest bidder.

One nice thing about "employees" that consist of chips and circuits and a lifeblood of electric impulses is that they don't present much of a workers compensation exposure. Of course, the workers comp system itself underwent an almost total transformation in 2007, when Congress overrode President Bush's veto and created a Canadian-style national health care system.



Many employers, saddled with ever increasing health costs and a graying work force thanks to changes in Social Security eligibility and general demographics, had already abandoned their traditional opposition to a single-payer system because paying higher employment tax was more palatable—and predictable—than trying to project annual health care cost increases. Under the new health-care system, the single payer—and not the employer—also funded the medical component of workers comp, albeit through a special tax levied on all companies with more than 25 employees.

The nature of the commercial properties we sought to protect changed, too. For example, some of us remember shopping malls. Some of you younger folks may have visited the Mall of America National Park in Minnesota and marveled at the idea of actually having to go to some jumble of stores—physical brick, mortar and plastic places—to buy things. With our e-shopping system, property exposures shifted from outdated malls and shopping centers to delivery fleets and acre after acre of usually highly protected warehouses.

Of course, no look back at the last century would be complete without noting the rise and fall of the chief risk officer. As business grew ever more complex—and dangerous—more and more companies created the position of chief risk officer to sort out all of the things that could go wrong and then prepare for them. Some of the older of you—and I mean older than me as well—may remember a character of fiction named James Bond. Well, many CROs began viewing themselves as a sort of James Bond with a CPCU license to manage everything.

The catch was that the very complexity of risk rendered the CRO obsolete by the '50s. No one person—whether human or electronic—could simultaneously act as a procurer of insurance, loss-control expert, chief security officer and often unofficial diplomat, yet that was what the job demanded. The CRO had to be a master of several tongues, both human and electronic. The strain was simply too much, and the opportunity for human—or artificial human—error grew exponentially as each new responsibility was added to the job. Decentralization became the word of the day.

The consolidation of so many duties under one job description mirrored somewhat the consolidation of the insurance industry. Under pressure from the new financial institutions that sprang up in the 'zips following the 1999 financial services modernization law, traditional insurers—even those with banking and securities affiliates—found themselves forced to merge into larger and larger entities.

Consolidation reached its apex in 2023, when The St. Paul Allianz and Zurich-American International Group became one. The resulting insurer was simply known as The Company.

That merger caused the remaining mutual insurers—Kemper, Liberty Mutual and FM Global—to follow suit, demutualize and create The Other Company in 2026. There was also, of course, the establishment of The Reinsurance Store as a result—one-stop shopping for all of your reinsurance needs. And faced with shrinking markets, brokers also followed suit, with the final merger of industry giants Marsh & McLennan and Aon into the McAon superbrokerage predicted by former *Business Insurance* Publisher Kathryn McIntyre years before the turn of the last century.

Of course, such consolidation lasted only into the '40s, when neo-trustbusters cracked down on business concentrations throughout the economy. The Justice Department broke up The Company, The Other Company, the Reinsurance Store and McAon, just as previous reformers had broken John D. Rockefeller's Standard Oil Co. and tried unsuccessfully to break up William Gates' Microsoft Corp.

That was generally good news for risk managers, as some of you will remember. As megacorporations of all sorts were taken apart, there were more job opportunities for us as we mutated into CROs. There was more choice in the marketplace, and we needed it, as I mentioned before.

Financial risk, enterprise risk, security risk—all took on new and broader meanings. We self-insured where we could, took advantage of bargains in the marketplace when they arose, and prayed that we'd made the right decisions.

The very question "What is risk?" took on new importance as the century progressed.

The consolidation and breakup of the property/casualty industry, combined with ever-tighter integration among all types of financial institutions, the advances in biotechnology and genetic therapy that extended lifespans beyond the wildest dreams of our parents' generation, the blurrier and blurrier line between living and artificial intelligence, the gradual introduction of fusion energy, the weakening of nation states to the extent that some countries became little more than mafias with a national anthem. . . .I could go on all day and still not mention all of the major factors that changed risk in this past century.

The notion of holistic risk management underwent several mutations. Who among us can forget the Zen risk management so popular in the 60s—the 2060s, that is? And, who among us can explain exactly what Zen risk management was?

Yet in some ways, the profession and the risks it dealt with remained remarkably familiar. The unusually violent earthquake activity along the Pacific Rim—including the Great San Francisco Quake of 2069 and culminating in the Tokyo Bay Catastrophe of 2078—reminded us how little some things change.

Indeed, this great city experienced considerable damage during the last of the three New New Madrid quakes of 2032-33, later rising from the ashes as the Post Memphis that hosts our conference today. This devastation occurred in spite of nearly a half-century of preparation and loss mitigation spearheaded by members of this very society, which illustrated that, even with ever-better engineering and more-sophisticated prediction techniques, we could not—and cannot—protect against every hazard.

