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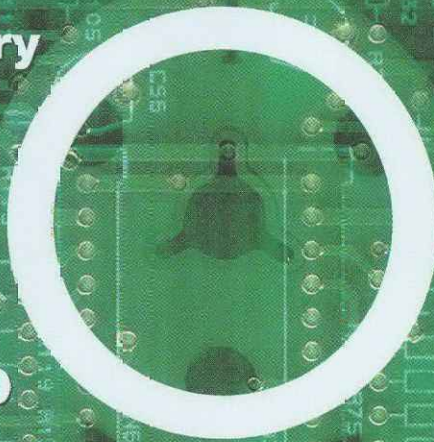
IN FOCUS

Individuals
across the
industry talk
about essential
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companies look
for solutions to
legacy IT issues

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E-discovery forces insurers
to rethink data policies

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E-proxy voting saves money
but may create privacy risks

PAGE 16

EVOLVE

- or -

DIE



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COVER FOCUS

INFORMATION TECHNOLOGY

In the works

Aging legacy IT systems present a variety of problems for insurance companies. A look at possible solutions and opportunities in mining stored data. **Page 10**

E-discovery: A complex case

Rules related to preserving and producing electronic documents in civil disputes are forcing companies to make stored data available and searchable. **Page 13**

E-proxy: Reward and risk

The Securities and Exchange Commission's new program to provide proxy materials to willing shareholders by posting them on an Internet site will reward the many, though it may create some new risks for a few. **Page 16**



FEATURES



Clear or confusing?

While increased transparency is an improvement, the industry overall finds itself with little clarity regarding the changes brought about to remedy the controversy over contingent commissions. **Page 20**

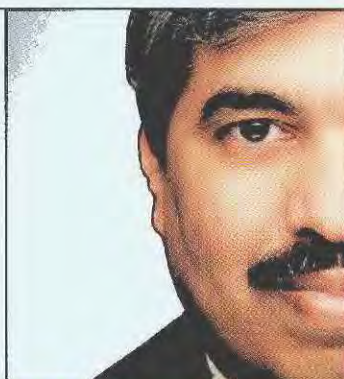
Tools of the Trade

Various personal technology devices are critical to getting the job done. Again this year, we've asked individuals across the industry to tell us about their most essential Tools of the Trade. **Page 22**



Standard issuer

When it abandoned its Kinnect initiative in January 2006, Lloyd's of London said its future in exchange technology would focus on setting standards, not developing infrastructure. Recent steps show Lloyd's is keeping that promise. **Page 23**



THREE QUESTIONS

Prakash Shimpi, enterprise risk management practice leader at Towers Perrin discussed ERM and its potential benefits. **Page 5**

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Forward view drives best decisions

With the Risk & Insurance Management Society Inc. bringing its annual conference back to New Orleans for the first time since Hurricane Katrina, it's probably little surprise that the first question to a panel of top industry executives gathered at the conference a few weeks ago focused on whether there's "real science" behind the industry's models and its catastrophe underwriting.

Evan Greenberg, president and chief executive officer of Hamilton, Bermuda-based ACE Ltd., told the audience, "There is a science and there is a framework" to those industry activities, but cautioned that that science shouldn't give insurance buyers too much comfort.

"It's a crude science and it's an evolving science," Mr. Greenberg said. "And those models probably are as good as the next cat season."

Another member of the executive panel, Shivan S. Subramaniam, chairman and CEO of Johnston, R.I.-based FM Global, agreed that there's an "evolution" in risk modeling, but emphasized that what the models really provide is a tool for helping insurers manage aggregations of risk.

"The thing to remember is that models don't predict disaster," he said. "What they do is predict what aggregations should be, given a certain set of circumstances."

The executives on the RIMS panel discussed a wide range of other topics as well during the 90 minutes or so they were on stage, ranging from broker compensation to industry diversity to the state vs. federal regulation debate. I'll examine some of those issues more fully in an upcoming *Industry Focus*.

Overall, though, I think much of the discussion showed an industry looking to respond—as it often must—to change, whether in the weather, demographics or technology.

On the subject of technology, before the executives on the RIMS panel began answering questions, insurance industry consultant Myron Picoult cited information technology as an area where he thinks the industry can do better.

While the industry does a good job of collecting data, he said, it doesn't do as good a

job as it could of using it. "The bottom line," Mr. Picoult said, "is the industry has to do a better job on the IT side."

With Microsoft Corp. based in Redmond, Wash., the Seattle area is often seen as an information technology hotbed. So it was interesting to hear the top executive of a Seattle-based insurer offer some thoughts on technology the week before RIMS.

The occasion was the 20th Annual MSU Insurance Day at Mississippi State University last month, and the speaker was Paula Rosput Reynolds, president and CEO of Safeco Corp.

Ms. Reynolds covered a lot of ground in discussing "Disruptive Forces in Insurance," including what she described as a technology "arms race" underway between insurance

MUCH OF THE discussion showed an industry looking to respond—as it often must—to change, whether in the weather, demographics or technology.

and the banking industry, a race in which the insurance industry, she said, is "a little behind."

The banking industry, Ms. Reynolds said, tends to be more "customer facing" than the insurance industry in its technology investments, though she said she feels there's no reason the insurance industry couldn't follow suit.

The key, she said, is "You have to know how to deploy smartly and you have to have a vision around the future." With that in mind, Safeco plans to include some of its product development folks in upcoming meetings with Microsoft. "It's really important to us to try to program ahead rather than be programming in the rear view mirror," Ms. Reynolds said.

As companies move forward with IT investments, Safeco's is probably a good model—the best decisions will be those made looking toward the changes that will drive and reflect future business strategy, rather than those made with an eye on the past.

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Wells Fargo offers flood analysis tool

CHICAGO—Wells Fargo Insurance Services Inc. has formed a Flood Analysis and Placement program offering business customers tools for flood hazard analysis and insurance placement.

The new program is intended to help customers choose the right flood insurance to complement their existing business insurance programs.

For agents and brokers, Flood Analysis and Placement offers flood hazard analysis, flood elevation certification, National Flood Insurance Program flood insurance placement and excess flood insurance placement, in addition to education and troubleshooting support.

