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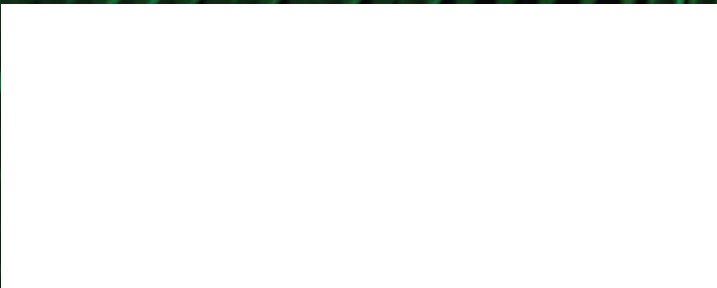
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CORPORATE KIDNAPPERS

Firms face up to growing threat
of ransomware attacks on systems

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VIEW FROM THE TOP

ARTEMIS EMSLIE

Artemis Emslie, Tampa, Florida-based CEO of pharmacy benefit manager Matrix Healthcare Services Inc., which does business as myMatrixx, has served in her role since 2012 and has nearly 25 years of experience in both the workers compensation and group health industries. With technology playing a growing role, she discusses trends and issues developing within the workers comp sector. **PAGE 17**



OFF BEAT

A court rules Snugglies are merely blankets, not priestly robes, when it comes to taxation. **PAGE 34**



COVER STORY

Businesses are increasingly under attack from hackers who, rather than steal or corrupt a firm's data immediately, bar access from the data until a ransom is paid. To fight hackers, companies must invest in training and contingency plans. But if they can't stop the ransomware attacks, coverage is available under several different insurance policies. **PAGE 18**

Final cyber rule eases insurer concerns

BY GLORIA GONZALEZ

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New York's final cyber security rule for insurers and other financial institutions is much less prescriptive than the original proposal, but it is still raising compliance concerns.

The final rule, which became effective March 1, requires companies to put in place controls to ensure a robust cyber security program, including requirements for a program that is adequately funded and staffed, overseen by qualified management and reported on periodically to the board or the most senior governing body of the organization.

The New York State Department of Financial Services received more than 150 comments during two public comment periods after the release of the initial proposal in September 2016, and amended the final regulation in several critical ways, experts say.

"They paid attention to many of those comments," said Theodore Augustinos, a Hartford, Connecticut-based partner with Locke Lord L.L.P. "While the cyber security regulation still imposes very onerous requirements on anyone who is licensed with the New York DFS, the changes were very sensible."

The key change, experts agreed, was that although the original proposal featured a series of rigid requirements, the final rule evolved into a more flexible approach that allows companies to develop a cyber security program based on their individual risk assessments, with most of the requirements now tied to those risk assessments.

"In looking back at the initial regulation that was proposed, I think our biggest concern was that it was far too prescriptive, it was too detailed and didn't allow com-

CYBER SECURITY FAILURES

The failure rate in preventing cyber security breaches is alarmingly high, according to a survey of 2,000 security executives at large global firms released in 2016 by consulting firm Accenture P.L.C.:

- On average, an organization will face more than a hundred focused and targeted breach attempts every year, and respondents said one in three of these will result in a successful cyber security breach.
- 51% of survey respondents said it takes "months" to detect successful breaches, while another 17% identify them "within a year" or longer.
- While 75% of survey respondents expressed confidence in their cyber security strategies, only 37% have confidence in their organization's ability to monitor for breaches, and 36% said the same about minimizing disruptions.

Source: Accenture P.L.C.'s High Performance Security Report 2016



panies to utilize a risk-based approach to cyber security," said Alison Cooper, Albany, New York-based Northeast region vice president of state affairs for the American Insurance Association. "Some of those initial requirements were so restrictive, we actually worried that there would be an unintended consequence of reducing security rather than enhancing it."

The final version still presents compliance challenges but "it gives great flexibility for insurers to tailor their cyber security programs in a risk-based manner," she said.

However, the department also stated that while it believes that each organiza-

tion should model its cyber security program on its individual cyber security risks, the risk assessments are not intended to be a cost-benefit analysis of cyber security.

"They're saying 'yes, you can have a program tailored to your specific risks, but you can't say that the cost of compliance is a burden as compared to the benefit,'" said Andrew Holland, leader of the insurance regulatory practice at Sidley Austin L.L.P. based in New York. "They've definitely given something there, but they've also set a high bar."

In addition, unlike the original proposal, the final rule does not mandate that financial institutions always use encryp-

tion. Instead, they can use alternative controls reviewed and approved by their chief information security officer. Mr. Holland called this revision a "big practical change" that recognizes that encryption may not be feasible in some circumstances, particularly for entities with older legacy systems.

The original proposal would have also required financial institutions to notify the department of both successful and unsuccessful cyber attacks, but the final rule evolved to require notification only of attempts that have a reasonable likelihood of causing material harm to the firm's business operations.

Financial institutions are frequently targeted by cyber criminals but most attacks are repelled by the security measures they have in place.

"The final rule still does reference attempted attacks, however, because of the insertion of the materiality standard and the more risk-based nature of the regulation in general. It ensures that you're only focusing on those types of run-of-the-mill instances when they might actually pose a significant problem for some reason," said Kristina Baldwin, Albany-based vice president of state government relations for the Property Casualty Insurers Association of America.

But the department maintained some parts of the rule that had been criticized, including challenges to the scope of the regulation, which applies to all entities licensed by the department, and an "over-broad" definition of information systems to be protected. And financial institutions must take action such as hiring a chief information security officer and developing and implementing an incident response plan ahead of quickly approaching deadlines featured in the regulation, experts say.



Financial institutions governed by New York's new cyber security regulation will have numerous and perhaps confusing implementation deadlines, but many firms have already started down the

Clock starts on cyber compliance

compliance path.

"The companies knew ever since this was proposed that this was going to happen," said Angela Gleason, senior counsel for the American Insurance Association in Washington.

In response to concerns about implementation time frames, the New York State Department of Financial Services added several transitional periods to its regulation. But Ms. Gleason said there may still be some confusion on these transition periods. For example, companies are required to complete their risk assessments by March 1, 2018, but some elements of

the cyber security program that would be driven by the risk assessments must be in place within 180 days.

"In a way, it essentially forces you to move up your risk assessment, but there is still some room for a longer transition period, which helps companies," she said.

The department also reduced the retention provisions related to audit trails — designed to reconstruct material financial transactions sufficient to support normal operations and obligations, and detect and respond to cyber security events — to five years, or three years for certain records, from six years.

Concerns about the compliance time frames in the original proposal have been alleviated to some extent by the department's adoption of the risk-based approach, said Kristina Baldwin, Albany, New York-based vice president of state government relations for the Property Casualty Insurers Association of America.

"But these are very comprehensive requirements, and in some cases the time frames for compliance are as short as 180 days," she said. "There are concerns it may be difficult for companies to meet these deadlines."

Gloria Gonzalez



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Pharma risks could rise under deregulation

BY GLORIA GONZALEZ

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President Donald Trump has vowed to reduce U.S. pharmaceutical prices, but a potential de-emphasis on testing the effectiveness of drugs at the regulatory level could affect the risk profile of companies in the sector.

“The U.S. drug companies have produced extraordinary results for our country, but the pricing has been astronomical for our country,” the president said after meeting with pharmaceutical industry leaders at the White House in January. “We have to lower the drug prices.”

Insurers are concerned that some actions the administration could take to reduce pricing might heighten risk and litigation potential for pharmaceutical firms, said Walker Taylor, Wilmington, North Carolina-based managing director of Arthur J. Gallagher & Co.’s life sciences practice.

“I appreciate his willingness to try to put more supply of product out there or get these drugs approved faster or loosen some regulations,” he said. But “I’ve talked to some underwriters at insurance companies, and I know they are concerned about anything that weakens pre-emption defenses, reduces oversight of post-marketing surveillance or could be perceived or argued by plaintiffs class action counsel as decreasing the certainty of safety for profits.”

“I get what Trump is saying as far as ‘Hey, the prices are too high,’ but on the other hand, that’s the cost of having these miraculous new drugs and having an incredibly safe marketplace,” Mr. Taylor added.

The president has pledged to expedite pharmaceutical reviews done by the U.S. Food and Drug Administration. Specific details have not been released, but there



are growing concerns that this effort could diminish the focus on testing drugs’ efficacy. While Phase 1 drug trials emphasize safety, the emphasis in Phase 2 is on effectiveness — whether the drug works for those with a particular disease or condition.

“The length of time it takes to get a drug approved is largely related to the efficacy standard,” said Jur Strobos, partner in the health care and intellectual property practices of law firm Baker McKenzie in Washington. “The efficacy standard is statutory. I don’t think that people in the scientific, medical or even the pharmaceutical industry actually have that much of an interest in lowering the efficacy bar.”

The president’s rumored nominees to lead the FDA are driving part of this concern, including libertarian Jim O’Neill, who has argued that drugmakers should not have to prove the efficacy of drugs in clinical trials. The idea of not testing for efficacy is an extreme proposal that has raised numerous concerns, said Dr. Bill Bithoney, chief physician executive at The BDO Center for Healthcare Excellence &

Innovation based in New York.

“Do we want drugs that have not been tested for efficacy?” he said. “There’s a strong contingent of people who believe the current efficacy tests are inadequate ... If there is a true libertarian movement away from efficacy testing and only having safety testing, that may well lower the cost of medication, but could put the public more at risk.”

A speedier FDA review process that lowers or eliminates emphasis on efficacy could lead to additional litigation against pharmaceutical companies, experts say.

“Getting a drug approved by the FDA does not immunize somebody from a lawsuit,” said Simon Elliott, senior counsel with law firm Foley & Lardner L.L.P. in Washington. “If something was brought into the market without FDA proving that it was effective, you can just imagine someone saying, ‘I was made sick and this drug wasn’t fully approved by the FDA.’ I’m not saying it’s a fair argument, but it would have more weight.”

Underwriters would be concerned about

lessening the focus on efficacy because “ultimately if it’s not effective, safety concerns will pop up,” Mr. Taylor said.

John Connolly, North American practice leader for life science and pharmaceuticals with Willis Towers Watson P.L.C. based in Radnor, Pennsylvania, said a de-emphasis on efficacy at the regulatory level could impose a greater burden on drugmakers to monitor it post-approval. “You will be expected to monitor your patient population of any new product much more closely than you have in the past, and if you see a variance in adverse effects, failure of the drug to work, patient deaths, there will be a higher-than-ever duty to swiftly report back to the FDA and update any warnings on your labels,” he said. “That would lead to an increased risk.”

IN THE LEGAL CROSSHAIRS

Pharmaceutical companies faced a record number of securities class action lawsuits in 2016, according to a report published in January by Cornerstone Research.

▶ In 2016, 27 securities class actions were filed against pharmaceutical companies, up from 19 lawsuits in 2015 and 15 in 2014.

▶ The 27 lawsuits filed last year against these firms more than doubled the 1997-2015 historical average of 12 lawsuits per year.

▶ The number of filings in the pharmaceutical, biotechnology and health care sector overall increased for the fifth consecutive year.

▶ Eighty lawsuits were filed against companies in this sector, an 86% increase from 2015.

Source: Securities Class Action Filings—2016 Year in Review by Cornerstone Research and the Stanford Law School Securities Class Action Clearinghouse

PHARMA PRODUCT LIABILITY CAPACITY PLENTIFUL, D&O EXPOSURES GROW

Pharmaceutical companies are increasingly the target of securities litigation, making it a difficult risk to insure, but the market is generally still very favorable for buyers seeking product liability coverage.

Six years ago, the key exposure for pharmaceutical companies was “failure to warn” claims, meaning the company’s product labeling did not reflect the risks that existed, said John Connolly, North American practice leader of life science and pharmaceuticals for Willis Towers Watson P.L.C. based in Radnor, Pennsylvania. However, a 2011 U.S. Supreme Court decision that generic drug manu-

facturers could not be sued for failing to warn as long as their labels followed the brand-name version led several insurers to enter the space because the ruling made it difficult to sue under that product liability claim, Mr. Connolly said.

Large pharmaceutical and biotech companies generally self-insure the risk, but the market remains “very buyer-friendly” for firms wanting coverage with numerous primary insurer options, including Chubb Ltd., CNA Financial Corp. and W.R. Berkley Corp., and flat to lower pricing, he said.

However, a small number of costly catastrophic claims define the product liability

market. For example, Merck & Co.’s pain killer Vioxx, which was pulled from the market in 2004 because of increased heart attack and stroke risks, led to nearly \$5 billion in product liability lawsuit settlements and \$830 million to settle a federal class action lawsuit by shareholders.

Insurers are concerned about a spike in securities-related litigation claims against pharmaceutical companies, brokers say.

These lawsuits generally revolve around milestone events such as clinical trials or drug approvals that make insurers nervous, Mr. Connolly said.

“When these events happen and the news isn’t positive, the plaintiffs bar tends

to sue on behalf of shareholders,” he said. “On the converse, they are suits that are very easy to foresee and defend with strong corporate governance. What you see in the D&O market is a large volume of claims against these companies, but very few of them go as far as costing a lot of money, because for the most part they are defensible.” The primary directors and officers layer for a public life science company “is hairy because there are a lot of claims, but the excess D&O is often very good to write because most claims don’t generate enough damages to hit the excess layers,” he said.

Gloria Gonzalez

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Pipelines fuel more risk for energy sector

BY GLORIA GONZALEZ

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President Donald Trump's early actions to expand and upgrade U.S. energy infrastructure will likely promote growth in the sector, but also carry some critical risk management challenges.

Already, the president has signed an executive order that aims to expedite environmental reviews and approvals for high-priority infrastructure projects, such as upgrades to the electric grid and pipelines.

"It's a very exciting time for the energy industry," said David Russell, Washington-based senior policy advisor for law firm Bryan Cave L.L.P., which represents energy industry clients in acquisitions and project development. "The last eight years have been a challenge for almost everyone, except renewables. There's a brand-new approach at the policy level and at the regulatory level, which is driving a lot of attention from Wall Street, particularly on

the traditional fossil fuel sector."

President Trump also signed presidential memos to expedite review of the controversial Keystone XL pipeline project, intended to transport oil from Alberta to the Gulf Coast, and the Dakota Access oil pipeline, from North Dakota to Illinois. Both projects are opposed by environmental and Native American groups and stalled under the Obama administration.

A Trump presidential memo also directed the Secretary of Commerce to develop a plan to ensure that all new pipelines will use American-made materials and equipment where possible. The memo doesn't address the legality of such a requirement without an express statutory mandate or the challenges the Obama administration experienced while trying to enforce the "Buy American" provisions of the American Reinvestment and Recovery Act, said Mary Anne Sullivan, a Washington-based partner with law firm Hogan Lovells.

"There is an opportunity for a challenge that the president doesn't have the authority to require a private party to purchase American-made goods and equipment on a project that under statute has no such requirement," she said.

In addition, environmental, tribal and other groups will likely continue to push back against the projects, through the courts and acts of civil disobedience.

"High-profile projects are likely going to be litigated and the companies involved in the construction and the financing and the insurance side are going to want to make sure the record supporting the permitting decisions has been adequately developed and is defensible in court," Mr. Russell said.

For Dallas-based Energy Transfer Partners L.P.'s Dakota Access pipeline, a judge denied a request by a tribal group for a



REUTERS

President Donald Trump talks to reporters while signing an executive order to advance construction of the Keystone XL pipeline.

temporary restraining order preventing the start of construction in February, after the U.S. Army Corps of Engineers allowed the project to move forward per President Trump's direction.

"They don't have a great argument to say that construction should stop because construction isn't the risk to their water source," said Brandon Barnes, a Washington-based senior litigation analyst, Bloomberg Intelligence, the research arm of Bloomberg Finance L.P. "But that doesn't mean there isn't another bite at the apple to try and halt oil flowing through the pipeline after construction is complete."

In late February, law enforcement officials arrested several protesters who refused to leave a camp on federal lands along the Dakota Access pipeline route and threat-

ened to arrest others who refused to voluntarily vacate.

Insurers can add civil commotion perils into first party property or builders risk policies that offer protection against delays, although there would be a discussion over whether coverage must be triggered by physical damage to the infrastructure, said Bill Helander, executive vice president, JLT Specialty USA, based in Houston.

"There are a lot of creative underwriters that can help create solutions," he said. "It's not something that is necessarily an off-the-shelf product, but with proper negotiation, discussion and tailoring, we can address that risk."