And now new exposures face us.

E-commerce now binds us beyond the earth's orbit to the robot-manned mines on the moon. We might not have to worry about workers comp with our robotic friends, but we must make sure that we've taken steps to adequately protect our employers from losses physical, financial and reputational if the power fails a quarter-million miles away or a transport rocket goes haywire. With human endeavor soon to reach beyond Mars to the moons of Jupiter, we can only expect the demands upon us to grow more complex.

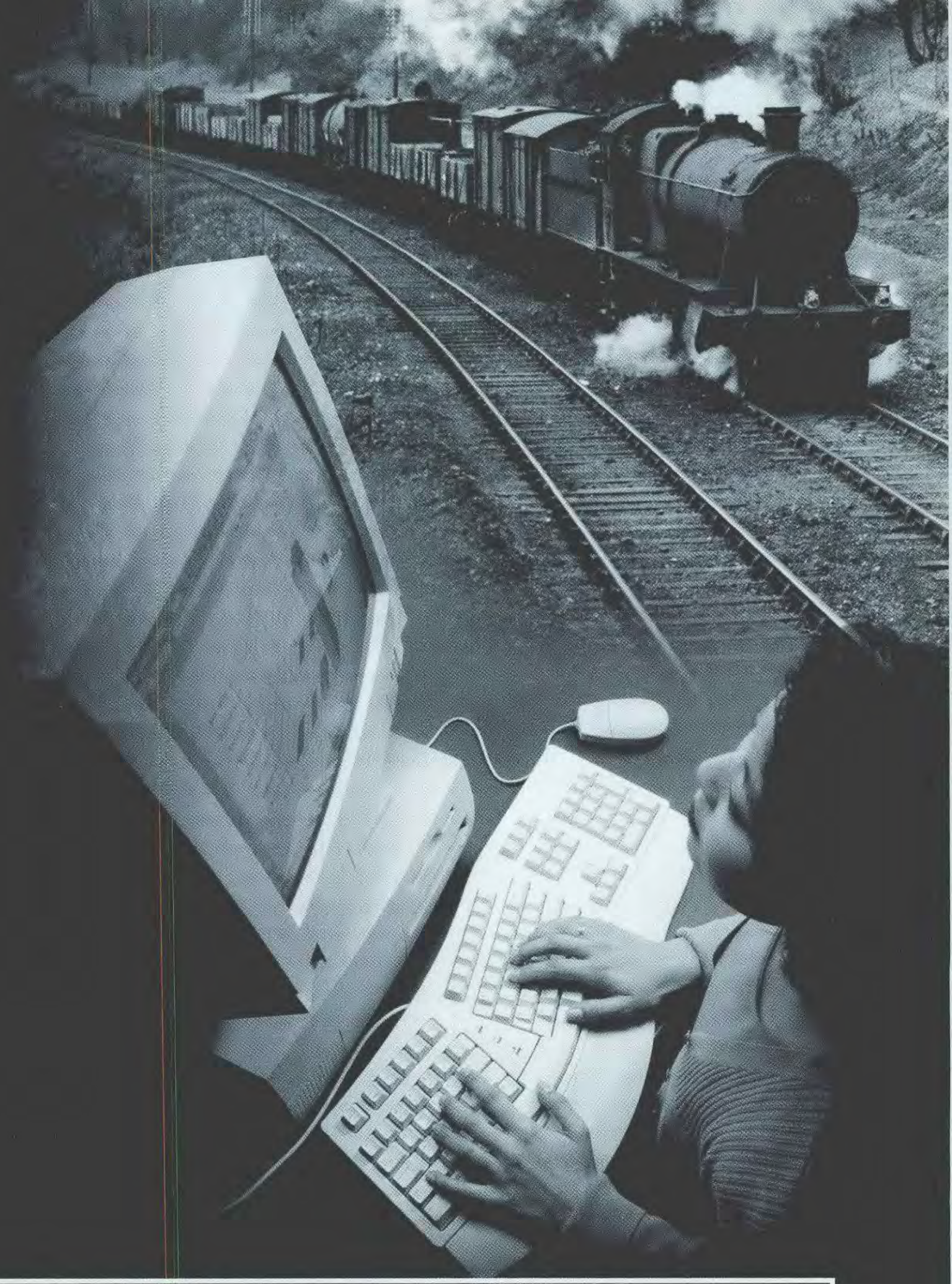
As I said at the beginning—and this is no senior moment—our profession is both a risky and serious business. But in closing, I would like to remind you of what one of my 20th century predecessors said more than 100 years ago when asked to share the biggest lesson he'd ever learned as a risk manager. He replied, "Never take yourself too seriously."

I believe that philosophy, more than holistic risk management, Zen risk management or whatever, should guide us as we go about our jobs. To do otherwise is to accept an unacceptable risk. BI

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