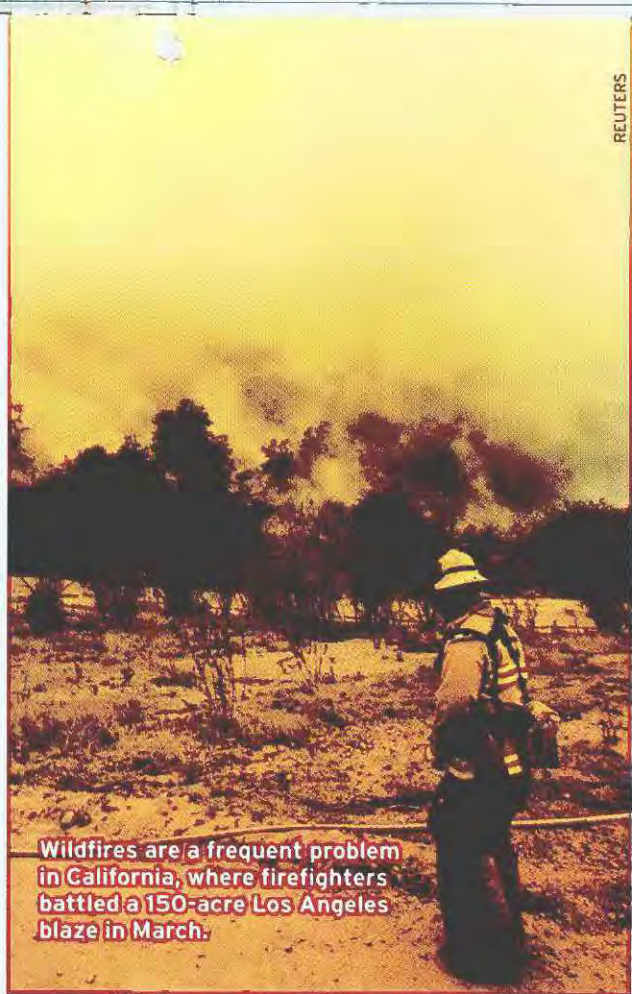
The program also can benefit Wells Fargo's banking and financial services customers by offering all those services in addition to lender-placed flood insurance and mortgage

impairment insurance.

The comprehensive program helps banking and financial services customers meet Federal Deposit Insurance Corp. regulatory requirements and offers the potential for developing fee income on insurance sales.

Using mapping tools, Chicago-based Wells Fargo Insurance Services can individually underwrite the specific risk of the property, considering Federal Emergency Management Agency maps along with street maps, aerial photography, wind and water projections, elevation information, and distance to the nearest water source and flood zones.

According to Wells Fargo, the program offers wide market availability, rate stability and excess flood capability with limits above those prescribed by the National Flood Insurance Program. ■



Wildfires are a frequent problem in California, where firefighters battled a 150-acre Los Angeles blaze in March.

California wildfire protection expands

NOVATO, Calif.—Fireman's Fund Insurance Co. has expanded the territory and offerings of FireProtec, a vegetation cutting crew staffed by off-duty firefighters assisting California policyholders with reducing wildfire exposures.

Through its alliance with FireProtec, the Novato, Calif.-based insurer said it can offer its California policyholders expert advice on wildfire mitigation techniques and discounted vegetation clearing services.

FireProtec aims to preserve life and property and reduce wildfire threats by clearing defensible spaces around properties to provide firebreaks that will slow fast-moving wildfires.

While the recommended defensible space is 100

feet, Fireman's Fund noted that achieving that distance often means crossing property lines. To help negotiate potential property line issues, FireProtec works with code compliance officers from the California Department of Forestry who enforce vegetation clearing, even if the defensible space zone extends onto neighboring property.

The FireProtec experts also can recommend minor changes in homes that can help mitigate wildfire risks such as blocking for gable vents and decks to changes in roof coverings.

Since 2004, Fireman's Fund has awarded grants totaling more than \$11 million to hundreds of different fire departments across the country. ■

BY THE NUMBERS

Security, going paperless and Web portal development are the top areas of focus for NAPSLO members' IT staffs, according to a recent survey by the association's Communications & Technology Committee.

TOP FOCUS AREAS	TOTAL	BROKERS	MGAs	INSURERS
Security	47%	55%	42%	40%
Going paperless	45%	45%	45%	40%
Developing a Web portal	43%	34%	49%	50%
Policy issuance/rating	35%	26%	36%	80%
Management systems	34%	40%	25%	50%
Data transfer	23%	19%	25%	30%

Source: National Assn. of Professional Surplus Lines Offices Ltd.

IIABNY launches skills training course for customer service reps

DeWITT, N.Y.—The Independent Insurance Agents & Brokers of New York has announced the launch of a workforce development program for insurance agencies.

The new IIABNY Essentials for Customer Service Representatives module-based training will be rolled out to agencies and brokerages across New York this summer. The program is intended to help agencies fill staff positions with well-trained job candidates at reduced training costs.

In surveys, IIABNY members had indicated a need to train newly hired customer service representatives. The program will include insurance technical skills for CSRs new to the insurance industry, communications skills for professional handling of oral and written client requests, and errors and omissions loss prevention.

The program will also include instruction on managing priorities to improve representatives' ability to handle their workloads and training on building business relationships aimed at helping CSRs improve results in daily interactions and negotiations.

The IIABNY expects to add other topics to the CSR training program by the end of the year.

By offering the four-hour training sessions in locations across New York, the IIABNY will reduce the need to travel to take advantage of the program.

The program begins with a skill assessment to identify the individuals' strengths and needs, and participating employees can then choose to take all or just some of the courses, depending on their needs.

For more information on the program and course offerings, visit the state trade association's Web site at www.iiabny.org. ■



Driven by pressures from regulators and rating agencies—as well as recognition of the potential impact on their bottom lines—insurers and reinsurers have begun to firmly embrace enterprise risk management. Prakash Shimpi, enterprise risk management practice leader at Towers Perrin in New York, is well-versed on the subject of ERM, having previously served as president of Fraime L.L.C., an ERM consulting boutique; as president and chief executive officer of Swiss Re Financial Services Corp., where he was involved with products such as insurance-linked securities and credit and weather derivatives; and having written a book on the topic. Recently, he discussed ERM and its potential benefits.

After years of discussion of the benefits of an enterprisewide approach to risk management, it seems like it's begun to take hold in many companies. Is this something that just took time or the right set of conditions to fully develop?

It was rather like the development of the catastrophe bond market. Things were percolating for several years and then this “magically happens overnight.” It's one of those overnight successes that took many years to develop.

I think the good news is that it's been on the stove for a while, slowly

stewing and percolating.

It seems that at the heart of ERM are the notions of spreading the risk management culture throughout the organization, that of a coherent approach to risk and the ability to make informed risk-reward decisions. Are those concepts becoming more widely accepted?

When you undertake any business activity, like it or not you've got risk in that. So risk management is inherent in almost any business endeavor.