Environmental risk remains top of the list for certain energy projects, particularly oil pipelines (see related story). And terrorism, both physical and cyber, are major issues for energy infrastructure, experts say.

"The terrorism concern runs across all infrastructure," said Jamie Miller, head property and special lines North America Swiss Re Corporate Solutions in New York. "When you think of dams, when you think of power grids, when you think of transformers, when you think of pipelines, when you think of utilities and petrochemical plants, that's always been a risk."

After the Sept. 11, 2001, terrorist attacks, the government and the energy industry became increasingly worried about the physical threats to infrastructure, he said.

"I think the industry is well aware of what they think are the right protections or the right concerns and how best to address physical risks. The cyber risk is one that I'm asking all my clients about every day I meet with them. They're all worried about being hacked. There's a perception of more capability of hacking into any type of infrastructure, Mr. Miller said."

CYBER EXPOSURE

Modeled hypothetical scenario of a blackout caused by a malware attack that plunges 15 U.S. states and the District of Columbia into darkness and leaves 93 million people without power.

The total impact to the US economy: \$243 billion, rising to more than \$1 trillion in the most extreme version of the scenario.

Total claims paid by the insurance industry: estimated at \$21.4 billion, rising to \$71.1 billion in the most extreme version of the scenario.

Source: Business Blackout, a 2015 report by Lloyd's of London and the University of Cambridge's Centre for Risk Studies.

INSURANCE PLENTIFUL FOR MOST RISKS, BUT POLLUTION REMAINS A CHALLENGE

President Donald Trump's energy infrastructure push may create business opportunities for insurers, but they will still likely be wary of some of the projects due to their environmental risks.

Robert Hartwig, clinical associate professor in the finance department and co-director of the Center for Risk and Uncertainty Management in the Darla Moore School of Business at the University of South Carolina in Columbia, called the Trump administration's policies towards the domestic energy industry "an unambiguous positive" for the property/casualty industry.

The commercial insurance sector is

awash with capital and "would very much welcome the opportunity to put some of that capital to work," he said.

While there is sufficient capacity for many energy infrastructure projects, certain types of projects present challenges.

Petroleum projects are typically the most difficult energy projects to insure, as insurers tend to be cautious about the associated risks such as off-shore drilling incidents, fire or concerns about shale gas, said Richard Sheldon, Radnor, Pennsylvania-based environmental practice leader and head of environmental broking, for Willis Towers Watson P.L.C. Electrical generation and renew-

able energy projects tend to be more acceptable risks for insurers, he said.

Roughly 50 insurers will provide some form of pollution legal liability coverage to energy projects, but for riskier classes such as petroleum pipelines, "that window closes very quickly to the point that you only have two or three markets that would consider that risk, if at all."

Severity and frequency serve as the basis for how underwriters price the risk of potential losses related to the transportation of petroleum, said Bill Helander, executive vice president at JLT Specialty USA, based in Houston. Transporting oil by truck is more likely to result in an

accident than if the oil is transported via a pipeline, he said.

"But generally when it does happen, it's not as severe of an event as a massive breach in a pipeline or an explosion in a pipeline," Mr. Helander said. "When we're looking at pipeline risk, we're talking about \$10 million, maybe even \$25 million, tranches of liability afforded by a single insurer," so losses can be significant, he said.

Mr. Sheldon said he expects insurers will be able to handle an influx of new energy projects, but petroleum projects will remain a more difficult class to place.

Gloria Gonzalez

Too much information on chat can leave employers in legal lurch

BY ROB LENIHAN

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Internal office chat applications are intended to make life easier by connecting co-workers in real time, but analysts warn that using them recklessly can have serious repercussions.

Legal and security experts say companies could leave themselves open to lawsuits, embarrassment and other problems if offensive or incriminating material is exchanged in chat programs, which include Slack, Campfire and HipChat.

The misuse of these applications was highlighted in a lawsuit against Gawker Media L.L.C. that had been filed by Terry Gene Bollea, known professionally as Hulk Hogan, who sued after the Gawker website posted portions of a sex tape that featured the former wrestler.

Last year, a jury awarded Mr. Bollea \$140 million and three months after the verdict, Gawker filed for Chapter 11 bankruptcy protection and put itself up for sale. A tape of a deposition was shown at the trial where a Gawker reporter was asked about off-color jokes that were made about Mr. Bollea on Campfire, a commercial application by Chicago-based Basecamp.

Jason Fried, Basecamp's founder and CEO, referred to comments in a March 7, 2016 post where he advised against using group chat "as the primary, default method of communication inside an organization."

"A slice, yes," he wrote. "The whole pie, no. If it's an important conversation, it shouldn't happen in the chat room. Chat should be about quick, ephemeral things. Important topics need time, traction, and separation from the rest of the chatter."

A spokesperson for Atlassian, the Sydney, Australia-based company that produces HipChat, declined to comment and a representative for Slack did not respond to a request for comment.

Lindsay Burke, Washington-based counsel at Covington & Burling L.L.P. and vice chair of the law firm's employment practice group, said some of the issues that have come up with Campfire and other such applications are similar to problems that arose when email and instant messaging first arrived.

"People think of it as a casual form of communication," Ms. Burke said, "and they forget that it's business and usually the company is keeping a record of the communication. And if the company finds itself in litigation, then the discovery request ... may call for the company to produce those records."

In that sense, Ms. Burke added, "it



can be tricky or at least embarrassing for employees and employers if they have disregarded general rules of professionalism and decorum in these conversations. And the friendlier and less formal your workplace, the more likely people might forget what the boundaries are."

Ms. Burke said many companies have software systems that will automatically delete emails and other communications after a certain period of time, although certain companies may be bound by law or regulation to maintain their communications.

"Part of the reason to do that," she said, "is so that you don't end up with a huge backlog of communications, and you don't know quite what's in there, and then they get requested in litigation. Obviously, you cannot do that if there is active litigation; you can't destroy documents that you know to be relevant. But if you just have a general policy about your document retention or document destruction policies, those can cover chat conversations, (instant message) conversations, email conversations."

Heather Morgan, a Los Angeles-based partner with law firm Grube Brown & Geidt L.L.P., said there is an inherently more informal nature to chat, which can lead to serious problems, including lawsuits and data breaches.

"If they're going to employ it," Ms. Morgan said, "I think they should be very particular about what the purpose of it is. Why are they using it? What is the

need? And if it's a means of doing business, then I would suggest the company make sure it sets guidelines and informs employees about the proper use of that software application."

Ms. Morgan suggested that rapidly growing startup companies might be more likely to fall victim to a chat application problem.

"They're thinking about getting the job done and having good employee morale," she said, "and if HipChat or Slack allows that to be accomplished, then that's front and center, and the concern about what's being said takes a back seat."

"The reason collaboration is so popular and why it's becoming more widely spread than email in some regards is because it allows teams to be more effective, more efficient," said Evan Blair, co-founder and chief business officer at ZeroFox Inc., a Baltimore-based social media cyber security company. "But it creates a tremendously challenging environment from a regulatory perspective, from a legal perspective and from a security perspective."

Mr. Blair said all types of companies are susceptible to chat application challenges.

"This is a human problem," he said. "It's an epidemic where we like to overshare. We like to be in the know. There are probably different risks that are more likely to occur depending upon the type of organization and the type of people you're engaging with, but it's really going to be down to the way the technology is

used and the type of engagement that employees are used to."

Mr. Blair said the advice on how to prevent catastrophes from occurring is easy, but the follow-through is hard because "you get into a conversation and the keys just fly."

"What I tell my kids is that anything you post, no matter where you post it, assume that it's 100% public and it will live forever," he said. "So don't post something that you don't want to be publicly available for the rest of time, because that's the way the internet works."

"The reason collaboration is so popular and why it's becoming more widely spread than email in some regards is because it allows teams to be more effective, more efficient. But it creates a tremendously challenging environment from a regulatory perspective, from a legal perspective and from a security perspective."

Evan Blair, ZeroFox Inc.

States seek to limit comp for pro athletes

BY JOYCE FAMA KINWA

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Despite the spotlight on their positions, professional athletes are covered under state workers compensation systems and, like average workers, must contend with legislative proposals to limit the comp benefits they receive.

While professional sports leagues oversee most of the activities involving their teams, in the player-team relationship the team is the employer, said Nathaniel Grow, associate professor of legal studies at the Terry College of Business at the University of Georgia in Athens.

“Each team has under each state’s respective workers comp law the legal obligation their state imposes on employers of that state to provide workers comp for their employees,” Mr. Grow said. “Within that, the players have the benefit of potentially having that financial security. If they get hurt, the team then has insurance that covers them in case of catastrophic injuries and avoids any lawsuits over alleged negligence.”

In professional sports, the teams cover all the injury costs, and the policies they buy generally have very large deductibles, said Alex Fairly, president of Amarillo, Texas-based Fairly Group, a private risk consulting firm that works with professional sports teams.

“The culture in (workers) compensation in the sports world is that there are very few insurance carriers that want to insure professional athletes,” he said. “The capacity in the insurance marketplace is extremely limited. In general, there is not an insurance company out there covering these claims. There is an insurance policy and the carriers process the claims, but the terms of the coverages are such that most of the money ... comes from the dollars of



the teams and the leagues.”

In recent years, legislation has attempted to limit workers comp coverage for professional athletes. For instance, California passed a law in 2013 that prevents athletes from other states from filing workers comp claims there. “What would happen was that a football player from, say, the Miami Dolphins could file a workers comp claim in California, asserting that the injuries he sustained while playing games against the 49ers, Raiders, or Chargers contributed to his disability,” said Mr. Grow.

Other state laws also address comp coverage for professional athletes. Highly paid professional athletes in Michigan are limited from collecting wage differential benefits. In Massachusetts and Florida,

professional athletes are not categorized as employees. Florida law prevents workers from filing workers comp claims in other states for injuries incurred while working outside of Florida.

In Illinois, Senate Bill 12, a package of 13 bills that was jointly introduced in January by Illinois Senate Republicans and Democrats in agreement with Illinois Senate President John J. Cullerton, D-Chicago, and state Sen. Christine Radogno, R-Lemont, would, among other changes, cut off workers comp benefits for professional athletes at 35 years old. The bill is an attempt to help balance the Illinois budget.

“Illinois law currently caps workers’ comp benefits at around \$775 per week. The most a professional athlete would stand to

gain would be around \$40,000 per year or around \$1.3 million for the 32 years from 35-67. Realistically, then, the cost savings to the teams would be a reduction in their workers comp insurance bill based on the reduction in this long-term potential exposure,” said Mr. Grow.

While the executive director of the National Football League Players Association, DeMaurice Smith, has publicly spoken out against the bill, Chicago’s major sports teams — including the Bears, White Sox, Bulls, Cubs and Blackhawks — sent a letter to the Illinois Senate in January expressing their support for the legislation.

In Illinois, injured workers can collect wage differential benefits for workers who are unable to earn as much as they did prior to the injury. These workers are compensated for the difference in pay until age 67. Mr. Fairly noted the law was not written with professional athletes who earn a substantial amount of money in short periods of time in mind. The career span of a professional athlete is much shorter than in other fields, and this reform would adjust the law to reflect this, he said.

“In my opinion legislation like (S.B. 12) makes that benefit in the professional sports world fair,” said Mr. Fairly.

Aside from S.B. 12, there has also been attention on professional athletes and workers comp because of a recent NFL concussion injury lawsuit settlement. Former NFL football players sued the league in 2009, claiming the NFL was aware of the risks associated with repetitive traumatic brain injuries and failed to warn and protect players against the long-term risks. The settlement covers over 20,000 players, and registration for former players began in February. Current NFL players were not included in the settlement.

“What’s coming to light is the lack of treatment for head injuries that have been prevalent in the NFL,” said Los Angeles-based Aaron Swerdlow, counsel at Gerard Fox Law P.C. “The power struggle between teams and coaches, who want players to get back in the game or recover quickly from a head injury or a concussion, and the players whose medical needs might require them to sit out a week or two — the statistics are pretty damning about how often players that have head injuries go unreported or untreated. For example, one-third of all concussions are left off NFL injury reports,” he said, citing a 2014 investigative report.

The NFL denies wrongdoing but will pay former players based on age and qualifying diagnosis, including amyotrophic lateral sclerosis, Parkinson’s disease, Alzheimer’s disease and deaths involving chronic traumatic encephalopathy.

NFL SETTLED WITH FORMER PLAYERS OVER HEAD INJURIES

The National Football League reached a major settlement in 2015 with former players who sued the league after experiencing head trauma during their football careers that resulted in brain injuries.

The former players accused the league of being aware of the risks associated with repetitive traumatic brain injuries but failing to warn and protect players, and ignoring and concealing this information.

The benefits of the settlement include a baseline assessment program to provide neuropsychological and neurological assessment examinations to determine if retired NFL football players are suffering



from cognitive impairment and provide additional medical testing, counseling and/or treatment if they are diagnosed with moderate cognitive impairment.

The settlement also provides monetary compensation for amyotrophic lateral

sclerosis, Parkinson’s disease, Alzheimer’s disease, dementia, and deaths involving chronic traumatic encephalopathy through 65 years old. The settlement designates \$10 million in funding to support safety and injury prevention education programs, including safety-related initiatives in youth football.

The settlement class includes living NFL football players who retired before July 2014 and authorized representatives of deceased or legally incapacitated retired NFL football players. The spouses, parents and dependent children of the retired players are also included.

Joyce Famakinwa

Detecting mental health issues can cut workers comp claims costs

BY LOUISE ESOLA

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It's not always physical injuries that can lead to the most costly workers compensation claims; psychosocial issues such as depression or anxiety also can delay return to work and increase claim costs, experts say.

"How these claims usually morph is you have the fractured ankle, which morphs into the bad knee, which morphs to the bad back, then to a psych claim, then to sexual dysfunction, and before you know it it's permanent disability," said Bill Barbagallo, Los Angeles-based managing director who leads the claims and insurance operations practice nationally for Price-Waterhouse Coopers L.L.P.

According to experts, psychosocial issues run the gamut and include depression, anxiety and addiction — the leading issues affecting comp claims, they say.

Anecdotally, most workers comp payers have a horror story, experts say, adding that concrete data is hard to come by because psychosocial claims can sometimes cross over into group health coverage.

Hartford Financial Services Group Inc. in 2016 analyzed its workers comp claim data from 2002 to 2015. The analysis found that 10% of claims featured at least one psychosocial issue, and that those claims account for 60% of claims costs, according to Dr. Marco Iglesias, the insurer's vice president and medical director based in Hartford, Connecticut, who helped mine the data.

The problem for the workers comp industry is two-fold; sometimes an injured worker's mental illness existed before a work-related injury or illness, and the risk factors that lead to psychosocial issues creeping into a workers comp claim are often out of the employer's hands, experts say.

"It's controversial (because) we are seeing a lot of depression and anxiety arise out



of an injury," said Michael Gavin, president of Prium, a Duluth, Georgia-based medical cost management firm. "But a lot of those issues were pre-existing, they just weren't documented. This creates a significant burden on the workers comp system."

A spokesman for third-party administrator Gallagher Bassett Services Inc. said environmental factors are also at play: "You have the situation in the home, family conditions ... financial condition."

Getting a better grasp on the injured worker's life is key, and predictive modeling tools could help in that effort, experts say.

Many workers comp insurers are "beefing up their departments with predictive modeling staff" to help mitigate the risk of a physical injury claim morphing into a psych claim, said Mr. Barbagallo, who added that insurers are "loath to pay for" such claims.

"Insurers are collecting an exorbitant amount of information about the injured worker," he said. "Culture, divorces, home life ... The industry is relying on sophisticated algorithms and data."

The investigations involve case man-

agers doing much more than collecting forms, according to Gallagher Bassett's spokesman.

"You will have to observe these issues on the front line and actively listen to what could be plaguing the individual in his or her environment," the spokesman said.

For claims related to pre-existing psychological conditions, work is now being conducted to better understand the worker's mentality, said Dr. Teresa Bartlett, Troy, Michigan-based senior vice president of medical quality for TPA Sedgwick Claims Management Services Inc. That can include tests that gauge the likelihood that a person would become addicted to opioids or what that person's childhood was like (see related story).

The early identification of potential mental issues in a claim can make the difference between a claim with an injured worker experiencing a speedy recovery and one that remains stagnant, she said.

For example, injured workers who are identified early as likely to exhibit psychosocial issues tend to feel more pain or think "catastrophically," both increasing

the claim's resolution time and creating the potential for litigation, Dr. Bartlett said.