For example, a company looking to cut costs by outsourcing some activities, how far do they think ahead about, “And what really are the implications of this?” Have you actually diversified your risks or have you multiplied them? Or say you're adding branch offices overseas. You've added global reach, but you've also added foreign exchange risk, you've added people risk, you've possibly added political risk.

You have to think about, “If it doesn't go well, is it a small blip in our earnings or is it potentially firm destroying?”

Is ERM really a new discipline? How does it differ from previous approaches to risk management?

It's been there all the while, but business managers have not been trained to look at it.

The value of risk management is in allowing shareholders to earn a levered return. What enterprise risk managers have done in the end game is better economics for the business. It's not an alarmist view. It's, “What is your ability on a day-to-day basis to manage the things that are affecting your firm?”

And you can't just look at the statistics and the number of risks. One of the things to recognize is you can have too much of a centralized risk management. The value is to understand the connections, not just to understand the total. ■

XL sponsors Grand Slam

HAMILTON, Bermuda—XL Capital Ltd. has entered into an agreement with Turner Network Television to be a broadcast sponsor of the 2007 PGA Grand Slam of Golf.

The Oct. 16-17 event, the 25th PGA Grand Slam, will make its Bermuda debut at the Mid Ocean Club.

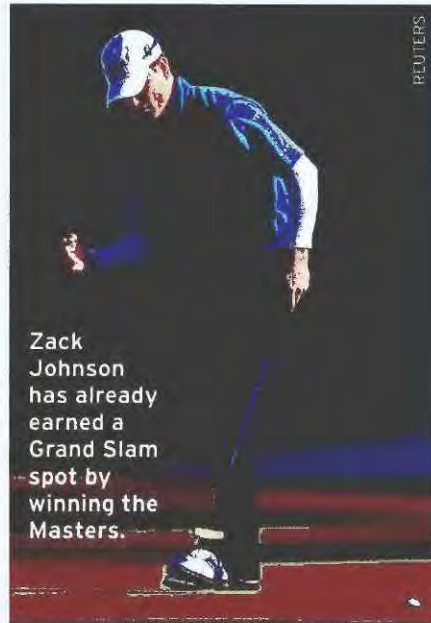
Automatic invitations to the tournament are limited to the winners of the year's four major men's golf championships. Zach Johnson, this year's Masters champion, is the first to qualify for the 2007 PGA Grand Slam of Golf.

Hamilton, Bermuda-based XL's sponsorship package includes graphic and audio exposure as well as customized branded content during TNT's coverage

of the two-day event.

XL also will receive branded presence in a series of Turner Sports-produced congratulatory spots to air on sister network CNN following each of the remaining men's majors, along with rotation during TNT's coverage of the British Open Championship, PGA Championship and President's Cup.

In a statement, Brian M. O'Hara, XL's president and chief executive officer, said, "We view this as a natural fit as golf is the insurance industry's preferred sport." The fact that the event will be televised in major target markets presents "an opportunity to increase awareness of XL's global insurance, reinsurance and financial product capabilities," Mr. O'Hara said. **IF**



Zach Johnson has already earned a Grand Slam spot by winning the Masters.

REUTERS

THE QUOTE

'THE INSURANCE INDUSTRY HAS a well-known reluctance to change something that works.'

JUDY JOHNSON

VP AND PRINCIPAL SOLUTIONS ARCHITECT
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Guardian expands alternative treatments for group health plans

NEW YORK—Guardian Life Insurance Co. of America is providing its group medical plan members expanded access to discounts for a variety of alternative medical treatments.

Guardian, which provides employee and voluntary benefits to small and mid-size businesses, has increased plan access to discounts for such disciplines as yoga, Pilates, personal training, massage/bodywork, nutritional counseling, acupuncture, chiropractic, homeopathy, hypnotherapy, qigong, tai chi and holistic medicine.

New York-based Guardian's

Complementary Alternative Medicine discount program provides up to 30% off the cost of services and treatment at over 36,000 providers. While many Guardian medical plans already offer coverage for alternative medicine procedures, this program expands discipline choices, locations and providers.

The Complementary Alternative Medicine program was developed in conjunction with Whole Health Networks. Guardian medical plan members can get information about the practitioner network online at www.guardiananytime.com. **IF**



Indonesian brokerage joins Assurex Global

JAKARTA, Indonesia—Indonesian brokerage PT. Mitra, Iswara & Rorimpandey Insurance Brokers has joined international broker network Assurex Global.

Assurex, which invites only one independent broker per market to join its network, said it selected Jakarta-based MIR because of its commitment to client service.

MIR offers a full range of services—including employee benefits, engineering, marine cargo, fire and property coverage, personal accident and motor vehicle protection—from its Jakarta headquarters and five branch locations across Indonesia.

Djoko Gazali, MIR's president, said in a statement that it had been a goal of his firm to join the Assurex partnership and that the broker considers its membership an endorsement of its performance thus far.

Founded in 1954, Assurex Global has 118 partner firms with more than 500 offices in 80 countries generating more than \$23 billion in annual premium volume. **F**



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ON THE MOVE

Joseph (Jay) Lughes Jr. has joined Duluth, Ga.-based Maxum Specialty Insurance Group as president and chief operating officer of Maxum Indemnity Co. and Maxum Casualty Insurance Co. Mr. Lughes previously was president of Western Heritage Insurance Co.

Hilb Rogal & Hobbs Co. has named **David M. Hofele** president of its San Francisco-area operations. Before joining McLean, Va.-based HRH, Mr. Hofele was managing partner, general counsel and secretary of

Palmer & Cay Inc.

Jacksonville, Fla.-based insurance broker Harden & Associates Inc. has named



Mr. Lunetta

Paul Lunetta president and COO. Before joining Harden in 1992, Mr. Lunetta was treasurer of Sawyer Gas Cos.

New York-based program business insurer Delos Insurance Co. has appointed **John DiBlanda** to the newly created position of chief financial officer. Mr. DiBlanda comes to Delos from Gallagher Re, where he was U.S. COO and global CFO.

Lincolnshire, Ill.-based Hewitt Associates Inc. has named **Jay Rising** president of its human resources outsourcing business. Mr. Rising, who most recently was president of software company RightNow Technologies Inc., succeeds **Julie Gordon**, who has been acting president of HR outsourcing at Hewitt since the resignation of Bryan Doyle last June. Ms. Gordon will become president of client and market leadership, a new post at the company.

As part of an effort to increase its presence in the small-business market, New York-based Willis Group Holdings Ltd. has named

Tom Bartleet to the newly created position of CEO of its Global Small Commercial business. Previously, Mr. Bartleet was chief executive of Global Markets North America at Willis.

John Giblin has been named CFO of Chattanooga, Tenn.-based Blue Cross Blue Shield of Tennessee and its affiliated companies. Most recently, Mr. Giblin was CFO of Amedisys Inc., a Baton Rouge, La.-based home health nursing company.

Hamilton, Bermuda-based specialty insurer Lancashire Holdings Ltd. has named **Simon Burton**

YOUR DECISIONS ARE ONLY AS



CEO and chief underwriting officer of Lancashire Insurance Co. Ltd., the group's Bermuda underwriting platform, as well as deputy CEO of the holding company. He previously served as deputy chief underwriting officer. Lancashire also named **Elaine Whelan**, formerly financial controller, CFO of Lancashire Insurance.

Richard Houghton has been named CFO of Hamilton, Bermuda-based Aspen Insurance Holdings Ltd. Mr. Houghton, who most recently served as COO of the Royal Bank of Scotland Group P.L.C.'s insurance division, succeeds **Julian Cusack**, who was promot-

ed last year to chairman and CEO of the Aspen Insurance Ltd. unit.

Haier New York Life Insurance Co. Ltd., the Shanghai-based joint venture between New York Life Insurance Co. and China's Haier Group, has named **Xiaoxia Zhao** president and CEO. Most recently, Mr. Zhao was director of the board and executive vp for AXA-Minmetals Assurance Co. Ltd.

Matthew Elderfield has been appointed CEO of

the Bermuda Monetary Authority, effective July 16. Mr. Elderfield most recently was department head of the major retail groups division at the U.K. Financial Services Authority. He replaces Cheryl-Ann Lister, who last year announced her intention to step down from her positions at the regulatory



Mr. Zhao

body.

Judith A. Patterson has been named president of Boston-based surplus lines underwriter First State Management Group, a subsidiary of Hartford Finan-

cial Services Group Inc. She succeeds Ralph J. Palmieri, who is retiring.

Robert F.X. Feeney has been appointed CFO of New York-based Integro Ltd. He joins the broker from HSBC Holdings P.L.C. where he was a managing director and business manager for the Global Markets Americas unit.

Chicago-based Aon Corp.'s Aon Re Global unit has named **Elliot Richardson** CEO of a newly formed facultative reinsurance unit, Aon Re Global Fac. Mr. Richardson joins Aon from London-based Benfield Group Ltd. ■

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IN THE NEW SOA

Industry companies look for solutions to legacy IT issues

By Meg Fletcher

Modernizing legacy information systems through service-oriented architecture appears to offer many insurers real hope, not just hype.

It remains to be seen, though, how many insurers will maximize SOA's potential by using it to implement broad business goals through a series of manageable, measurable projects, as experts recommend.

"SOA is in its early states of evolution," said Keith Sievers, senior vp and chief information officer with the Jacksonville, Fla.-based Kemper Auto & Home Insurance Co., an affiliate of Chicago-based Unitrin Corp.

"The challenge with SOA is that it is still not a well-defined term," said Brian S. Cohen, president and CEO of Denver-based Clear Technology Co. Inc. If you asked different people in a room, they would each have different definitions, he said.

Experts have their own definitions of SOA, which range from the philosophical to the technical:

- "SOA is a life-long journey, not a quick fix." Andy Labrot, chief technology officer in the Hartford, Conn., office of Innovation Group, a consulting firm based in Whitely, England.

- "SOA is for a client with a computer system what a strip mall of services is

to a consumer." Doug Roller, CEO, Duck Creek Technologies Inc., a consulting firm in Bolivar, Mo.

- "A service-oriented architecture is the underlying structure supporting communications between services. In this context, a service is defined as a unit of work to be performed on behalf of some computing entity, such as a user or another program. SOA defines how two computing entities, such as programs, interact in such a way as to enable one entity to perform a unit of work on behalf of another entity.... Each service interaction is self-contained and loosely coupled, so that each interaction is independent of any other interaction." WhatIs.com, an information technology-specific online encyclopedia.

"Conceptually, SOA is a great idea, but it is still in its infancy in terms of applying it," Mr. Cohen said.

INTEREST GROWING

A service-oriented architecture approach to information technology systems has its basis in deploying enterprise software applications that share logic and data across both legacy and newer IT systems, providing a way for companies to share data across the enterprise, increase business information and make better use of that information.

The interest in SOA is growing among the insurance industry and other industries. "It's a wave and people standing in the water who don't deal with it will be swept away," Mr. Cohen said.

A recent study commissioned by Progress Software Corp. of Bedford, Mass., found that "an SOA-based approach is gaining ground quickly" as

a "solution across enterprises to achieve successful end-to-end data management and integration results."

The survey, released in March 2007, tallied the responses of 407 senior IT decision-makers at companies with more than \$250 million in annual revenues. The survey found that "while 44% of enterprises use SOA today, 59% of respondents reported that they plan to use SOA for integration efforts over the next two years."

In addition, the study found that 32 of 53 financial services and insurance companies responding to the survey are using SOA as the basis for application and data integration.

The survey also found that about 80% of all respondents still manually make changes to integrate data. Such manual processing increases maintenance costs, respondents said. Manual processing also is troublesome because of its slow speed and "unforeseen breakage of other applications dependent on the same data," respondents said.

The concern about the time and cost associated with manual fixes is one of the main concerns that insurers have with their legacy systems, sources said. Consequently, most experts say the problem insurers face due to legacy systems is "very serious."

The problem posed by legacy systems represents "a huge risk" to the organization, said Judy Johnson, vp and principal solutions architect in the New Brunswick, N.J. office of Patni Computer Systems Inc., which is headquartered in Mumbai, India.

"Insurers can spend between 70%

to 85% of their IT budget maintaining legacy systems, which leaves very little for growth and transformational projects," according to an e-mail from Stephen Forte, principal research analyst with Insurance Advisory Service, a unit of Gartner Inc., a Stamford, Conn.-based research and consulting firm.

The problems with legacy systems are many and varied, experts say.

Legacy systems are silos that stand apart, Mr. Labrot said. They can't differentiate customers, or tailor services, products or rates.

They are plagued by operational difficulties including

"hard-coded business logic, inflexible systems, lack of rules-driven processes," Mr. Forte said. Legacy systems are driven by policies instead of clients and are slower in getting products to market and adapting to changing market conditions. As a result, an insurer dependent on a legacy system likely is losing market share to its technologically savvy competitors, he said.

LEGACY DIFFICULTIES

Legacy systems were designed for handling processing at a specific point in time and are not responsive enough for the current era when change is constant, said Art Barrios, managing director with PricewaterhouseCoopers L.L.P. in New York. Many legacy systems require manual fixes, but it is increasingly diffi-

cult—and expensive—to find staff who understand how to make those changes on mainframe equipment that is decades old, Ms. Johnson said.