Tom Lynch, Shirley, Massachusetts-based principal at workers comp consulting firm Lynch Ryan & Associates Inc., said the earlier an insurer can identify a potential issue, the better.

"(The industry) is starting to realize that their old system doesn't really accommodate the discovery of these issues until it is pretty late," he said. "It takes way too long for adjusters, nurses, and case managers to come to the conclusion that something is going on there. It has been the last thing they look at, and by the time they see it, it's an iceberg straight ahead and they are about to hit it."

In addition to early intervention, better communication and worker advocacy are fast becoming best practices, according to experts.

"There are some good proactive management techniques that can be utilized to help avoid these claims or manage them," said Paul Primavera, Washington-based executive vice president and practice leader of national risk control group for Lockton Cos. L.L.C. "There is a potential link between a lack of communication and the unknown that leads to stress and the mental component of a claim."

An analysis last year of Hartford Financial Services Group Inc. workers compensation claims between 2002 and 2015 showed:

- ▶ 10% of workers comp claims featured at least one psychosocial issue.
- ▶ Claims with psychosocial issues such as anxiety and depression account for 60% of overall claims costs.
- ▶ Text-mining analysis uncovered "fear" as a risk factor for injured workers, upping the severity and cost of the claim eleven-fold.

Source: Hartford Financial Services Group Inc.

TROUBLED CHILDHOOD MAY FORETELL TROUBLESOME CLAIM

Workers compensation payers are now relying on tests that screen for potential mental health issues that could affect the outcome of a claim, including one that mines a person's childhood for signs that a physical injury could eventually lead to a mental one.

Dr. Teresa Bartlett, Troy, Michigan-based senior vice president of medical quality for third-party administrator Sedgwick Claims Management Services Inc., said one of the most interesting trends in early identification for potential psychosocial factors in a claim is the use of a test that grew out of an obesity

study conducted by Kaiser Permanente and the U.S. Centers for Disease Control and Prevention between 1995 and 1997.

Researchers wanted to know why people who lost significant amounts of weight tend to regain it, she said, adding that the common issue was mental. People who regained tended to experience one or more of 10 "adverse childhood events" singled out in the study, she said.

Those included physical abuse, sexual abuse, emotional abuse, physical neglect, emotional neglect, seeing their mother treated violently, household substance

abuse, household mental illness, parental separation or divorce, and/or an incarcerated household member.

"If those were present in early childhood, it was likely you would carry it through your life and it would impact you," Dr. Bartlett said. "Screening for adverse events in childhood in a workers comp claim enables us to perhaps see that this might be a troublesome claim."

"You'll see delayed recovery, more perceived pain (and) more dependent personalities," she added.

Louise Esola



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Budget proposals weigh workers comp cuts

BY KRISTEN BECKMAN

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State budget proposals that target employee safety programs and agencies, including workers compensation systems, are raising questions about the balance between federal and state oversight of workers comp and safety enforcement under the new presidential administration.

Wisconsin Gov. Scott Walker introduced Assembly Bill 64, a two-year budget bill, to the State Legislature last month with a provision that would eliminate the state's Labor and Industry Review Commission, which reviews workers comp administrative decisions.

West Virginia Gov. Jim Justice's budget proposal, announced last month, diverts \$38 million from the \$50 million designated annually to pay down unfunded comp liabilities to the state's general fund.

The San Diego City Council's Budget Committee voted in February to ease workers comp reserve policies to free up \$25 million in the city's budget, according to a report in the San Diego Union-Tribune.

And Pennsylvania Gov. Tom Wolf's proposed budget, also introduced last month, includes a provision to centralize government services, including directing the state's Department of Community and Economic Development to create a single point of entry for workers comp claims along with unemployment insurance and other services.

"We're encouraged that the governor is considering options to improve efficiency and find cost savings as potential alternatives to tax increases to address our budget challenges," said Alex Halper, director of government affairs for the Pennsylvania Chamber of Business and Industry in Harrisburg, Pennsylvania.

It isn't uncommon for governors and legislators to target workers comp and labor budgets to help address a budget shortfall, observers say.



REUTERS

Gov. Scott Walker of Wisconsin's proposal to cut the state's Labor and Industry Review Commission is one of several moves by states that would affect safety and workers comp.

"Periodically, states have budget concerns and will look to other departments for money to help balance their budget," said Peter Burton, senior division executive for state relations at the Boca Raton, Florida-based National Council on Compensation Insurance Inc.

These budget activities don't necessarily reflect a wider trend, he said: "It happens every two to four years."

Mr. Burton said when states seek to make themselves more competitive, they evaluate the state's tax structure, energy costs and other elements, including workers comp costs, that can affect how attractive a state is for businesses.

These types of budget initiatives, viewed against a backdrop of a potential shift away from federal workplace safety enforcement activities under President Donald Trump, raise questions about funding for workplace safety programs and enforcement activities.

More than 20 states have opted out of U.S. Occupational Safety and Health Administration oversight by establish-

ing their own state OSHA agencies that are approved and partially funded by the federal agency, said Deborah Berkowitz, senior fellow with the Washington-based National Employment Law Project.

With potential budget cuts to the federal agency on the horizon under the new administration, state enforcement budgets will also be cut, she said. Coupled with state-level legislation and budget cuts targeting workers comp, along with a trend of decreasing benefits paid to injured workers since the early 1990s, this means workers could be negatively affected, Ms. Berkowitz said.

"In the end, workers lose, and they'll lose twice over," Ms. Berkowitz said. "They'll lose if they get injured, and they'll lose because of lack of oversight of their companies."

Nickole Winnett, an attorney at Washington-based law firm Jackson Lewis P.C., said state safety agencies and labor departments are often not a high priority in state budgets and do not receive all the resources they request to enforce safety

and health initiatives, which results in less enforcement and compliance assistance for employers.

"A lot of states don't have the resources or money to have a robust inspection program like the federal government does, so most states will likely maintain the level of enforcement they typically have had," Ms. Winnett said.

Another outcome is a potential easing of tension between federal OSHA and state safety agencies, said John Martin, an attorney with Washington-based law firm Ogletree, Deakins, Nash, Smoak & Stewart P.C.

States that opt out of federal OSHA oversight are required to have a program that is considered "as effective" as the federal program, and OSHA has tended to require states to run their safety programs the same way as the federal agency, which sometimes conflicts with state laws, Mr. Martin said.

"Under the last administration, there were a lot of arguments between state and federal OSHA about what it meant to have a state plan," Mr. Martin said. "I think we will see a little more cooperation" with the current administration.

WORKERS COMP MEASURES BEING CONSIDERED BY STATE LEGISLATORS

CALIFORNIA: The 2017-18 budget proposal increases funding for the state's Labor and Compliance Fund to \$11.4 million by 2020-21.

CONNECTICUT: Gov. Daniel Malloy has proposed cutting 11 Workers Compensation Commission jobs if the state is unable to reach concessions with state employee labor unions.

PENNSYLVANIA: Gov. Tom Wolf seeks to eliminate overlapping bureaucratic steps of multiple departments by making the state's Department of Community and Economic Development the single point of entry for workers comp claims and other matters.

WISCONSIN: Gov. Scott Walker has proposed eliminating the state's Labor and Industry Review Commission.

STATES LOWER COSTS BY CHANGING PROCESS TO RESOLVE COMP DISPUTES

While some states are looking to balance their budgets by making cuts within agencies that oversee workers compensation programs, others have taken a different direction in recent years by modifying their process for workers comp administration and adjudication.

Oklahoma and Tennessee both reformed their workers comp systems in 2013, each including provisions to shift to an

administrative process for workers comp administration and dispute resolution rather than a process that relied on the judicial system to resolve claims disputes.

Under an administrative process, the state creates and maintains an agency to oversee the workers comp system and handle dispute resolution. In a judicial review system, comp disputes advance to a local or circuit court system more

quickly, said Peter Burton, senior division executive for state relations at the Boca Raton, Florida-based National Council on Compensation Insurance Inc.

"When they try to internalize this process and keep it within the experts who know workers comp law, the thought is the system works quickly, is more efficient, reduces attorney involvement, and the worker gets his or her case resolved a

little bit more promptly," said Mr. Burton, who noted that most states operate under an administrative comp system run by a workers comp commission or within a labor department or industrial accident division.

Internalizing the comp process can reduce inconsistencies caused when multiple state judges issue workers comp rulings with disparate precedents, Mr. Burton said.

Kristen Beckman

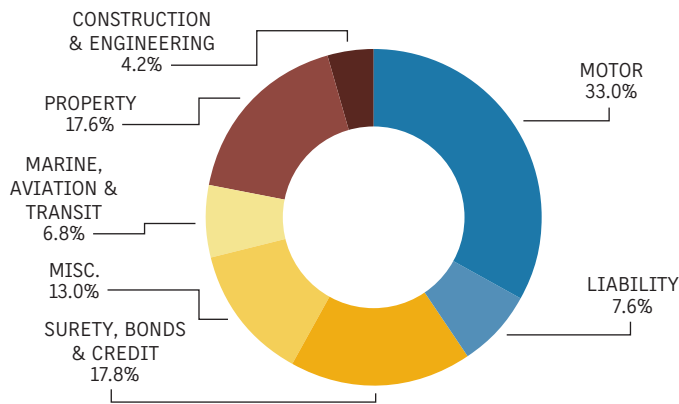
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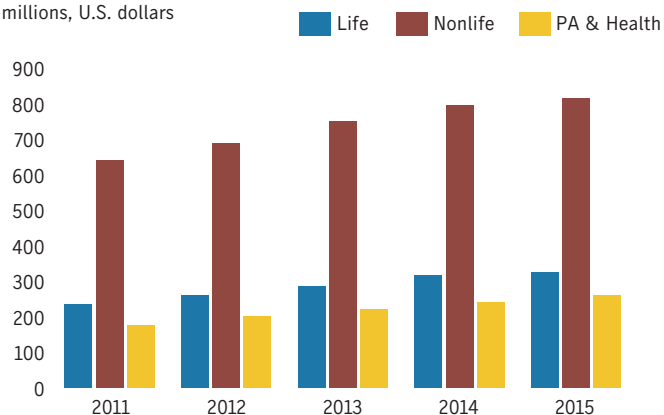
The number of insurers in Panama has been reduced in recent years, with the compulsory liquidation of two insurers and the acquisition of American International Group Inc.'s Panamanian operation by Grupo ASSA S.A. However, some observers still feel that with 27 insurers, Panama's insurance market will see further consolidation. Market growth in recent years has shown some correlation with that of Panama's economy and in 2015 slowed as the economy cooled. Completion of the Panama Canal expansion in 2016 is likely to have an adverse effect on the insurance market, as no other major projects are planned.

MARKET SHARE



MARKET GROWTH

In millions, U.S. dollars



Source: Axco Global Statistics/Industry Associations and Regulatory Bodies

COMPULSORY INSURANCE

Several lines of insurance are compulsory, including:

- Auto third-party liability
- Personal accident cover for bus passengers
- Errors and omissions for foreign reinsurance brokers
- Aviation third-party liability
- Shipowners liability for oil pollution

NONADMITTED

Nonadmitted insurance is not permitted in Panama. The law provides that insurance must be purchased from locally authorized insurers unless specific permission has been granted by the insurance supervisor for a risk to be placed with a nonadmitted carrier.

INTERMEDIARIES

Brokers and agents must be authorized to transact insurance business. Intermediaries are not allowed to place business with nonadmitted insurers unless specific authorization has been given by the SSRP. Brokers involved in nonadmitted placements do not appear to be obliged to warn buyers that their insurer is not subject to local supervision but would be likely to do so.

MARKET PRACTICE

The law does not seem to be abused on the property/casualty side. The Panama Canal Authority has special exemption to place its insurances directly into overseas markets, although a proportion is also placed locally. The SSRP indicated in 2016 that it receives only a handful of requests to authorize nonadmitted placements each year. Fronting may be used for large risks.

MARKET DEVELOPMENTS

Updated December 2016

Insurance Superintendency (SSRP) Acuerdo No 4 of Sept. 6, 2016, provided that insurers had to establish premium insufficiency reserves if the underwriting result plus net investment income over the past 24 months were negative in particular lines of business, including auto, fire and allied lines, cargo and hull, engineering and surety.

In January 2015, Joaquin Riesen, formerly of Seguros Suramericana, was appointed superintendent of insurance. The introduction of premium insufficiency reserves is one of several regulatory measures designed to strengthen the market and improve technical results while maintaining growth.

In August 2016, ASSA finalized the acquisition of 100% of the share capital of AIG Seguros Panama, making it the property/casualty market leader.

In October 2015, Seguros Constitucion S.A. was liquidated due to reporting irregularities and solvency concerns. This followed a failed attempt by the regulator to secure corrective action from the Venezuelan owners.

The SSRP announced its intervention in the administration of Seguros Confianza S.A. in September 2016, owing to an insufficiency of capital, and confirmed the company's forced liquidation. The insurer ranked 19th among property/casualty insurers.



AREA

29,762

square miles

POPULATION

4.1

million

MARKET CONCENTRATION

66.8%

market share of top 5 insurers

2016 GDP CHANGE (PROJECTED)

5.6%

Information provided by Axco Insurance Information Services.
www.axcoinfo.com

Settlement ends old battle between Greenberg, Spitzer

■ A 12-year legal battle between former American International Group Inc. CEO Maurice R. Greenberg and successive New York attorneys general came to end last month with the parties involved agreeing to a nearly \$10 million settlement.

The unexpected announcement by New York Attorney General Eric Schneiderman ended a lawsuit that was first filed by Eliot Spitzer when he held the office in 2005. The suit focused on a \$500 million retrocessional loss portfolio transfer contract between AIG and General Re Group, a unit of Berkshire Hathaway Inc.

The suit accused Mr. Greenberg and AIG's former CFO, Howard Smith, of setting up a fraudulent transaction to create the appearance of reserves when none existed. The executives were also accused of involvement in another allegedly improper transaction, which involved an offshore reinsurer, to remove auto warranty losses from AIG books.

AIG settled charges over the transactions, among other things, for \$1.6 billion in 2006, but Mr. Greenberg fought the allegations with numerous motions and appeals.

The case against Mr. Greenberg and Mr. Smith eventually went to trial last September, but was suspended midway when the parties agreed to mediation. As part of the settlement, Mr. Greenberg agreed to pay \$9 million and Mr. Smith \$900,000. In a statement, Mr. Schneiderman said: "After over a decade of delays, deflections, and denials by Mr. Greenberg, we are pleased that Mr. Greenberg has finally admitted to his role in these fraudulent transactions."

In a statement accompanying the announcement, Mr. Greenberg said: "As a result of these transactions, AIG's publicly-filed consolidated financial statements inaccurately portrayed the accounting, and thus the financial condition and performance for AIG's loss reserves and underwriting income." He noted that subsequent restatements by AIG corrected the accounting for the transactions.

In public appearances after the settlement announcement, Mr. Greenberg took issue with characterizations of the settlement agreement as one where he had admitted to fraud.

Zurich off the hook for crane damaged in Superstorm Sandy

■ A Zurich Insurance Group Ltd. unit is not obligated to provide coverage in connection with a crane damaged during 2012's Superstorm Sandy under a policy exclusion, says New York's highest court.

New York-based Lend Lease (US) Construction LMB Inc., the construction manager on a 74-story skyscraper on West 57th Street in Manhattan, had arranged with another firm to furnish and install two diesel tower cranes, according to a ruling by the New York Court of Appeals in *Lend Lease (US) Construction LMB Inc. et al. v. Zurich American Insurance Co. et al.*

When Superstorm Sandy made landfall in October 2012, the crane's boom collapsed, and it "teetered precariously" from the building's top, causing the blocks surrounding the building to be evacuated for six days, according to the 6-0 ruling.



The company building the skyscraper had a total of \$700 million in builders risk insurance coverage among five insurers, including Schaumburg, Illinois-based Zurich American, which had assumed half the aggregate risk, according to the ruling.

Zurich American denied coverage for the claim, and Lend Lease filed suit. A contractor's tools exclusion applied, said the New York Court of Appeals ruling, which found the clause included losses to "contractor's tools, machinery, plant and equipment" not destined to become a permanent part of the insured project.

Chubb fails to win injunction in case against Endurance

■ A federal judge in New Jersey refused to issue a preliminary injunction barring Endurance Specialty Holdings Ltd. from soliciting Chubb Ltd. real estate and hospitality clients following Endurance's recruitment of former Chubb executive Michael Chang and several of his staff last year.

But the judge in *Chubb INA Holdings Inc. v. Michael Chang et al.* also refused to throw out a revised lawsuit filed by the Chubb unit alleging that employees poached by Endurance had obtained confidential business records "on a massive scale through multiple mediums" prior to leaving Chubb.

Mr. Chang worked at Chubb for more than 19 years in its real estate and hospitality division, and allegedly indirectly coordinated Endurance's recruitment of many key employees of that division. Other former Chubb employees named in the suit include Bentley Betts and Daryl Dubrovich, who are now casualty under-

writers at Endurance.

Endurance announced in February 2016 that Mr. Chang would be joining the company as CEO of global risk solutions. In the following weeks, the complaint said, Mr. Chang began indirectly working with other Endurance employees and an outside search firm to coordinate a simultaneous lift out of a block of Chubb employees to create a "turnkey" operation for Endurance.

Chubb also charged that Mr. Chang and other former Chubb employees accessed confidential information on Chubb's computer system to send it to their personal email accounts so they could transfer, save or store the information on cloud service platforms and portable storage devices. The complaint said the alleged data transfers generally occurred while the accused employees were still working at Chubb.

In allowing the case to proceed but in denying a preliminary injunction, the court said while Chubb had "made a persuasive showing that Chang breached his nonsolicitation agreement," any alleged harm that resulted could be "remedied by money damages. The same is true with respect to Endurance's alleged use of confidential information to solicit Chubb's customers."

MetLife faces 'wage and hour' suit from claims specialists

■ MetLife Inc. faces a \$50 million lawsuit alleging the insurer wrongly reclassified the job of long-term disability claims specialists and stopped paying them overtime.

According to a suit filed in U.S. District court in Connecticut, the insurer reclassified the LTD claims specialists in an effort to reduce costs but kept paying short-term disability claims workers as nonexempt hourly workers.

A MetLife spokesperson declined to comment about the case, which seeks class-action status.

Lead Plaintiff Stephanie McKinney, a former LTD claims specialist worked for MetLife in Bloomfield, Connecticut, from September 2013 to July 2016 as an LTD claim specialist, according to the suit.

"LTD claim specialists regularly work between 45 and 60 hours per week," the complaint said, but Ms. McKinney alleged that for over three years MetLife didn't compensate her and other LTD claim specialists for overtime.

The complaint said that MetLife used to pay its LTD claim specialists hourly wages and overtime pay. But in November of 2013, MetLife "reclassified" LTD claim specialists and stopped paying them overtime, without any change in LTD claim specialists' job duties.

"By contrast," the complaint said, "short term disability claim specialists remained classified as non-exempt hourly employees and continued to receive overtime pay."

DOCKET



EMPLOYEE MAY SUE COLLEAGUE FOR WORK ACCIDENT

A restaurant worker can sue her colleague for injuries she suffered because workers compensation exclusive remedy rules don't apply to co-workers, the Missouri Court of Appeals ruled.

The plaintiff fell from a ladder that had been moved by her co-worker and she sued her co-worker for negligence. The Missouri appellate court found that Missouri's workers comp law only protects employers against tort claims and not co-employees.

BUILDERS RISK POLICY DOESN'T COVER EXISTING STRUCTURES

A Travelers Cos. Inc. unit is not obligated to cover a construction firm under its builders risk policy because of an exclusion for existing structures, the 10th U.S. Circuit Court of Appeals found.

The University of Denver hired a firm to renovate its library. Melting snow damaged existing drywall and insulation in areas that the contractor planned to preserve and update.

The circuit court upheld an exclusion in the contractor's builders risk policy, finding that "the damaged areas already existed at the job site."

INVESTIGATION WAS RETALIATION FOR COMPLAINT

An investigation into an employee who was fired was motivated by a complaint the worker made against his supervisor, the 5th U.S. Circuit Court of Appeals found.

The plaintiff, who is black, complained that a supervisor used the term "boy" to address him. Pornographic DVDs later were found in the worker's locker, which he claimed were planted there. When supervisors tried to search his car, the plaintiff left work and he was ultimately terminated.

The worker claimed he was fired in retaliation for complaining about his supervisor, and the U.S. District Court in New Orleans ruled in his favor.

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OFFICIAL CONFERENCE COVERAGE | MONDAY, APRIL 24

Q&A: JULIE PEMBERTON
Julie Pemberton, the 2017 president of RIMS and director of general risk and insurance management at Charnett Inc. in Bellevue, Washington, opens the show for the RIMS conference.

Getting business back on track tops cyber concerns
Businesses of all types put business interruption resulting from a breach at the top of their cyber risk concerns, according to a report issued Monday by Aon P.L.C.'s Aon Risk Solutions unit at the Risk & Insurance Management Society Inc.'s annual conference in San Diego.

Q&A: BARRY HILLARD
RIMS lower middle management chairwoman Barry Hillard discusses how he entered the industry and what he feels most rewarding about his job and the sector can do to attract young people in the field.

Temple students build best solution for Lego risks
Lego is one of the world's favorite toys. But for eight teams of risk management students, it became more than just child's play at the Risk & Insurance Management Society Inc.'s annual conference in San Diego this week.

Next Generation
Risk management students from Temple University in Philadelphia received a check for \$4,000 for their school after winning a competition to develop a risk management solution to a case study for Denmark-based Lego Systems A.S.

Q&A: CINDY STEELE
Cindy Steele, president of risk at San Diego chapter, discusses the risks unique to the area, the growth segment of military operations, and the chapter is playing in this year's conference and exhibition.

Risk management hinges on perspectives and observations
Having the right perspective, collaborating with the right partners and being able to pick up as telltale signs of disruption are critical skills for risk managers.

Insurance industry transforms to tackle new risk environment
The insurance market has all the feel of the beginning of a hard market, said a speaker at Business Insurance's executive panel at the Risk & Insurance Management Society Inc.'s annual conference in San Diego Tuesday.

Firms try different techniques to woo millennial workers
The risk management and insurance sector has a lot of work to do to integrate millennials into its workforce, including using the right channels to recruit them and offering them the mentorship programs they value.

Award winners
Risk Manager of the Year breakfast

Safety
Employees need to win workers' trust

Around the Ball
The exhibit hall in pictures

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Artemis Emslie, Tampa, Florida-based CEO of pharmacy benefit manager Matrix Healthcare Services Inc., has served in her role since 2012 and has nearly 25 years of experience in both the workers compensation and group health industries. Her firm, which does business as myMatrixx, was founded in 2001 and continues to grow. She said myMatrixx leverages technology to bridge the gap between the clients it serves and the needs of injured workers. She spoke recently about trends and issues in workers comp with *Business Insurance* Reporter Louise Esola. Edited excerpts follow.

Artemis Emslie

MATRIX HEALTHCARE

Q A buzzword in workers comp right now is advocacy. What is being done to improve service for injured workers and why?

A We can start with the why, because the why is really simple in the fact that we are firm believers in really championing the message of kind of changing the face of workers compensation from an adversary-type model to an advocacy-type model. And we're doing that for the simple reason that if you think about all the money that a company deploys to retain and engage their workforce and then somebody in that workforce gets hurt on the job, all of a sudden this really odd environment can be tricky to navigate. And it feels like, or it has felt like in the past, that people are just going to say "no" or are just going to reduce cost by denying the claim.

And we feel pretty strongly that "no" is not necessarily always the right answer. The right answer is to help them navigate through their claim and educate them and engage with them for a positive impact. And what we do see is that when you do that, people are more likely to get involved themselves in helping — in our case, medication therapy — but also helping close that claim, helping them get back to work quicker. And not to lose sight, they are less likely to call an attorney because they're mad or because they feel like they're not being treated fairly.

Q What are some of the areas for improvement in workers comp as you see them?

A I think we have a long way to go educating on patient advocacy. I think we have to start being more conscious about how do we integrate and collaborate with each other and all of the different stakeholders. There's a sense of, "if I hold the data, I have the power." And I think that as an industry, if we come together and collaborate, we're going to achieve better outcomes. Thinking about the patient as a whole — not just the physical injury, but the mental and the spiritual aspect of the patient — is what we have to consider. Again, patient advocacy is a part of that, but I believe (education) is the next direction we're going in.

Q Opioid prescribing is under attack by way of state legislation and formularies. How do you view this shift?

A I think it's long overdue. I think workers compensation is way behind the eight ball on opioid management. And not to say that opioids used in the right scenario for the patients that they help are a bad thing. When I think about workers compensation, I think that we as an industry accept that if the medication's related to the injury in some vague way, it's OK to dispense with not having a little bit more control over that. I believe that this is not a new topic. This is a relatively old topic that now is getting the right amount of press, the right amount of attention to actually reduce



(overprescribing). And we've seen opioid reduction occur in our population. I think overall you could claim that opioid reduction is occurring in workers compensation. And I think that comes from the increased visibility from the states, the increase in visibility just from the nation. I think that we've made really good progress on that. I think that as the states are starting to look at opioids, they shouldn't just be looking at opioids, but they should be looking at the bigger picture, which is: What's the right legislation to put in place that helps payers and/or their partners manage medication therapy as a whole? There's a lot more that we could do from a legislation (standpoint).

Q What's being done to reduce prescription drug costs in comp?

A Workers compensation drug costs have already come down significantly. And the industry as a whole, through the payers contracting with PBMs and the competitive nature of that marketplace, has already closed the gap. So there was this old belief that a drug in workers compensation was so much more expensive than a drug in a commercial plan, and that was absolutely the truth. But as soon as you allowed competition and as soon as you gave payers the ability to negotiate, price became highly competitive.

Q What are the key technological innovations that you're seeing in workers comp claims handling at the moment, and how are they being used to restrain costs and improve service for injured workers?

A I think the biggest area of technological advancement is using mobile technology to engage with patients. Everybody has a smartphone. People are used to it. They interact very easily on their phones. And allowing stakeholders to touch a patient via a mobile app with really quick bites of information, or video, or a picture helps increase engagement for the patients and ultimately, hopefully, (creates) overall better outcomes.

Q MyMatrixx is growing and celebrating its 16th year in business. Can you talk about what is driving the company's strategy and what's to come?

A We were founded on the core principles of making managing a patient or an injured worker's medication therapy easy for anybody — for the patient, for the claims handler that might be handling the claim. We do that with leveraging technology and providing really quick, actionable data. If you treat the people that you work with correctly and right and you keep them happy and engaged in the workplace, that extends to the client base. There's a ton of different ways we get there, but at the core, making it simple for somebody to manage their medication therapy and doing it with a smile and being happy about going to work every day is definitely driving that success.

There was this old belief that a drug in workers compensation was so much more expensive than a drug in a commercial plan, and that was absolutely the truth. But as soon as you allowed competition and as soon as you gave payers the ability to negotiate, price became highly competitive.



GLOBAL DATA SECURITY THREATS EVOLVE AS HACKERS HOLD BUSINESSES TO RANSOM

Companies face choice of paying up or losing often-sensitive information

BY JUDY GREENWALD

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Virtual shakedowns of organizations via ransomware computer software are becoming both more prevalent and more sophisticated, and are an increasingly major problem for businesses.

Although primary targets are small and midsize businesses and health care institutions, all companies are vulnerable to ransomware, which involves criminals encrypting data and preventing companies' access to their files without first paying a ransom — generally in bitcoin, the untraceable digital currency.

The infected software is often downloaded through “phishing,” when employees inadvertently click on phony links.

Observers say major factors behind its prevalence is that criminals generally demand relatively small amounts, often only a few thousand dollars, which makes it worthwhile for businesses to accede to their demands — although there is no guarantee their data will be restored uncorrupted, if at all, or that the criminals won't return for another bite of the apple.

There are steps companies can take

to avoid falling victim to ransomware, most notably employee training, and insurance coverage is readily available (see related stories).

Ransomware “is increasing, and it's increasing on a global scale,” said Alan Brill, senior managing director at Kroll Associates Inc. in Secaucus, New Jersey.

Ransomware incidents among Beazley P.L.C. clients, for instance, more than quadrupled in 2016 over 2015's total to more than 200 and are expected to double in 2017, according to a report issued by the insurer in January. And there isn't any end in sight, as defend-

ers struggle to stay one step ahead of criminals.

Reports of ransomware so far this year include a police department in Cockrell Hill, Texas, that lost eight years' worth of data because of a ransomware attack, and a four-star resort hotel in Austria that paid about \$1,600 in ransomware after hackers penetrated its security system and locked its room doors from the inside.

“Basically, the criminals figured out it's a lot easier to deny access to information rather than trying to implant malware, exfiltrate data and sell it on the web,” said John Riggi, Washington-based managing director in BDO Consulting's technology advisory services practice and head of its cyber security and financial crimes unit. “It's been a pretty effective business model.”

The small amount the criminals demand “sometimes makes it easy for a company to want to pay,” said Dave Navetta, a partner with law firm Norton

Rose Fulbright US L.L.P. in Denver.

However, he warned, there is no guarantee that the amounts being demanded will not increase.

“The frequency is there. What hasn't happened yet is the severity,” said Ben Beeson, Washington-based vice president for cyber security and privacy at Lockton Cos. L.L.C.

Meanwhile, the ransomware itself is becoming more sophisticated as it evolves, experts say. “It's being updated faster and faster, so it becomes more difficult to recognize it” when it infects systems, Mr. Brill said.

In addition, new versions of ransomware copy whatever they encrypt, so “now the threat is, if you don't pay the money, not only will you not have access to (the data) but I'm going to release it to the world,” Mr. Brill said.

“Ransomware is becoming smarter,” said Mr. Navetta. Rather than encrypt-

See **RANSOMWARE** next page



81%

of ransomware detected in corporate environments occurred in North America.

51%

of ransomware detected in home/consumer environments occurred in Europe.

Source: State of Malware Report, Malwarebytes Inc.

RANSOMWARE

Continued from previous page

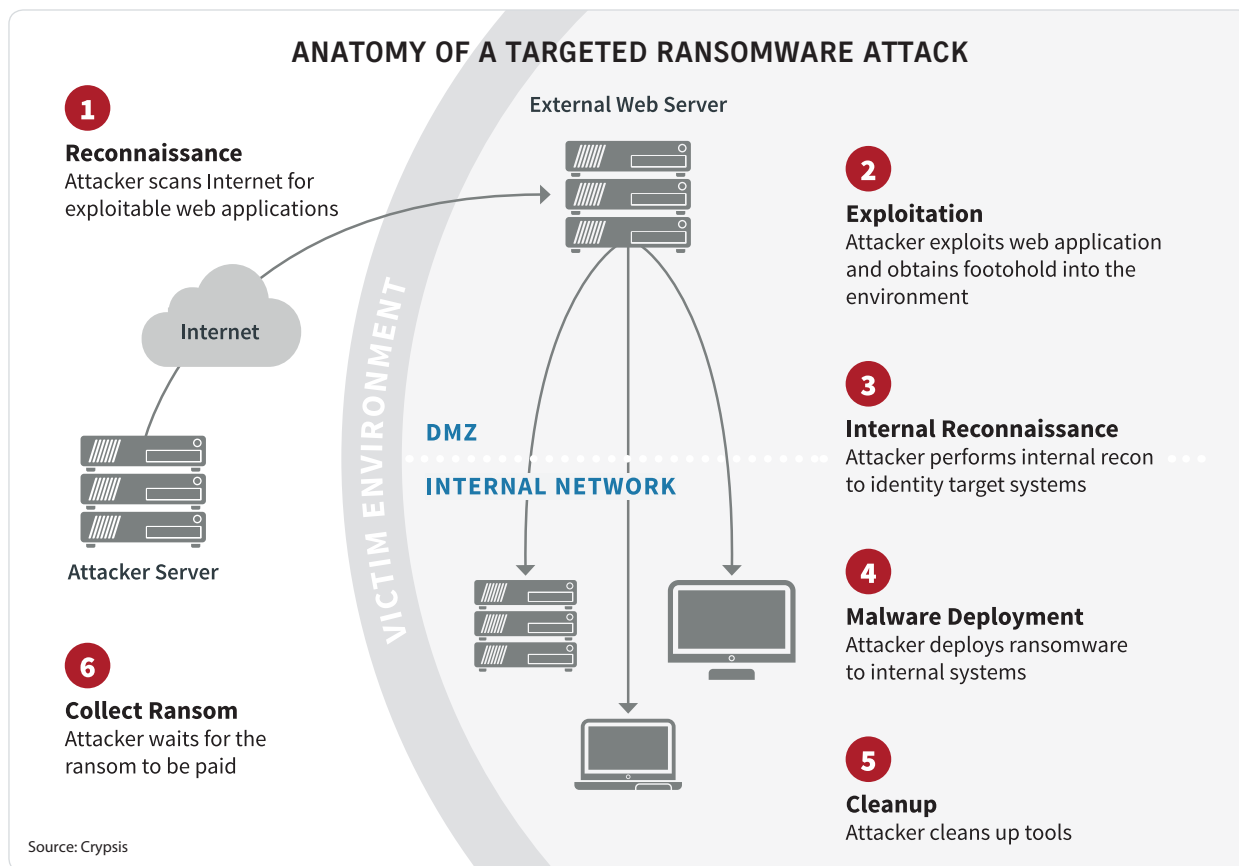
ing only the data it first touches, he said, it can now look for certain types of more valuable data.