Pressure is mounting to improve the IT performance from the business side of insurers' operations because the product is increasingly sold as a commodity, regulators are increasing their reporting demands and customers are demanding better service, Mr. Barrios said. Those pressures are being transmitted to insur-

'THE INSURANCE INDUSTRY has a well-known reluctance to change something that works.'

JUDY JOHNSON
PATNI COMPUTER SYSTEMS INC.



ers' IT departments and their legacy systems cannot meet those demands, he said.

Despite those problems, most large insurers continue to operate their legacy systems rather than replace them, because the systems can still perform essential functions, such as the batch processing of data.

"The insurance industry has a well-known reluctance to change something that works," Ms. Johnson said. "It's a very thorny issue."

"We know we need to change, but we don't want to do it quickly," Mr. Labrot said.

Despite the high cost of operating mainframes, that equipment will continue to have a role in insurance industry processing over the next five years, in part because it is hard to find equivalent power in a server-

based system, some experts say.

In addition, IT systems are both difficult and expensive to install and get working, Mr. Cohen said. A company with \$1 billion in annual revenue can expect to spend about \$30 million to "rip (out) and replace" a core IT system, and that does not include the cost of the actual system itself, he said. Also, "businesses can get killed by failed strategic IT efforts," he said.

MODERNIZATION EFFORTS

Larger insurers face more problems in trying to modernize IT systems, especially those that have acquired disparate IT systems in past mergers, experts say.

And, they say, midsize insurers are generally considered to be more nimble than larger insurers because of their smaller needs.

Experts have mixed opinions about whether property/casualty insurers face more problems with legacy systems than do their life/health counterparts.

Experts also differ about whether U.S. insurers face more challenges than their non-U.S. counterparts. Most consider European-based insurers, which operate in a less regulated environment, to have more flexible IT capabilities.

Emerging countries with developing insurance markets often are a "green field" opportunity for insurers, Mr. Roller said.

While SOA is the most recent solution for modernizing insurers' legacy systems, both property/casualty and life/health insurers often have tried a variety of other strategies to modernize their legacy systems, experts say.

Some insurers have used "wrapper strategy," in which new technology is added to extend a system's life.

The wrapping approach can be done through technical or functional extensions or migration from one platform to another, Ms. Johnson said.

That solution is best achieved by installing integration hubs that serve as "traffic cops" to route new incoming information. That provides a way for

the Web and for servers to communicate with the mainframe, Mr. Roller said.

Some companies also have tried to modernize their legacy systems by outsourcing processes that are hard to handle in-house. For example, some insurers outsource processes like claims handling, application coding and maintenance to places like India, Mr. Labrot said.

Such outsourcing is not without risks, though. "There is a huge danger that the company will forget how those systems work," as happened with an insurer that he declined to identify. After several years, an insurer is faced with having to buy a new system or negotiate with the off-shore service provider, who "will have a gun to your head" because its services are now essential to the insurer's operations, Mr. Labrot said.

An SOA approach can help legacy systems problems or can be used as an alternative to such systems, Mr. Forte said.

"Fortunately, SOA is moving from the purely theoretical stage to a place where SOA can really be used to develop better and more flexible systems," Ms. Johnson said.

The SOA approach has several potential advantages.

"SOA is so powerful" because it includes transparent services that a company can use to augment and improve its existing legacy system, Mr. Cohen said. "You can mix and match," he said.

EXPEDITING PROCESSES

SOA also can help expedite several processes within a single company, experts say.

It can help insurers' existing legacy systems by improving batch processing and making hard-coded processes more flexible, Mr. Forte said. SOA also can be "a short-term bridge to support front-office requirements while replacing or upgrading legacy systems," he said.

Also, "SOA takes information and processes from systems that aren't able to connect with portal technology and makes them accessible to agents, cus-

tomers and external users via the portal," he said.

In addition, SOA is "a tool for insurers to (make components of) processes that they can reuse across systems and product lines as well as a tool to support processes that cross multiple back-end systems," Mr. Forte said.

Three key advantages of the SOA approach are consistent service performance, ease of management and remote access, Mr. Roller said.

Adding to SOA's popularity is the fact that it uses cheaper "open standards" rather than the more expensive proprietary ones of the past, Ms. Johnson said. The "World Wide Web Consortium" is developing those standards collaboratively, "in a kind of virtuous cycle—which is the opposite of a vicious circle," she said.

Also, using SOA allows an insurer to replace portions of its systems "on an incremental basis," Mr. Sievers said.

Regardless of the definition of SOA that insurance company managers use, they must do a comprehensive analysis of their company's fundamental needs before embarking on projects to implement it, several experts say.

"The whole solution hinges on management vision," Ms. Johnson said. "If the solution is (only) technically based, it is sure to fail."

"What is becoming critically important is that SOA needs to be something that is positioned as a benefit to the business," Mr. Barrios said. An effective SOA program requires the involvement of skilled and experienced "business architects," who understand both a company's business operation and IT needs.

The managers need to develop measurable, manageable projects that have clearly identifiable goals and provide value to the business, Mr. Barrios said. The goals, for example, could be improving speed to market, providing more in-depth knowledge to the sales force or improving the customer's experience.

Engaging in such projects and evaluating their outcome is the only way to prioritize services and to know the appropriate order in which to implement them to optimize benefits to the company, he said. ■



Mr. Roller



E-discovery falls hardest on insurance industry

By Meg Fletcher

In the first six months since sweeping changes altered the Federal Rules of Civil Procedure for federal court cases, some large insurers are making progress in revising their operations so they can preserve and produce electronically stored information—if and when needed.

The federal rules, which were amended last December, require parties to any federal court civil dispute to meet early to discuss so-called “e-discovery” issues related to preserving and producing e-mails and other ESI. For most companies, complying requires significant re-engineering, especially to make stored data available and searchable.

The challenge for the insurance industry is particularly important because of an insurer’s dual role: It is both a large corporate entity—that may itself be sued—as well as the insurer of corporations for which it provides defense coverage as part of policies that

protect them from liability or directors and officers risks.

As such, insurers now face higher litigation costs for themselves and their insureds as well as increased costs for new hardware and software to fund more sophisticated records management programs. They also must fund better training and coordination for legal and information technology staff, which must cooperate more closely than ever before.

OPPORTUNITY TO RETOOL

If handled correctly, though, the challenge will become a long-term opportunity to streamline and rationalize records management for both insurers and insureds alike.

Insureds, though, are expected to face increased scrutiny from underwriters of liability and D&O policies about their own data management programs, which may be reflected in future insurance premiums.