Sixty new types of ransomware were distributed last year, said Bill Hardin, Chicago-based vice president at consulting firm Charles River Associates. “They’re always one step ahead.”

Companies of all sizes are at risk, say experts. Ransomware is “a largely automated business, so they’re sending out tons of phishing emails. And since it costs them essentially nothing, they’re going on the fact that some small percentage of people will fall for it,” said Mr. Brill. The criminals have even established call centers that direct victims how to pay in bitcoin, he said.

Health care, however, remains a particular target, as well as school districts, higher education and government agencies — all of which may have less robust cyber security systems than large corporations, experts say.

Just by the nature of it being health care, the sector has “more significant exposures. It truly could be a life-or-death situation,” said Erica Davis, New York-based head of specialty products errors and omissions at Zurich North America.



KEEP STAFF, TECHNOLOGY UPDATED TO REDUCE MALWARE VULNERABILITY

A critical factor in avoiding ransomware attacks is training employees to be exceedingly cautious about clicking on email links.

Experts warn that phishing attacks, which often serve as ransomware’s gateway into companies’ information technology systems, have become more sophisticated and often originate from apparently legitimate contacts.

“You have to train your staff to be vigilant. It all relates to preparation from the boardroom down,” said Richard J. Bortnick, senior counsel at law firm True Lieberman Strauss & Shrewsbury L.L.P. in Red Bank, New Jersey.

Make sure there is a password management system in place, keep up with system upgrades and maintain updated antivirus programs and high firewalls to eliminate some of the initial phishing, said Matt Chmel, Chicago-based team leader of Aon Risk Solutions’ professional risk solutions team. In addition, introduce segmentation around data and restrict who has access to it, he said.

On key systems, firms should also consider whether it is appropriate “to use some form of whitelisting,” where the computer is given a list of executables, which are files capable of being run as a program in the computer, that employees are authorized to run, said Alan Brill, senior managing director at Kroll Associates Inc. in Secau-



cus, New Jersey.

Data backups are critical, say experts.

“It’s all about backups,” said Brett Anderson, Atlanta-based breach response services manager with Beazley P.L.C.. It minimizes the damage ransomware can cause “if you can restore your system.”

Experts stress that backup systems should be kept offline. If it is online, the malware “kills that, too,” said Mr. Brill.

Furthermore, the backup should also be configured so “it doesn’t take a great deal of time” to restore the system, said John Riggi, Washington-based managing director in BDO Consulting’s technology advisory services practice and head of its

cyber security and financial crimes unit.

If a company does get hit by malware, one of the first steps that should be taken is to isolate the problem. “You want to make sure that the ransomware is not going to spread through your enterprise,” Mr. Brill said. “It’s bad enough to have a machine hit with ransomware. It’s considerably worse to have 500 machines.”

“You need to find out what the attack vector was, how did this ransomware attack get into your system,” because trying to remediate the situation without finding that out first means “you can be hit again,” said Bret Padres, CEO of the McLean, Virginia-based Crypsis Group, a cyber

security services firm.

He said he has seen situations where companies recover with a backup and “then the backups often become corrupted by additional ransomware” because the ransomware attack’s full scope was not initially discovered.

In addition, “You want to find out if the ransomware that has hit you is one that has been previously analyzed,” said Mr. Brill, adding that in some cases cyber security firms have developed programs “that will crack the ransomware.”

Experts advising businesses on ransomware demands say they generally leave it up to the business to decide whether to pay ransomware.

Mr. Riggi, who is a former FBI agent, said at the agency “we would never encourage paying the ransom, because that encourages that type of behavior, and you’re funding the criminal organization,” which could be involved in more serious crimes.

“That being said, the FBI understood it’s a business decision that the company has to make,” Mr. Riggi said.

But there are no guarantees paying the ransom will work.

“Some organizations that pay get a decryption key. Others will pay and not get a decryption key, so it’s a judgment call,” said Mr. Brill.

Judy Greenwald

RANSOMWARE ATTACKS COVERED UNDER MULTIPLE INSURANCE POLICIES

Insurance for ransomware-related costs is readily available, at least for now, experts say.

While ransom demands to date have been low enough to fall under policy retentions, coverage can be triggered by crisis management and forensics investigation expenses, said Meredith Schnur, Madison, New Jersey-based senior vice president and professional risk national practice leader at Wells Fargo Insurance Services USA Inc.

"This is an area where the role of insurance is increasing," with insurers offering prequalified vendors in the event an attack does occur, said Erica Davis, New York-based head of specialty products errors and omissions at Zurich North America.

Experts say that in addition to coverage under policyholders' cyber policies, there may be coverage in business interruption and kidnap and ransom policies.

Historically, coverage for ransomware attacks is sublimited within cyber policy limits, but now policyholders may be able to obtain full limits for the coverage, said Matt Chmel, Chicago-based team leader of Aon Risk Solutions' professional risk solutions team.

Policy language should be reviewed with a broker, Mr. Chmel advised. There are



67 cyber insurers, "each one with different language and verbiage," he said.

"You would want to do your homework ... and look for the right coverage and the right price, and always be careful of the sublimit," said Judy Selby, Stamford, Connecticut-based managing director of BDO Consulting's technology advisory services.

Do not mistakenly assume that because the ransomware demand is low the insur-

er need not be notified, said Roberta D. Anderson, a partner with K&L Gates L.L.P. in Pittsburgh.

If a company does find itself to be a victim of malware, "one of the first things it should do is notify its cyber insurance carrier," she said. Otherwise, if it later becomes a much larger claim than initially thought, the policyholder "could end up facing an insurer's argument that notice was provided late, and therefore there was

no coverage," said Ms. Anderson.

"Follow whatever requirements are in the policy, so you don't do something in advance of getting any required consent or authorization from the insurance company and put your coverage at risk," Ms. Selby added.

She also said that firms' incident response plans "should include the insurance component in there. Whatever other requirements you have in your policy, put that into the incident response plan" so "it doesn't fall through the cracks when you're dealing with a crisis."

"The irony, perhaps, of ransomware" is that it has been insured "since the emergence of cyber insurance under the cyber extortion insurance agreement," said Ben Beeson, Washington-based vice president for cyber security and privacy at Lockton Cos. L.L.C. in Washington.

"It wasn't thought to be as much of a risk" as network interruption and first-party loss risks, he said.

Clearly, he said, that "is becoming a more relevant part of the insurance policy. At the moment, insurers seem happy to cover it, but what happens when, or if," they begin to pay out more money on these claims?

Judy Greenwald



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CAPTIVES REPORT

Captives increase options for cyber cover

INSIDE

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Microcaptives are getting more attention from both potential owners and regulators. **PAGE 24**

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▶ CAPTIVE SECTOR RANKINGS

Business Insurance's 2017 rankings of the top captive managers and domiciles. **PAGE 27**

BY ROB LENIHAN

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After some initial reluctance, owners of captive insurers appear to be showing some enthusiasm for using captives to cover cyber risks, industry analysts say.

But difficulties in measuring cyber exposures and concerns over the size of the exposure, are still holding many captive owners back.

Tina Summers, a senior vice president with Marsh L.L.C.'s captive solutions practice in San Francisco said that while cyber capacity remains abundant in the commercial market, market pricing and appetite has deteriorated for clients in certain industries.

"In some cases," Ms. Summers said, "cyber risk is evolving faster than the commercial market, which forces clients to retain exposures that the market will not

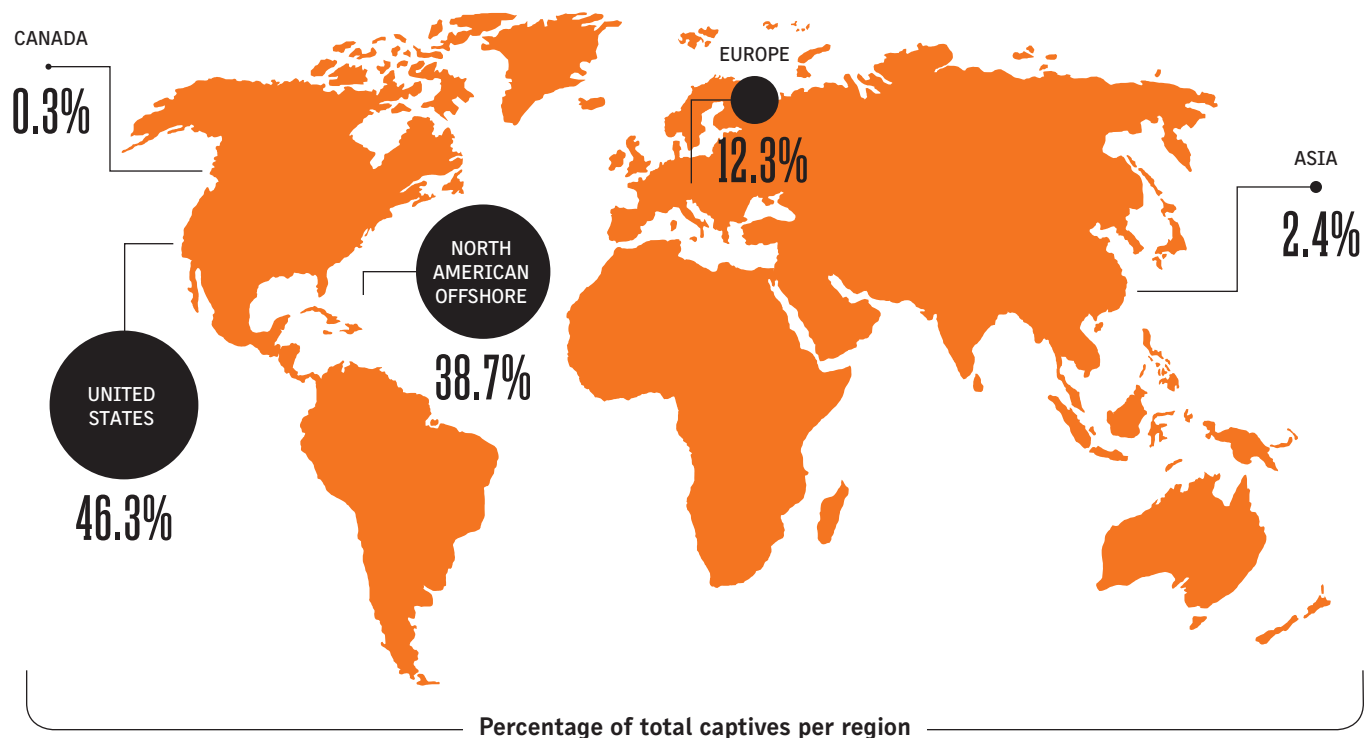
write. For these clients, using a captive to fund increasing retentions or gaps in their cyber program can reduce the volatility of retained losses and lessen the balance sheet impact."

Ms. Summers added that Marsh has some clients for whom cyber is still a relatively new risk, "so they're using the captive as a way to kind of incubate the risk before approaching the commercial market to try and get insurance."

ONSHORE/ OFFSHORE BY THE NUMBERS

There were 7,006 captives worldwide in 2016, a 2.3% increase over 2015.

Source: BI survey



“So it’s a good transition state from being uninsured into a risk transfer program,” she said. “They feel like having the data can provide them with more negotiating leverage because they have more information about their exposure.”

Samit Shah, insurance solutions manager at security ratings company BitSight Technologies Inc. in Denver, said some captives might have “difficulty wrapping their arms around what cyber risk means, what it is, what the risk exposures are, and how they measure the impact that risk might have to the company.”

“When you’re putting risk like that into a captive,” he said, “you should have some baseline understanding of what the risk exposures are so you can underwrite it and identify the gaps with other coverages that you might have in the captive.”

As far as potential solutions, Mr. Shah said many companies are bringing pre-breach, loss-mitigation, and post-breach services to the market, decreasing costs and increasing quality and breadth of services. In addition, he said several risk modeling firms are taking the available data and generating severity models to better approximate the financial impact of an event.

“They’re trying to find the data,” he said. “They’re trying to help companies understand what’s the likelihood of a breach and what’s the financial impact of a breach. Industry and government associations are all trying to help drive some kind of standard around information sharing. And that’s been one of the challenges for a long time, and it still is a challenge — something that I think carriers are reluctant or slow to get involved with, but it is starting to slowly take shape.”

In August, Zurich Insurance Group Ltd. announced its security and privacy protection policy for companies and their captives cover the costs associated with a data breach.

“I think going forward, businesses will look for better options to address their cyber risk, and that may mean the captive use will continue to grow for at least retention and deductible amounts,” said Erica Davis, New York-based head of specialty products errors and omissions for Zurich North America.

Ms. Davis added that “it could be the captive use is more intended for the unique kind of ‘uninsurables,’ so what currently isn’t covered in a traditional cyber product available in the market-

place, or we may see it grow by ways of risk transfer here in the U.S. but fronting outside of the U.S., because the exposure is less understood generally speaking outside of the U.S.”

Carolyn Snow, director of risk management at Humana Inc. in Louisville, Kentucky, said that while there are several good business uses for captives, cyber is currently probably one of the coverages that’s less frequently placed in a captive.

“When you place risk or coverage in a captive,” Ms. Snow said, “you need to

do an actuarial study or a reserve analysis so that you can evaluate your true exposure, as cyber coverage is relatively new compared to other lines of coverage and there generally is not as much industry experience that an actuary could use. So it’s harder to evaluate your exposure if you’re a looking to use a captive for your cyber coverage.”

Ms. Snow said cyber is typically placed in smaller company captives, where their

See **CYBER** page 25

GROWTH EXPECTED IN ALTERNATIVES TO CYBER INSURANCE

While captive insurers have been accustomed to underwriting workers compensation, liability lines and some property risks, Aon P.L.C. said it has seen growing enthusiasm for underwriting cyber risk.

In the 2016 study “Cyber, the Fast Moving Target,” Aon said that by covering cyber risks with a captive rather than self-insuring the risk, “the company gets the opportunity to see how the risk will behave in a formal insurance structure subject to underwriting and claims adjustment disciplines.”

“Over time,” the report said, “that experience and data can be used to negotiate program structure with insurance carriers and inform cost allocations of cyber loss.”

A 2016 Marsh L.L.C. study, “Captive Solutions: Creating Security in an Uncertain World,” found that cyber liability is one of the most well-known emerging risks that is constantly evolving and having an effect on most modern organizations.

From 2014 to 2015, the study said,



the number of Marsh-managed captives using cyber liability programs increased by 30%. Over the past four years, cyber liability programs in Marsh captives, both new and existing, have grown by 160%.

“There is a need for innovative solutions to create security against emerging cyber risks, and captives are meeting this need for many of our clients,”

the report said.

Cyber liability, political risk and medical stop-loss have experienced less explosive growth at 30%, 27% and 14% respectively. However, Marsh said, all three coverages experienced consistent and significant growth over the past four years, a trend that is expected to continue.

Rob Lenihan

Higher premium cap widens appeal of 831(b)s

BY GAVIN SOUTER

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The past several months have seen positive and negative developments for owners of so-called 831(b) captive insurers, and the year ahead may yield more changes.

On the positive side, the premium cap on the microcaptives was raised in January — the first increase in 30 years — to \$2.2 million from \$1.2 million. That increase makes the captives increasingly attractive as alternative risk transfer vehicles for larger companies, captive experts say.

But on the negative side, last month the Internal Revenue Service again listed 831(b) captives on its “Dirty Dozen” list of tax scams. In addition, last November the IRS issued a notice stating that it believes 831(b) transactions have “a potential for tax avoidance or evasion” and demanded more information on the vehicles from 831(b) owners.

More changes, as yet unknown, are expected later this year when courts rule in test cases brought by the IRS that allege abuse of microcaptives.

831(b) captives have become increasingly popular over the past several years. Captives electing Section 831(b) of the tax code for insurers are taxed only on their investment income, not their underwriting income.

In the past, 831(b) captives were often used by small and midsize firms that are too small to establish conventional captives, but many observers say they have also been used by wealthy individuals and others to avoid tax.

While several captive management experts say they have seen a slowdown in microcaptive formations over the past several months as prospective owners await more clarity from the IRS, the increase in the premium cap has generated more



interest in the vehicles, particularly from larger firms.

“The overall increase to \$2.2 million really opens up the ability of 831(b)s to be a true risk management vehicle for midsized companies, so we view it as a net positive,” said Ernie Achtien, executive vice president of enterprise risk management at Captive Resources L.L.C. in Schaumburg, Illinois.

Companies that are looking to form 831(b) captives now include larger firms that wouldn’t have considered 831(b)s under the previous \$1.2 million cap, said Mike Serricchio, Norwalk, Connecticut-based senior vice president at Marsh Captive Solutions, a unit of Marsh L.L.C.

“The increase to \$2.2 million is opening

the door to larger private companies and even smaller public companies that are thinking about captives,” he said.

The increase has widened the appeal of 831(b) captives, with companies with annual revenue of \$500 million and up examining the vehicles, said Adam Forstot, Greenville, South Carolina-based vice president of business development at USA Risk Group Inc.

“A lot of larger companies who may have looked at a captive and determined that for a variety of reasons that it may not have been attractive, are now looking more closely because the \$2.2 million limit may give the captive more value,” he said.

While 831(b) captives can be used to

cover high-frequency risks that traditionally are covered in all sizes of captives, such as general liability and workers compensation, they are often used to cover lower-frequency exposures, such as cyber risks, property wind deductibles and product recall exposures, for example.

And the microcaptives can be a stepping stone to larger captive structures, Mr. Serricchio said.

Captive owners can fund “some of those more nontraditional, more exotic lines in their captive, but they are also going to build the captive to become a larger captive in the future,” he said.

But 831(b) owners do face some immediate challenges. In November 2016, the IRS issued Notice 2016-66 nam-

IRS AGAIN CASTS SKEPTICAL EYE ON MICROCAPTIVE FORMATIONS

The Internal Revenue Service has previously indicated that it suspects 831(b) captives can be used for tax avoidance, but last November the agency signaled increased scrutiny of the vehicles with the issuance of Notice 2016-66 requiring years of information and data from owners.

In the 15-page notice, the IRS raised numerous questions about the structures and noted that 831(b) captives have “a potential for tax avoidance or evasion.”

With a deadline extended to May 1, the IRS requires 831(b) owners and

related parties to file a Form 8886, reportable transaction disclosure statement providing detailed information on the captives going back as far as 10 years. The parameters of the tests on whether a captive owner should file the form are broad enough to include most 831(b) captive owners, experts say.

Among other things, the IRS requires the captive owners to provide details on: the jurisdiction where the captive is domiciled, the risks it insures, how the premiums were priced and contact information

for the underwriter or actuary, descriptions of claims paid and information on how the captive’s assets are invested.

Once the IRS has reviewed the information, the notice says, it may do one of several things, including: remove 831(b)s from the transactions of interest category; designate them as a listed transaction, essentially labeling them tax avoidance schemes; or provide a new category of reportable transactions.

Meeting the requirements of the notice may be onerous, but it could have a ben-

eficial outcome for owners if it provides clarity about 831(b)s to captive owners, said Charles J. Lavelle, senior partner at Bingham Greenebaum Doll L.L.P. in Louisville, Kentucky.

“In the notice, the IRS affirmatively says ‘this is a legitimate structure and we recognize tax payers can make this election,’ but they say that they don’t have enough information to decide which ones are abusive and which ones are not abusive,” he said.

Gavin Souter

ing 831(b) captives as a “transaction of interest” and required microcaptive owners to file detailed information on the vehicles and the risks they cover going back as much as 10 years (see related story).

The extended deadline to file the information is May 1, and there is an expectation that the IRS will require the information to be filed annually going forward.

Although captive industry organizations are lobbying to have the requirements of the notice delayed or scrapped, several captive managers say that for corporate owners who use 831(b) captives for legitimate risk management purposes, the requirements are more of an onerous administrative burden than a threat to the captives.

“The worst that can happen really is that we are required to file, and we do,” said Martin Eveleigh, chairman of Atlas Insurance Management in Charlotte, North Carolina.

“If it discourages those few people who were looking to use this as an estate planning tool, well, that’s fine,” he said.

“While there’s a negative to this IRS scrutiny, we also believe that this will weed out the players out there that aren’t doing these captives correctly,” said Mr. Achten of Captive Resources.

And for larger captive owners, the IRS is asking for information that they already have and are used to dealing with, said Mr. Forstot of USA Risk.

“They will have a thorough feasibility study with detailed actuarial (analysis); they are going to have very detailed policies and risk analysis, and they are writing traditional lines of coverage with established policy forms,” he said.

While the notice may discourage smaller companies that are considering forming an 831(b), larger companies have not been deterred, said Mr. Sericchio of Marsh.

“A lot of clients that we do business with that we’ve brought the idea to in the last year weren’t really affected by the notice — it’s just another level of compliance that they are used to,” he said.

Another potential challenge on the horizon are U.S. Tax Court cases that are expected to be ruled on this year and next year. The case expected to be ruled on first is *Avrahami v. Commissioner*, where the IRS alleges that a St. Kitts-licensed 831(b) captive for a jewelry business in Phoenix that ostensibly covered terrorism risks for a pool of third-party insureds was really being used for estate planning. Among other things, the IRS alleged that the captive made loans to entities controlled by the owner’s family members to purchase real estate; that the policies were vague; and the premium amounts were not reasonable.

While 831(b) captives can be used to cover high-frequency risks that traditionally are covered in all kinds of captives, such as general liability and workers compensation, they are often used to cover lower-frequency exposures such as cyber risks, property wind deductibles and product recalls.

The Tax Court rulings will likely provide guidance for 831(b) owners, said captive law expert Charles J. Lavelle, senior partner at Bingham Greenebaum Doll L.L.P. in Louisville, Kentucky.

The court rulings will provide guidance to both the IRS and the captive owners on “what’s proper and what’s improper,” Mr. Lavelle said.

The cases will likely go through an appeals process and other cases will be brought, but “I think in three to five years we’ll reach a new equilibrium and the courts will help us understand what that equilibrium is,” he said, noting that “in tax years that’s not that long.”

fy their cyber exposures, ultimately making more informed decisions around risk retention in a captive as well as providing broad-form risk transfer capacity of potentially up to \$400 million, Aon said.

Historically, Aon said, captive insurers have most often been used to underwrite property damage, workers compensation, medical malpractice and third-party liability risks. Eight percent of respondents to an Aon survey in 2015 indicated interest in underwriting cyber risk in a captive, a trend that is projected to increase threefold in the next five years.

Peter Mullen, CEO of Aon Global Risk Consulting’s captive and insurance management team in Bermuda, said one of the challenges Aon discovered that clients had was actually understanding the risk.

“The clients were struggling when it came to risk identification and quantification,” he said. “So we knew there was a need in the market for an identification assessment quantification process, certainly for larger clients. We also find cyber risk varies dramatically by industry. That in turn was reflected in the insurance buying habits of the various industries. We found that in the health care space, 70% of the clients were buyers of insurance, whereas in the manufacturing space, 17% were buyers.”

COUNTING CAPTIVES

Ranked by number of captive licenses at year-end 2016

Rank	Domicile	2016	2015
1	Bermuda	776	797
2	Cayman Islands	711	708
3	Vermont	593	596
4	Utah	462	440 ¹
5	Delaware	385	323
6	Guernsey	321	319
7	Anguilla	287 ²	319
8	Nevis	285	268
9	Barbados	246	236
10	Luxembourg	208	217
11	Nevada	207	202
11	Hawaii	207	197
13	North Carolina	190	94
14	Montana	184	196
15	South Carolina	164	167
16	Tennessee	160	127
17	British Virgin Islands	137	142
18	Puerto Rico	128 ²	186 ¹
19	Arizona	113	110
20	Isle of Man	110	115
21	District of Columbia	100	93 ¹
22	Dublin	85	84
23	Kentucky	84	92
24	Oklahoma	75	73
25	Singapore	71	68
26	Turks & Caicos Islands	64	64 ¹
27	New York	60 ²	62 ¹
28	Missouri	48	50
28	Alabama	48	42
30	Sweden	40 ²	44
31	Labuan	39	40
32	St. Lucia	35	33 ¹
33	Texas	34	21
34	Switzerland	31	36
35	Georgia	28	16
36	New Jersey	23	22
37	Bahamas	21	20
38	Michigan	20	23
38	British Columbia	20	20
40	Micronesia	19	17 ¹
41	South Dakota	16	14
42	Connecticut	14	10
42	Ohio	14	4
44	Denmark	13	13
45	Gibraltar	11	11
46	Netherlands Antilles	10 ²	12
46	Liechtenstein	10	11
46	Norway	10 ²	11
46	Panama	10	10
46	Malta	10	9 ¹
51	Germany	9 ²	9
52	Vanuatu	8	8
52	New Zealand	8	7
54	Mauritius	6	0
55	Australia	5	6 ¹
56	U.S. Virgin Islands	4	8
56	Dubai	4 ²	4
56	Nebraska	4	4
56	Colorado	4	3
60	Guam	3	3
60	Hong Kong	3	3
60	Arkansas	3	2
60	Illinois	3	2
64	Jersey	2	3
64	Maine	2	3
66	Kansas	1	2
	TOTAL	7,006	6,851¹

¹ Restated. ² BI estimate.
Source: BI survey

CYBER

Continued from page 23

exposure might just be the cost of the breach and the cost of the credit monitoring.

“Bigger companies have different exposure,” she said. “You have not only the breach, you generally have a lot more records, so the cost of credit monitoring is much greater, and you also have a potential hit to your reputation and even a potential loss of business if people lose confidence in your ability to protect their information. A growing concern for publicly held companies is a potential related (director and officers liability) claim.”

“In my opinion,” Ms. Snow added, “it doesn’t make good business sense to put your cyber coverage in a captive unless you’re just a small company that can anticipate the cost of your breach.”

In January, Aon Global Risk Consulting said it was launching a cyber captive program to create a new risk transfer option for growing cyber exposures. The program guides companies through a series of steps to help identify, assess and quanti-

Solvency II complicates captive strategies

GLORIA GONZALEZ

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The implementation of Solvency II in Europe has provided an additional risk management tool to owners of European captives, but at a cost, forcing risk managers to re-examine whether they are getting the best use out of their captives.

Solvency II, the European Union-wide risk-based capital rules for insurers and reinsurers, came into force in January 2016, and with it came new elements that have affected captives, for better or for worse.

“What we’re seeing as managers is an increased interest in strategic reviews and companies re-examining the captives to explore optimization opportunities and thus potentially expanding the captive by including additional risks not considered prior to Solvency II,” said Derek Bridgeman, vice president and Solvency II leader EU for the Marsh Captive Solutions group based in Dublin. “Solvency II does demand that the owners and risk managers have a better understanding of the risks and drivers which will benefit overall risk management.”

The positive aspects of Solvency II include increased transparency in terms of capital adequacy, an easier ability for regulators to compare captives with peers because of more consistent reporting, added certainty for parent owners with regard to financial strengths because of the requirement to maintain a capital ratio of at least 100%, and increased risk awareness and management, said Paul Wöhrmann, head of captive services commercial insurance in Europe, Middle East, Asia-Pacific and Latin America for Zurich Insurance Group Ltd. based in Zurich.

A 100% ratio under Solvency II means an insurer’s capital is sufficient to with-



stand an event expected to occur once every 200 years.

The Own Risk and Assessment provisions, considered a key element of Solvency II, provides a process for captive owners and insurance companies to think through their risk profiles, tolerance and underwriting strategies.

“In a nutshell, it’s a useful risk management tool so that the captive or the insurance company gets deep insight into its risk,” he said. “We see it as a positive on the impact of Solvency II if the company didn’t have it in place already, but, of course, it is some work to put this together, so it is one of the additional burdens as well.”

Some captive owners are using the diversification benefits that Solvency II offers to bring in new lines, such as employee benefits, and restructuring to take advantage of the fact that well-diversified captives are subject to lower capital requirements.

“The previous regime was quite simplis-

tic in its capital calculation and did not reward prudent risk management such as diversification of risk within the captive program,” Mr. Bridgeman said. “Solvency II does, however, reward such prudent decision-making. Another benefit of Solvency II for owners is that it provides an increased flexibility, particularly around investments, that was not available to owners under the previous regime.”

However, there have been additional management, actuarial and other costs associated with Solvency II compliance.

“The cost burden has been a strain for the smaller captives, not so much the larger ones,” Mr. Wöhrmann said. “They require some mathematical expertise to calculate the Pillar 1 requirements.”

Pillar 1 refers to the insurer demonstrating the adequacy of its financial resources to meet all liabilities and features a solvency capital requirement and a minimum capital requirement.

“Now everything is risk-based, so everything has to be calculated more carefully in terms of the assets and the liability side,” he said. “There’s also the cost of writing these documents. Generally, the costs have been borne well by the industry. People have taken this in a positive way because they’re getting a lot of risk insight and knowledge about the insurance business.”

Several captive owners responded to the increased costs and regulatory requirements associated with Solvency II by shutting down their captives prior to the regime taking effect, although some of these moves may have also been partly driven by a desire to domicile a captive in the same jurisdiction as the corporate headquarters or take advantage of a favorable insurance market for buyers, experts say.

“There were a number of captives that closed down in the lead-up to Solvency II because they didn’t want to have to meet the capital requirements, and/or from a pricing perspective they thought, ‘We could do just as well in the market, we don’t really need a captive,’” said Elizabeth Bothwell, partner with law firm Arthur Cox based in Dublin. “For certain businesses, it wasn’t making economic sense anymore.”

The positive aspects of Solvency II include increased transparency in terms of capital adequacy and an easier ability to compare captives with peers.

Other owners with multiple captives have consolidated the exposures into one captive, while at least one major company, The Coca-Cola Co., relocated the risk in its Solvency II-domiciled captive to a domicile outside of the regime (see related story).

Solvency II is applied to captives using the “principle of proportionality” to consider the relative size and complexity of captives, which could mean that national regulators could impose lighter reporting requirements on captives than on commercial insurers, but some guidance from regulators would be welcome, experts say.

“How (the national regulators) implement that and the level of proportionality they apply to the captives is going to be important, because the overall aim of Solvency II is to create this harmonized approach,” Mr. Bridgeman said. “There is going to be clarification required from the regulators in terms of how they are applying proportionality so we can achieve that harmonization. That will be the main thing to come from the early years of implementation.”

CAPTIVE OWNERS ADJUST TO CHANGES UNDER NEW REGIME

Captive owners have responded to the Solvency II regime in several different ways, including consolidating exposures into one captive or relocating the risks covered in Solvency II-affected captives to other domiciles.

Atlanta-based The Coca-Cola Co. relocated the Canadian pension risk covered in its Ireland-based captive to a new Bermuda captive, Stacy Apter, director of global risk and investments, told attendees at the 26th annual World Captive Forum in Boca Raton, Florida, in January. The Irish captive was traditionally used to access the European markets,

but following Solvency II it made sense to move that risk to Bermuda, which was deemed Solvency II-equivalent last year, and consolidate the company’s international pension risk in the new captive at the end of 2016, she said.

“If we look at the move from Ireland to Bermuda, that was absolutely a Solvency II play,” Ms. Apter said.

However, other captive owners have embraced the positive effects of Solvency II, including the diversification requirements encouraging owners to place additional risks in their captives.

Phil Clark, director of insurance for

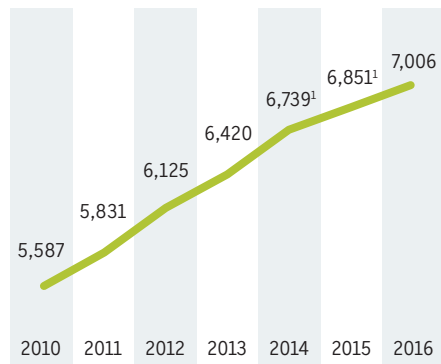
Vodafone Group P.L.C. in the United Kingdom, said his company merged its separate property/casualty and employee benefits captives into one captive last year because of Solvency II, “which is more efficient for us.” The diversification benefit of including employee benefits with the rest of its exposures released about \$20 million in capital, he said.

“I quite like Solvency II,” he said. “It does enable you to have that kind of analysis and see ... if you bring stuff in, if there’s more reinsurance, what happens to your captive.”