The new requirements—and the state court equivalents that are being devel-

oped—must also be coupled with recent case law developments that increase the obligation of a plaintiff or defendant to preserve documentation from the time the dispute became reasonably likely, said Jon Neiditz, an attorney in the Atlanta office of Lord, Bissell & Brook L.L.P.

The federal requirements represent “a big change in practice,” because they mandate early meet-and-confer discussions that must include information about material that won’t be produced, Mr. Neiditz said.

The requirements are particularly challenging because of the wide variety of digital information in e-mail, text messaging, word processing files, spreadsheets and databases. Huge quantities of frequently redundant data are processed through insurers’ headquarters and on employees’ personal computers and handheld devices. In addition, a company’s backup data often is archived offsite for security purposes.

Currently, 60% of corporate data resides in, or is attached to, e-mails, the National Law Journal estimated last year.

In litigation, “e-mail provides the smoking guns—casual, colorful communications,” Mr. Neiditz said.

The new federal rules are especially important to insurers, because “the insurance industry is significantly more litigious than any other industry,” said Marie-Charlotte Patterson, vp of market strategy for AXS-One Inc. in Rutherford, N.J. About 40% of the software company’s clientele is in the insurance or financial services industries.

“Insurance companies, historically the object of disputes brought by policyholders and class action claimants, are by far the biggest litigation magnets,” according to a 2006 survey by Houston-based law firm Fulbright & Jaworski L.L.P. “The approximately 1,700 cases pending by the average insurer was more than five times the average tally posted by the next highest sectors” of energy, retail and financial services, according to the survey of 422 in-house law departments worldwide.

Such cases continue to mount as “more than half of insurance company counsel reported taking on 50 or more new lawsuits in the past year,” the survey

said. "Insurers appear to get embroiled in the biggest stakes cases—17% reported having more than 50 lawsuits pending with at least \$20 million at issue. By contrast, only 6% of energy companies reported more than 50 suits in the \$20 million or greater range."

GOOD FAITH, BAD FAITH

Given the high volume of litigation, insurers should be particularly interested in the so-called "safe harbor" provision of the federal rules that "offers limited protection when ESI no longer exists," Mr. Neiditz said. "Absent exceptional circumstances, discovery sanctions may not be imposed if ESI has been lost as result of the 'routine, good faith operation' of a computer system," he said.

"Consistent and appropriate records management operations are now becoming a cornerstone in the plans of many organizations to establish 'good faith' for purposes of that provision," Mr. Neiditz said.

In addition, all companies should strive to comply because it helps avoid the bad-faith label that plaintiffs

can apply when their discovery requests are unmet as well as court sanctions plaintiffs can seek, said attorney Dennis Steckler, Downers Grove, Ill.-based senior solutions architect and alliance manager with Patni Computer Systems Inc., a consulting firm with worldwide headquarters in Mumbai, India.

Complying with the e-discovery requirement also helps companies avoid sanctions including default judgments and "adverse inference"—judges telling jurors that they can assume that missing e-mails contained damaging information, Mr. Neiditz said.

Missing ESI could result in millions of dollars in fines as well as punitive damage awards, attorneys say.

Most consultants say insurers are aware of the challenges and are taking steps to address them.

"Insurers are at the front end of the curve" in responding to the challenges of e-discovery, said Christopher Kruse, president and CEO of CaseCentral Inc., a San Francisco-based consulting firm on litigation and regulatory projects for

insurers and attorneys.

"Insurers are probably ahead of individual companies" and are "very involved," Mr. Steckler said. "Any large company—and the top four or five brokers—are actively working on it."

Smaller insurance-related companies, such as managing general agents, may have to struggle although there is help available to them, he said.

"Some insurers have been addressing e-discovery demands over the past few years," but the pace of activity increased since April of last year, said Mr. Neiditz, who has helped more than 100 insurers and reinsurers deal with e-discovery issues. They are establishing preservation processes and protocols as well as training employees, he said. They also are addressing how to develop record management programs that can be administered consistently.



Ms. Patterson, though, has a different perspective. "For the most part, insurance companies have been caught off their guard with the changes to the Federal Rules of Civil Procedure," she said.

"In the vast majority of cases, IT is out in the cold and not ready."

BOARDROOM INTEREST

Until a year or so ago, data management was a back-office function. As a result of the change in discovery rules, though, a company's board of directors is becoming more interested in how its information technology system works, Ms. Patterson said.

From an IT perspective, "e-discovery is further expanding how data and information must be managed and who needs access to use and (should) have access to it," said Aimee Siliato, director of government relations and the Data Management Department at the Insurance Services Office Inc. She also is president of the Insurance Data Management Assn., a voluntary organization of data management professionals. Both are based in Jersey City, N.J.

IT professionals no longer merely manage statistical and financial data, she said. The e-discovery regulations emphasize that "data is by far one of

the most critical assets" of an insurance company, she said. The requirements mean there are investments to be made in IT in addition to "some pain" in bringing them into operation, she said.

"It's an enormous task," Mr. Steckler said. "For most companies, it is a significant re-engineering effort."

For example, a large part of the project stems from insurers' need to document their own policies and rethink their document-destruction policies, he said. Many companies with paper-based documents destroy them in accordance with regulatory requirements, which typically allow destruction after a five- to seven-year period, Mr. Steckler said.

If an insurer has outsourced its IT services, it is important that vendor contracts contain strong indemnification provisions that benefit the insurer, consultants say.

In addition, there is a great need for closer coordination between an insurer's general counsel and its IT staff. They must be "on the same page," Mr. Kruse said.

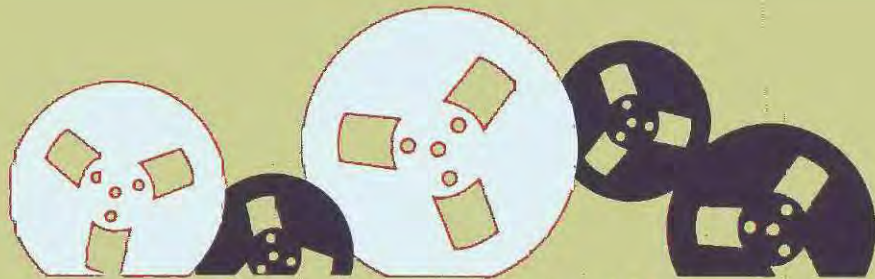
One approach that some insurers have found helpful is to appoint a document coordinator for each business unit, such as an insurer's claims department, Mr. Neiditz said. That person would be responsible for communicating policies to other staff members, among other things.

"Managing ESI is an enterprisewide activity that requires uniform records management policies and the technology infrastructure to automate and enforce them," according to "Managing Litigation Costs and Complexity," a white paper by CaseCentral.