Gloria Gonzalez

RANKINGS OF CAPTIVE DOMICILES & CAPTIVE MANAGERS

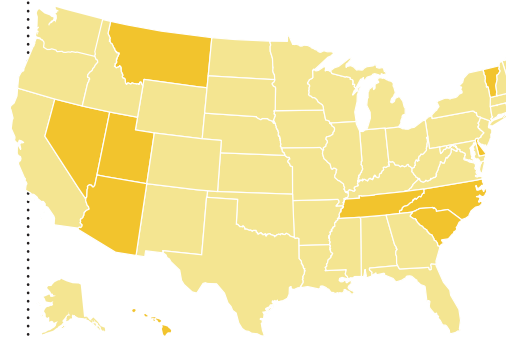
TOTAL CAPTIVES WORLDWIDE



¹ Restated
Source: BI survey

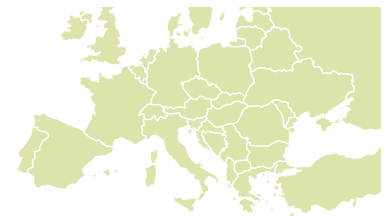
TOP 10 U.S. CAPTIVE DOMICILES

Ranked by number of captive licenses at year-end 2016



Rank	Domicile	2016	2015
1	Vermont	593	596
2	Utah	462	440 ¹
3	Delaware	385	323
4	Nevada	207	202
4	Hawaii	207	197
6	North Carolina	190	94
7	Montana	184	196
8	South Carolina	164	167
9	Tennessee	160	127
10	Arizona	113	110

¹ Restated
Source: BI survey



TOP 5 EUROPEAN CAPTIVE DOMICILES

Ranked by number of captive licenses at year-end 2016

Rank	Domicile	2016	2015
1	Guernsey	321	319
2	Luxembourg	208	217
3	Isle of Man	110	115
4	Dublin	85	84
5	Sweden	40 ¹	44

¹ BI estimate
Source: BI survey

TOP 10 CAPTIVE MANAGERS

Ranked by captives managed worldwide in 2016¹

Rank	Company/address	Phone/website	2016 Total captives ¹	2016 Captive premium volume ²	Domiciles	Total staff	Principal officers
1	Marsh Captive Solutions 1166 Avenue of the Americas New York, NY 10036	212-345-5000 www.marshcaptiveinsurancesolutions.com	1,215	\$44,879,793,575	46	417	Nick Durant, president; Julie Boucher, practice leader-Americas; Ian Clancy, practice leader-EU
2	Aon Captive & Insurance Management 8 Devonshire Square London, EC2M 4PL, England	44-2076-235-500 www.aon.com	1,191	\$25,500,000,000	52	507	Peter Mullen, CEO
3	Willis Towers Watson P.L.C. Global Captive Practice The Willis Building, 51 Lime St. London, EC3M 7DQ, England	44-2031-246-000 www.willistowerswatson.com	385	\$6,502,000,000	36	196	Paul Owens, CEO; Sean Rider, managing director
4	Strategic Risk Solutions Inc. 2352 Main St. Concord, MA 01742	781-487-9800 www.strategicrisks.com	268	\$2,577,500,000	22	86	Brady Young, president; Michael O'Malley, managing director
5	USA Risk Group Inc. 2418 Airport Road, Suite 2A Barre, VT 05641	800-872-7475 www.usarisk.com	218	\$2,839,641,943	25	58	Gary Osborne, president; Shawn Burger, chief operating officer; Paul Macey, head of captive operations
6	Artex Risk Solutions Inc. ³ 2 Pierce Place, 16th Floor Itasca, IL 60143	630-694-5050 www.artexrisk.com	200 ⁴	N/A	30 ⁵	400 ⁵	David McManus, president/CEO; Nick Heys, CEO-Artex International
7	JLT Insurance Management Cedar House, 41 Cedar Ave. Hamilton, HM HX, Bermuda	441-292-4364 www.jltcaptives.com	164	\$2,392,590,564	10	N/A	Steve Arrowsmith, executive chairman; Richard Daley, president
8	AMS Insurance Management Services Ltd. Sea Meadow House P.O. Box 116 Road Town Tortola, VG1110, British Virgin Islands	284-494-4078 www.amsinsurancegroup.com	115 ⁴	N/A	6	N/A	Derek Lloyd, director
9	R&Q Captive Holdings Ltd. 71 Fenchurch St. London, EC3M 5JT, England	44-2077-805-905 www.rqih.com	114	N/A	16	45	Nicholas S. Dove, chairman; Nicholas M. Frost, president
10	Atlas Insurance Management Whitehall House, Third Floor 238 N. Church St., George Town Grand Cayman, KY1-1107, Cayman Islands	345-945-5556 www.atlascaptives.com	86	\$213,195,669	12	30	Martin Eveleigh, chairman; Elaine Tapp, executive vice president

¹ Captives electing to operate under Section 831(b) of the U.S. Tax Code are not included.

² Premium volume includes total gross premium volume of captives managed by the company or on its behalf.

³ Artex Risk Solutions Inc. acquired Kane's Insurance Management operations in March 2016. They also acquired Quest Holdings (Gibraltar) Ltd. and Hexagon Insurance PCC Ltd. in 2016.

⁴ BI estimate

⁵ From press releases

Source: BI survey



TOP 5 NORTH AMERICAN OFFSHORE CAPTIVE DOMICILES

Ranked by number of captive licenses at year-end 2016

Rank	Domicile	2016	2015
1	Bermuda	776	797
2	Cayman Islands	711	708
3	Anguilla	287 ¹	319
4	Nevis	285	268
5	Barbados	246	236

¹ BI estimate
Source: BI survey



TOP 5 ASIA-PACIFIC CAPTIVE DOMICILES

Ranked by number of captive licenses at year-end 2016

Rank	Domicile	2016	2015
1	Singapore	71	68
2	Labuan	39	40
3	Micronesia	19	17 ¹
4	Vanuatu	8	8
4	New Zealand	8	7

¹ Restated
Source: BI survey

COMMENTARY

Tumultuous era changed little

Last month's settlement between New York authorities and former American International Group Inc. CEO Maurice R. Greenberg brings an undramatic end to a courtroom saga that began when former New York Attorney General Eliot Spitzer turned his attention to the commercial insurance and reinsurance industry 12 years ago.

Given the anger and frustration Mr. Spitzer's actions provoked within the insurance sector, it's perhaps not surprising that when his political career derailed after a prostitution scandal a few years later, the schadenfreude felt by many in the industry was clearly discernible.



Gavin Souter
EDITOR

But for all the billions in settlements and dozens of lawsuits, motions and appeals — in addition to the angst and the personal upheavals that resulted for many in the industry — it's fair to ask what the investigations achieved for the industry and its clients.

In terms of settlement funds, the \$9 million that Mr. Greenberg paid is comparatively negligible, considering the organizations involved and the size of the reinsurance contracts. The wider investigation into the use of finite risk coverage, however, did chill that part of the market. Today, reinsurers look for other ways to structure contracts to deal with long-tail risks, and the market appears to have adapted.

But the side of Mr. Spitzer's investigations that affected commercial policyholders the most was his probe of bid-rigging and practices where brokers allegedly steered business to insurers that paid the highest contingent commission. The settlement funds paid by the largest brokers were substantial, and, at least at the beginning, industry practices were forcibly changed to stop big brokers from charging contingent commissions.

The move was welcomed by many risk managers, who understandably saw a conflict of interest in their brokers being paid extra bonuses by insurers. But the bans on contingents ended, and some brokers found other ways of earning supplementary commissions. For midmarket brokers in particular, contingents never went away and remain an important component of their profits.

Perhaps the one lasting effect of the Spitzer investigations has been greater transparency, with brokers sharing details on their commission structures more openly with clients. That's a welcome development, but it's hard not to feel that such a simple business courtesy should have required far less turmoil to put in place.

SCHILLERSTROM



VIEW FROM WASHINGTON

Trump targets regulation

Politicians make a lot of promises when running for office, many of which they have little or no intention of actually fulfilling. But President Donald Trump, the ultimate nonpolitician, is doing exactly what he said he would do on the campaign trail when it comes to deregulation.

The former-businessman-turned-president vowed to undo as many regulations as possible to alleviate the burden on American businesses when running for office, and he has taken swift action to do just that. He issued an executive order on Jan. 30 stating that an agency may issue a new regulation only if it rescinds at least two existing regulations to offset the costs — drawing the ire of a coalition of environmental, consumer advocacy and labor groups, which deemed the order unconstitutional and sued the president to stop it.

The president and the Republican Congress are also moving fast to use an underutilized tool at their disposal: the Congressional Review Act, which allows Congress to reject major agency rules adopted in the prior 60 legislative days. He and Congress sent a Valentine's Day gift to the energy industry by toppling a U.S. Securities and Exchange Commission regulation on resource extraction disclosure, which would have required oil and gas companies to disclose in annual reports payments of \$100,000 or more made annually to U.S. or foreign governments related to energy development.

Two days later, the energy sector got more love from the president when he signed a resolution of disapproval against the Department of the Interior's Stream Protection Rule, which overturns a December 2016 rule to regulate water pollution caused by coal mining. Other disapproval resolutions to undo midnight regulations adopted by the Obama administration are moving through the legislative pipeline as well.

Without cooperation between the president and Congress, the use of the CRA is typically a major challenge because disapproval resolutions require either a president's signature or a two-thirds majority vote in each house to overcome a veto. Due to these limitations, the CRA had only been successfully used once to undo a federal agency regulation prior to this year. In 2001, President George W. Bush and Congress



Gloria Gonzalez
DEPUTY EDITOR

used the 1996 law to derail the U.S. Occupational Safety and Health Administration's efforts to regulate ergonomics via a formal standard.

OSHA rules passed during the final months of the Obama administration may suffer the same fate. A Republican legislator has just introduced a resolution of disapproval under the CRA that targets OSHA's rule that clarifies that employers have a continuing obligation to make and maintain an accurate record of each recordable injury and illness for five years — the controversial Volks rule.

The agency was criticized for its aggressive enforcement stance under the Obama administration, with employers and their representatives hoping for more collaboration on workplace safety programs with the Trump administration. Overturning some of the Obama's administration's handiwork, which employers argued had no impact on safety and could have the consequence of forcing them to spend more time on paperwork and less on actions to make worksites safer, could signal the start of a hearts-and-flowers relationship between the administration and employers.

Business interruption meets cyber risk coverage



Costantino P. Suriano (top) and Bruce R. Kaliner are partners at Mound Cotton Wollan & Greengrass L.L.P. in New York. Mr. Suriano can be reached at 212-804-4235 and csuriano@moundcotton.com. Mr. Kaliner can be reached at 212-804-4281 and bkaliner@moundcotton.com.

As more businesses come to realize that cyber attacks pose a serious threat to business operations, revenue streams and contingency planning, the market is starting to expand and develop new products to address business interruption, or BI, resulting from a cyber attack. Some of the more common cyber attacks against businesses include denial-of-service, brute force (to obtain passwords), insertion of malware or malicious code, ransomware, backdoor attacks and social engineering. This article provides a primer on the issues that may arise when the traditional concept of first-party BI coverage is married to cyber coverage.

BI coverage is a time-element coverage offered under first-party property policies. In the first-party context, for BI coverage to be implicated, there must be insured direct physical loss or damage by a covered cause of loss that causes a necessary interruption of the insured's operations, either wholly or partially as specified in the policy. Once these conditions are met, then the actual loss sustained is measured to determine the loss of business income from the interruption.

It is important to remember that first-party property policies do not traditionally extend property loss or damage to electronic data, as data is not considered a physical or tangible object subject to loss or damage. When BI coverage is offered for cyber policies, the direct physical loss or damage requirement may be substituted with an electronic data driven event — a specified type of cyber attack.

The scope and elements of what constitutes a cyber attack in the policy is therefore of critical importance. In other words, what triggers BI coverage for a network attack? As noted above, BI coverage was originally intended for physical loss and is now being imported into the ethereal and nonphysical world.

As part of a triggering event for BI coverage, there must be a direct causal connection between the cyber attack and the interruption of business and loss of revenue. For an active attack, where an adversary or perpetrator destroys or alters data that brings down the computer system, or a denial of service takes place and business operations cease, the causal connection to any business loss should be fairly straightforward to establish.

However, the causal connection is less clear in a situation involving a passive network attack, when a computer system is infiltrated but the perpetrator is only gathering data or exploring the system, and no data is disturbed, altered or destroyed. In such a situation, a network attack took place and remedial measures are necessary, but computer operations may continue uninterrupted while the security of the system is being restored and any mali-

cious software is neutralized. Although the cyber policy may respond and pay for the expenses to restore the network security under other coverages, a BI loss has not been established inasmuch as there would be no interruption of operations.

Another scenario could involve a passive attack combined with a public disclosure that an insured's network has been compromised. In that situation, daily business operations would continue unhindered, but there might be a loss of customers and revenue resulting from security concerns. On one hand, the network attack took place and the loss of network security is driving away customers; the insured is likely to contend that network security is an intrinsic service that it provides to customers.

On the other hand, relying on traditional concepts of BI coverage, there would be no complete or even partial suspension of the insured's network operations. The loss of revenue would be based on customers' decisions, and thus the causal connection of what is being insured — suspension/interruption of operations — is not tied to the loss of revenue. Additionally, if the customer no longer wants the insured's services, that may also be a "loss of market" situation, which is normally excluded in BI policies.

For BI coverage to be implicated, there must be insured direct physical loss or damage by a covered cause of loss that causes a necessary interruption of the insured's operations, either wholly or partially as specified in the policy. Once these conditions are met, then the actual loss sustained is measured to determine the loss of business income from the interruption.

There are countless cyber attack situations that can arise. Therefore, when a cyber attack claim is presented and adjusted, the policy wording and what constitutes the triggering event, as well as the causal relationship of the network attack to the revenue loss, must be examined closely. At times, it may be a challenge to correlate which incurred costs are associated with the covered event versus noncov-

ered costs, such as a permanent upgrade to network security. Adding to the complexity of analyzing a cyber BI claim is the insurer's reliance on the insured's cooperation on openly sharing what exactly took place in its system from the attack and how these compromised systems tie into its operations and revenue streams.

As part of BI coverage, the extent of financial reimbursement for a covered revenue loss is also controlled by other important policy provisions, as listed below:

- The specified BI sublimit in the policy will set forth the maximum BI exposure for the insurer. Regardless of the revenue loss, the BI sublimit caps the payout under the policy. The BI sublimit may at times be tied to an annual BI aggregate limit — the maximum payable in the policy period if separate network attacks take place.

- Policies that provide BI coverage will often include a separate BI deductible or BI waiting period, either in hours or days, before liability will arise under the policy. If a BI loss is below the deductible or does not exceed the waiting period, then the policy will not respond. An example of the waiting period not being met would be if a denial-of-service lasts two hours and the waiting period is four hours.

- BI policies will also provide that liability is only for the specified period of restoration. This period is usually a defined time period and requires the insured to use due diligence and dispatch to resume its operations.

- BI coverage for network attacks is usually restricted by excepting certain types of costs that are not covered. Costs that are not covered can include third-party liability, contractual liability, fines and penalties, and upgrades for the restoration of network security.

- In addition to certain types of non-covered costs, there will be certain BI exclusions, that can include idle periods when insured is not in operation for other reasons, consequential loss or loss of market. In addition, cyber policies typically exclude loss by insured perils under a first-party property policy, such as fire, smoke, explosion, earthquake and other events, as these physical perils are not the intended risk being insured. Service interruption of utilities is also commonly excluded.

Unlike other types of insurance, BI coverage is more nuanced, in that overlapping conditions must be examined as part of the determination of whether a BI claim is compensable. The starting point for making such an analysis is a comprehensive understanding of the cyber attack that took place, what was affected and its impact on operations, along with a careful reading of the policy.

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Berkshire Hathaway expands to London

Boston-based Berkshire Hathaway Specialty Insurance Co. said it has opened a London office to serve the United Kingdom and European countries, including Ireland, Spain, France and Italy.

Richard Nathan has been named as head of property lines; Patrick Brown head of executive and professional liability; and Andrew Walker head of claims, a Berkshire Hathaway Specialty statement said.

Mr. Nathan most recently was corporate property manager, U.K. and Europe, at Allied World Assurance Co. Holdings A.G. Mr. Brown joins Berkshire Hathaway from Travelers Europe Ltd, where he was head of management liability and financial institutions.

Mr. Walker most recently was head of casualty claims in Europe for AIG Europe Ltd., and prior to that, head of liabilities claims for AIG in the United Kingdom.

“Richard and Patrick will deliver bespoke specialty solutions backed by financial strength, while Andrew will ensure that excellent in-house claims expertise is available for customers from day one,” said Tom Bolt, president, U.K. and Southern Europe, for Berkshire Hathaway Specialty, in a statement.

Zurich teams with Deloitte on cyber risks

Zurich North America and Deloitte L.L.P. are working together to help their clients with cyber-related risks, Schaumburg, Illinois-based Zurich said in a statement.

Initial offerings include risk transfer options provided by Zurich and risk mitigation options provided by Deloitte Risk and Financial Advisory Cyber Risk Services, the statement said.

Deloitte, whose U.S. headquarters is in New York, has nearly 3,000 U.S. cyber risk professionals to whom Zurich clients will now have access, according to Bryan Salvatore, New York-based head of specialty products for Zurich North America.

Zurich’s security and privacy insurance policyholders will also have an opportunity to complement their coverage with a variety of pre-breach cyber risk assessment and management services through Deloitte to assist them in understanding their level of cyber exposure and resilience, said the statement.

The services include standards-based risk assessment of an organization’s threat detection and rapid incident response capabilities, as well as risk mitigation recommendations, according to Zurich’s statement.



QBE launches trucking policy

QBE North America has launched a liability insurance policy targeting the U.S. trucking industry.

The coverage combines motor truck cargo and logistics liability insurance in one policy, the New York-based unit of Australia’s QBE Insurance Group Ltd. said in a statement.

The policy protects shippers from financial losses occurring on the road and provides embedded coverage for a number of occurrences, including mobile equipment, refrigeration breakdown, trailer interchange, contract penalties, deceptive practices, and contingent coverage.

There are also optional policy enhancements, such as the ability to add another insured entity, scheduled shipper coverage, and specific conditions.

“We have flexible coverage that can meet the contractual needs of our insureds,” a spokeswoman said.

Safety National adds guaranteed-cost program

Excess workers compensation insurer Safety National Casualty Corp. said that it will begin providing large guaranteed-cost workers comp policies.

The offering targets large employers “in need of a first-dollar program,” including hotels, light manufacturing, technology, retail, and food-related companies, St. Louis, Missouri-based Safety National said in a statement. The minimum premium for eligibility is \$750,000.

Safety National said it also will begin providing captive services by offering additional insurance capacity for captives.

“Safety National will provide support for captive programs that would like a financially stable fronting carrier and risk-sharing partner. We offer support for workers compensation, liability lines and select non-admitted opportunities,” said Tom Hebson, St. Louis-based vice president of large guaranteed-cost workers comp and captive insurance services at Safety National, in an emailed statement.

Ironshore announces midmarket energy facility

Hamilton, Bermuda-based Ironshore Specialty Casualty has formed Ironshore Energy Solutions, a dedicated oil and gas facility that offers liability coverages for onshore middle-market energy classes in the United States.

Specialty managing general agency Ironshore Insurance Services L.L.C. will deliver capacity to underwrite middle-market sector risk on behalf of six consortium insurance companies, Ironshore Specialty said in a statement.

Ironshore Energy Solutions will provide up to \$11 million in insurance capacity for general liability and umbrella coverages for complex sector risks, according to the statement.

The facility will underwrite liability risk for U.S. middle-market energy entities with annual revenue of \$5 million to \$200 million. Target energy classes are onshore oil and gas operators, contractors and small midstream companies.

Argo Pro partnership provides M&A coverage

Jersey City, New Jersey-based Argo Pro, a unit of Argo Group International Holdings Ltd., has partnered with New York-based BlueChip Underwriting Services L.L.C. to provide transactional risk insurance for mergers and acquisitions.

BlueChip will sell and underwrite this suite of products, including representation and warranties, tax indemnity and contingent liability insurance products.

A spokeswoman said tax indemnity coverage is intended to insure against the contingent outcome of known tax risks.

Argo Pro will be the lead provider with capacity provided by Argo Group’s Lloyd’s of London operation, ArgoGlobal Syndicate 1200, which will offer clients across the globe limits of up to \$30 million for any one transaction.

“This is a compelling partnership between our colleagues in the U.S., Syndicate 1200 and BlueChip,” Ryan Barnes, head of casualty for ArgoGlobal, said in a statement.

DEALS & MOVES

Aon sells benefits unit to Blackstone for \$4.8B

Aon P.L.C. will sell its benefits outsourcing business to private equity firm Blackstone Group L.P. for about \$4.8 billion, the companies said in a statement.

Aon will continue to partner with the new Blackstone-owned company, but will invest the proceeds of the sale in other areas, Aon President and CEO Greg Case said in a conference call with analysts.

The deal is expected to close by the end of the second quarter. Blackstone will pay Aon \$4.3 billion and up to an additional \$500 million, depending on the performance of the unit.

Gallagher acquires New York retail agency

Arthur J. Gallagher & Co. has acquired Eagle Insurance Agency L.L.C. Terms of the deal were not disclosed.

Syracuse, New York-based Eagle is a retail insurance broker and consultant that provides property/casualty coverages and services throughout New York and Massachusetts, with a focus on the health care, energy, technology and manufacturing industries, Gallagher said in a statement.

JLT buys majority stake in construction risk broker

Jardine Lloyd Thompson Group P.L.C. has acquired a 50.1% stake in Construction Risk Partners L.L.C., a U.S. construction risk and surety specialty insurance broker, in a \$50 million cash deal.

Branchburg, New Jersey-based Construction Risk Partners has more than 150 construction clients, said London-based JLT in a statement.

JLT said the purchase price is subject to the achievement of performance conditions in the 12-month period following the deal’s completion. Its terms also allow JLT to increase its ownership of the firm to 100% over time.

Wholesaler All Risks buys group accident agency

Wholesale broker All Risks Ltd. has acquired American Management Advisors Inc., a managing general agent and underwriter for group accident insurance products, for an undisclosed amount, the firm said.

Langhorne, Pennsylvania-based American Management’s group accident products include K-12 student accident, special risk, intercollegiate sports, catastrophic accident and college accident and sickness, according to the statement.

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Winners will be announced online in April and their profiles published in the June 2017 issue of *Business Insurance*. The program culminates with **Break Out Awards** recognition events in Atlanta, New York, Los Angeles and Chicago in June.

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- Nominations must be submitted online at businessinsurance.com/BreakOut/Nominations
- Nominations must include three (3) recommendations from clients, managers and/or co-workers.
- While there is no age limit, nominees must have less than 15 years of experience in the risk management and property/casualty insurance field and must be working in the sector on June 1, 2017.

Nomination submissions are due Monday, April 3, 2017.

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UP CLOSE

Wayne H. Carter III

NEW JOB TITLE: Dallas-based president for U.S. Risk Underwriters Inc.

PREVIOUS POSITION: Chicago-based president for Berkley Program Specialists

LOOKING FORWARD TO: Working with a highly-energized group to capitalize on a solid youthful foundation with excellent financial backing and forward-thinking senior management.

ON LEADERSHIP: Being a great listener, humble confidence and knowing what you don't know. Hire the best people and get out of their way.

CRYSTAL BALL: Technology will finally be embraced with the changing demographics, and the wholesale distribution model will change drastically.

FIRST INDUSTRY JOB: Commercial lines account analyst for Travelers Cos. Inc.

WHAT SURPRISED ME: The persistent refusal to learn from prior underwriters' mistakes.

ADVICE: A strong work ethic beats lethargic brainiacs every time. Stay focused, be persistent and remain positive. The market will always change.

FAVORITE QUOTE: "When the student is ready, the teacher will appear."

OUTSIDE THE INDUSTRY, A DREAM JOB: Rock star, PGA professional.

HOBBIES: Golf and options investing.

PETS: Prefer dogs, not a big pet person.

THING MOST PEOPLE DON'T KNOW ABOUT ME: I was a stage star in high school.

DON'T LEAVE THE HOUSE WITHOUT: iPhone

BIGGEST OBSTACLE FOR WORK-LIFE BALANCE: Learning to deal with and enjoy leisure time.

CORPORATE IMPROVEMENT: A more collaborative leadership style; executives with listening skills and humility.

PET PEEVES: Victim mentalities

WHEN I RETIRE: Golf, beach, and muscle cars.

FAVORITE MEAL: Caesar salad, small filet mignon-medium, sourdough rolls, glass of Quintessa — any year.

FAVORITE BOOK: "The Sun Also Rises" by Ernest Hemingway

CAN'T-MISS TELEVISION SHOW: Hokies football

BEST CITY: Tampa, Florida

ON A SATURDAY AFTERNOON: Pebble Beach

MONDAYS: Do desk work, analytics, emails, etc. Meetings and conference calls best held Tuesday through Friday.

A strong work ethic beats lethargic brainiacs every time. Stay focused, be persistent and remain positive. The market will always change.



Bruce Carnegie-Brown was named chairman of Lloyd's of London after his appointment was approved unanimously by the Council of Lloyd's. Mr. Carnegie-Brown, who is chairman

of Moneysupermarket.com Group and vice-chairman of Banco Santander S.A., and previously headed Marsh Europe, will join Lloyd's in June, according to a statement. He will succeed John Nelson, who is set to retire in May.

Mr. Carnegie-Brown's appointment is subject to formal approval from the United Kingdom Prudential Regulation Authority and Financial Conduct Authority, the statement said.



Willis Towers Watson P.L.C. has named **Ken Ross** head of its FINEX North America business.

Based in New York, Mr. Ross will be responsible for the strategic direction

and growth of FINEX North America, Willis Towers Watson said in a statement. He succeeds Alexis Faber, who had been holding dual roles as head of FINEX North America and as global head of financial lines, according to a Willis spokeswoman.

Previously, Mr. Ross was head of Willis' claims and legal group, and thought and product leadership, according to the statement.



Lockton Cos. L.L.C. has named **Laura Walton** senior vice president for its new Seattle office as part of the broker's expansion into the Pacific Northwest.

Ms. Walton most recently worked as a senior vice president at Willis Towers Watson P.L.C., advising middle-market and complex clients. She will lead business development and client strategy for Lockton's Seattle office, Lockton said in a statement.

Ms. Walton works with clients on risk management and commercial insurance in several industries, including food processing, financial services, aerospace/aviation, technology, manufacturing, hospitality, retail, and real estate, according to the statement.



CNA Financial Corp. has named **Douglas Worman** to the newly created position of executive vice president and chief underwriting officer.

Mr. Worman, who will be based in Chicago, was most recently CEO of U.S. insurance at Endurance Specialty Holdings Ltd.

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Broker loses lawsuit after wild night out

A “drunk, aggressive, argumentative, angry and belligerent” insurance broker who claimed bouncers assaulted him at a Dublin nightclub has lost his lawsuit against the venue, according to media reports.

Michael Halloran, a Dublin-based broker with Aon Employee Benefits now reportedly has to pay €60,000 (\$64,000) in legal fees.

Mr. Halloran, who had been attending a work party with a colleague, attempted to head-butt one of two bouncers who were attempting to eject him from the club in early 2012, according to the Irish Times.

A hotel manager told a courtroom that Mr. Halloran, who reportedly downed eight pints of beer, had been performing front- and backflips on the dance floor, and security staff had no option but to approach him. A scuffle ensued when the bouncers tried to remove him from the club.

A judge said that video of the incident showed Mr. Halloran had tried to head-butt the bouncer, and therefore he had no case.

Lloyd’s dumps liquid lunches

With much grumbling from office workers used to a drink or two at noon, Lloyd’s of London has told its 800 employees that they are not allowed to drink alcohol during business hours, eliminating the deal-heavy “City lunch” concept.

In an internal memo to staff, Lloyd’s said that alcohol was a culprit in about half of its complaints and disciplinary actions over the past two years among employees, BBC News reported.

The booze ban reportedly will be in effect from 9 a.m. to 5 p.m. daily. Lloyd’s had considered the restriction for “some time to bring it into line with industry norms,” according to the BBC.

The BBC reported that disgruntled Lloyd’s staff have called the new measures “heavy-handed.”



JUDGE COUCHES SNUGGIES TAX WIN IN SACRED TERMS



The world can rest wrapped in the comfort of knowing that the federal courts have now ruled that Snuggies are blankets with arms, and not robes or priestly vestments.

According to a ruling in the U.S. Court of International Trade, the sleeved polyester fleece coverings that enable a person to read a book or fiddle with a remote control while remaining toasty should be classified as blankets for trade-tax purposes.

The ruling rejected the U.S. Department of Justice’s argument that Snuggies are wearable apparel and thus should be subject to higher duties than blankets.

The ruling weighed both sides of the argument, featuring over 13 pages of deliberations: “Defendant contends the Snuggie is akin to ‘clerical or ecclesiastical garments and vestments’ and ‘professional or scholastic gowns and robes’ because those garments ‘have wide-armed sleeves and flow loosely around the body.’ ... As Plaintiff contends, however, clerical and ecclesiastical garments have closures.”

The fact that Snuggies do not have closures and are open in the back appeared to have swayed Judge Mark Barnett, who noted that the product’s marketing line, “The Blanket with Sleeves,” makes it clear that it is not a garment, according to an article in International Trade Daily.

According to the article, the ruling means that instead of paying 14.9% duties when bringing Snuggies into the U.S., importers will only have to pay 8.5% duties.

Telltale heart prompts charges

An Ohio man was indicted on arson and insurance fraud charges after investigators reviewed data collected from his pacemaker that showed no indication that he leaped out of a window and raced away from his burning house, as he had claimed.



Ross Compton of Middletown, Ohio, pleaded not guilty after telling reporters that he had “no motive whatsoever to burn down” his house.

Meanwhile, authorities found gasoline on his clothing and ascertained the fire had started in several areas, according to the Associated Press. A search warrant allowed police to collect medical data in the case, including Mr. Compton’s heart rate, pacer demand and cardiac rhythms before, during and after the fire, police said.

A cardiologist reportedly found that it was “highly improbable,” due to Mr. Compton’s medical conditions, that he could move as swiftly during the fire as he had he told police.



Uber tips off wife to husband’s infidelity

It’s likely a French businessman didn’t realize his übermistake when using his wife’s smartphone to request a ride to take him on a rendezvous to his mistress — several times.

According to a BBC report, when his wife received multiple phone alerts from the Uber Technologies Inc. ride-sharing service — tracking his trips, which tipped her off to his affair — she eventually filed for divorce.

The man, in turn, filed his own court documents in the form of a lawsuit against Uber for a reported €45 million (\$47.9 million), zeroing in on a bug in the phone app that led to his wife’s discovery of his affair. According to the man’s lawyer, the bug “has caused him problems in his private life.”

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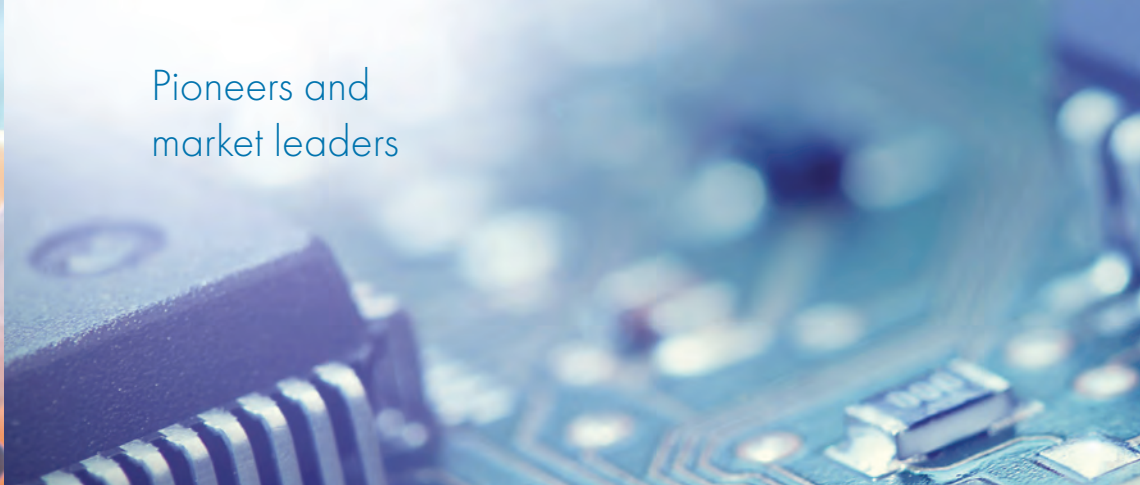
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