CaseCentral recommends what it calls "discovery life-cycle management" to enable companies to make every stage of discovery efficient and "a repeatable business process," it said.

Such a repeatable process "is reasonable and defensible, which is exactly what companies need to be compliant with" the federal discovery guidelines, it said. In addition, that process reduces costs, minimizes disruption, boosts responsiveness and reduces the risk of inadvertently producing information that is unnecessarily damaging.

Specifically, such a solution "features



Five steps toward getting your company's data under control

Insurers should consider following these steps to establish a good records management program, according to CaseCentral Inc., a San Francisco-based consulting firm.

1. Establish a definable and defensible IT process.

The new rules require all companies to clearly spell out their information technology processes to opposing counsel and articulate the process far earlier in a legal action at the first meet-and-confer meeting. To achieve this objective, companies need to implement a fixed business process for managing all electronic discovery requests. The process should establish permanent rules, including rules that minimize the duplication of data and prevent the inadvertent disclosure of privileged documents. In satisfying this obligation under the new rules, insurers should not provide opposing parties with so much access to information systems that they might compromise security or divulge trade secrets.

2. Centralize corporatwide data collections for all legal actions into a single, enterprisewide repository.

The new rules impose a greater responsibility on companies to ensure the integrity of data and avoid the inadvertent spoliation of electronic information. To minimize risk, insurers need systematic storage protocols to create a single complete copy of all data to eliminate the duplication of records and demonstrate that corporate data is reasonably accessible. The best way to achieve that objective is to establish an independent, online data repository that can be used by hundreds of legal teams and create a discovery life-cycle management protocol.

3. Standardize the form of production for all electronically stored information.

The new rules reward companies that have a single production format for all electronic discovery requests. The

production format is central to the electronic discovery process because it defines whether the documents are to be prepared in Microsoft Word as an image file or some other format.

The format decision is very important because it has a direct bearing on cost and speed with which the documents can be produced. Under the new rules, companies now have a real incentive to establish a consistent, corporatwide production format. This will enable insurers to reasonably reject requests from opposing counsel for alternative production formats that increase cost and risk.

4. Establish corporate control over data.

Insurance companies typically engage a large number of law firms to represent them in legal matters, and today those firms frequently control the electronic documents. Because of the greater process imposed by the new rules, insurance companies have a unique opportunity to more closely manage their repository of electronic documents. Better control of sensitive corporate documents reduces the risk of losing documents or inadvertent disclosure to opposing counsel. It will also eliminate the risk in having vital corporate information disbursed among the IT systems of dozens or even hundreds of outside law firms.

5. Focus on cost control.

The new rules add to the cost of managing and storing millions of electronic documents over potentially many years. An effective way to reduce the overall cost is to eliminate unnecessary duplication of privilege reviews. Once a document has been reviewed for privilege, the results of that review can be captured and reused in subsequent proceedings in which such documents might be relevant. Streamlining the process can result in substantial cost savings. The highest single cost of discovery is the attorney time required to review data prior to it being turned over.

a unified repository; automated, rules-based workflow; and audit capabilities" that enable a general counsel "to effectively capture, share, manage and store information," the paper said. "Once evidence enters the repository, retention policies ensure that litigation holds are enforced. During review, all annotations, redactions and designations become part of the evidence metadata. Instead of treating each new matter as a one-off entity, the company's legal team can reuse information effectively and leverage prior document reviews," it said.

THE COST OF COMPLIANCE

Complying with the requirements of federal law as well as case law "absolutely" increases insurers' costs because the amount of information they must track and control has grown exponentially, CaseCentral's Mr. Kruse said.

For many large insurers, the cost of dealing with the e-discovery issue has doubled or tripled over the last two years, he said. "The costs have a longer tail—a minimum of five years—than anyone wants," Mr. Kruse said. Ultimately, though, those costs should decline once companies have improved their records management systems, he said.

Predictions vary about the impact of e-discovery on litigation costs.

Theoretically, it may increase the cost of litigation involving individual plaintiff's who aggressively seek e-discovery, Mr. Neiditz said. In addition, e-discovery requirements may reduce the amount of business-to-business litigation because each side will prefer to settle rather than meet the requirements of the amendments to the Federal Rules of Civil Procedure, he said.

As the insurance industry becomes more accustomed to dealing with e-discovery exposures, insurers may tighten underwriting guidelines for insureds seeking to renew D&O or some liability coverages, some consultants say.

Mr. Kruse said his D&O insurer already asks about management's compliance with other regulatory requirements, so he anticipates that underwriters will ask about his firm's readiness to deal with the e-discovery rule changes in the future. ■



New e-proxy system packs rewards and risks

By Meg Fletcher

When it begins July 1, the Securities and Exchange Commission's new program to provide proxy materials to willing shareholders by posting them on an Internet site will reward the many, though it may create some new risks for a few.

Issuing companies, which include many insurers and agent/brokers, will experience the rewards of significant savings in printing and postage costs while society generally will benefit from fewer felled trees and less trash.

In addition, shareholders—especially dissident ones—will benefit from easier access to proxy materials and new rules that the SEC says will make it easier and less expensive for a shareholder to challenge a board's proxy recommendations.

The new risks may surface among shareholders, especially trusting seniors who may face "phishing" attacks that could result in the theft of personal information, some observers say.

In addition, issuing companies may

face claims under their cyber risk and directors and officers policies, sources say.

"As with any fundamental change in e-commerce, e-government or e-business that increases the use of the Internet as a permissible medium, there will be privacy and security issues," said Jon Neiditz, an attorney in the Atlanta office of Lord, Bissell & Brook L.L.P.

The amendments to the Securities Exchange Act of 1934 are taking advantage of technological developments and the growth of electronic communications, the SEC said in describing the final rule on the Internet availability of proxy materials in the Jan. 29 Federal Register.

The amendments require issuing companies to send a notice to shareholders, who have provided affirmative consent for the company to do so, to inform them that the proxy materials are available and how to access them.

The amendments also require companies to provide the materials on a publicly accessible Web site—other than the SEC's own EDGAR site—at least 40 calendar days before a share-

holder meeting date, or if there is no meeting, before corporate action may be taken. Then, the issuer must wait at least 10 days before sending a proxy card to a shareholder, to ensure that he or she has time to access the proxy materials, or request them.

The e-proxy program is among "dramatic changes" the SEC is adopting to remake the very nature of communications between companies and investors, SEC Chairman Christopher Cox said in a statement earlier this year.

"Issuers that rely on the amendments may be able to significantly lower the costs of their proxy solicitations that ultimately are borne by shareholders," the SEC said in its discussion of the final rule.

THEY SPEAK FOR THE TREES

In 2006, issuers and other persons soliciting proxies from beneficial owners spent about \$962.4 million for printing and mailing costs, the SEC said. In addition, the environmental costs of the traditional print-focused proxy solicitation process include paper, printing ink and adverse impact from cutting down trees as well as using fossil fuels, chemicals and bleaching agents.

If 81% of shareholders agree to the electronic delivery of proxy materials the amendments could save \$48.3 million to \$241.4 million annually, the SEC estimated.

In addition, shareholders will get more rapid dissemination of proxy information.

Another SEC goal of the e-proxy process is "to improve the ability of shareholders to participate meaningfully in the proxy process by reducing the cost of undertaking a proxy contest." That change "may increase management's accountability and responsiveness to shareholders due to heightened concern about the possibility of a proxy contest. This, in turn, may enhance the value of shareholders' investments," the SEC said.

Supporters of the change cite several positive goals of the program.

"The e-proxy can be a tool for an activist shareholder," said Donald A. Glazier, a Chicago-based principal with Integro Insurance Brokers based in New York

A dissident shareholder "may selectively choose the shareholders from whom it desires to solicit proxies without the need to send an information statement to all other shareholders," which an issuing company is required to do, the SEC said.

The issue of shareholder access arose late last year when the 2nd U.S. Circuit Court of Appeals in New York ruled in a case involving New York-based American International Group Inc. and the American Federation of State, County and Municipal Employees.

"In that case, the AFSCME union sought to include a proposal on AIG's proxy statement that would amend the company's bylaws to permit certain shareholders to nominate a competing candidate for director," according to a statement by SEC Commissioner Paul S. Atkins earlier this year. "The SEC staff agreed with AIG that it could exclude the proposal from its proxy statement...(but) the court, however, disagreed with the staff's position and ruled in favor of the shareholder," he said.

Although the new SEC amendments reduce the cost of a proxy contest, they do not eliminate all of them, such as costs of preparing the soliciting material and related fees. "We believe these surviving costs should discourage frivolous contests," the SEC said.

WILL MORE VOTE?

In deliberations about the e-proxy proposals, the SEC acknowledged there was, however, "significant disagreement" among those making comment regarding key issues related to the amendments, especially about security and privacy as well as whether it would increase voting by shareholders.

For example, some critics—including representatives of public entity retirees—were concerned whether seniors had adequate Internet access.

"We believe that current levels of access to the Internet merit adoption," the SEC said in discussions. The SEC based its decision on data from Automatic Data Processing Inc. showing that approximately 80% of investors in the United States have access to the Internet in their homes.

Also, the SEC attempted to mitigate

concern about access by requiring that any shareholder lacking Internet access, or preferring delivery of a printed copy of the proxy materials, can ensure that he or she will receive a free copy of proxy materials by making a single, permanent request, which can be revoked at any time.

Several of those making comments also expressed concern about the potential theft of investors' identification or control numbers from the company's notice or instructions for executing proxies.

In response, the SEC said, "We understand that these numbers, which are in common use today, usually provide the user only with access to execute proxies or provide voting instructions: They do not enable the user to buy or sell securities in a shareholder's account or transfer funds from that account." In addition,



'AS WITH ANY fundamental change in e-commerce, e-government or e-business that increases the use of the Internet as a permissible medium, there will be privacy and security issues.'

JON NEIDITZ
LORD, BISSELL & BROOK L.L.P.

the SEC noted that "85% of shares voted already are voted electronically using such identification or control numbers."

Also, the SEC said it did not believe that the rules "would provide significant opportunity for abuse through phishing," or tricking shareholders into disclosing personal information to persons purporting to be issuers or their intermediaries. In addition, the rules permit an issuer to include a protective warning that no personal information other than the identification or control number is necessary to execute a proxy.

Other observers disagree.

Attorney Mr. Neiditz said, "I think there is certainly a risk for phishing and similar types of fraudulent solicitation of seniors and others" to provide personal information about themselves. It's "remarkable" how people respond to such requests, especially when they come from a phishing Web site that

looks much like an issuing company's Web site, he said.

LICENSE TO PHISH

Mickey Estey, a San Francisco-based senior associate with Integro, agreed. "Phishing is potentially an issue," he said.

For example, a class of individuals whose confidential information was disclosed might seek to file a class action lawsuit claiming that their privacy was violated, he said. If they brought a lawsuit in their capacity as shareholders, it might trigger a claim under the issuing company's D&O coverage. If they brought it as individuals, it might trigger a cyber risk policy, he said.

A claim under a cyber risk policy also could include costs for notification of other victims as well as credit monitoring, he added.

An issuing company also may face risk from the actions of third parties, such as a Web site operator it hired to handle proxy materials, Mr. Glazier said. A third party's misstatements about the impact of a proxy proposal could create a burden on the issuing company to correct such misstatements, he said.

Any issuing company would want to have an appropriate indemnification agreement with a third party involved in the proxy issuance, Mr. Estey said.

Other critics were concerned that an issuer might use shareholder information inappropriately, such as selling e-mail addresses to third parties for advertising purposes. The SEC responded by revising its final rules to clarify that an issuer or its agent must post the proxy information in a way "that does not infringe on the anonymity of a shareholder accessing that Web site." ■

FEATURE RANKING

LARGEST MANAGING GENERAL AGENTS

Companies deriving more than 50% of their wholesale premium volume from acting as a managing general agent, ranked by 2006 premium volume.

Rank	Company	Address	Phone	Fax	Web site
1	Burns & Wilcox Ltd.	220 Kaufman Financial Center, 30833 Northwestern Highway, Farmington Hills, Mich. 48334	800-521-1918	248-932-9046	www.burnsandwilcox.com
2	Hub International Ltd.	55 E. Jackson Blvd., Chicago, Ill. 60604	877-402-6601	877-402-6606	www.hubinternational.com
3	Eastern America Insurance Agency Inc.	Metro Office Park, Street One, Lot 10, P.O. Box 193900, San Juan, Puerto Rico 00919-3900	787-273-1288	787-782-8233	www.universalpr.com
4	K&K Insurance Group Inc.	1712 Magnavox Way, Fort Wayne, Ind. 46804	260-459-5000	260-459-5606	www.kandkinsurance.com
5	NIF Group Inc.	30 Park Ave., Manhasset, N.Y. 11030	516-365-7440	516-365-7392	www.nifgroup.com
6	WKF&C Agency Inc.	1 Huntington Quadrangle, Suite 2C18, Melville, N.Y. 11747	631-756-3000	631-756-2500	www.wkfc.com
7	LoVullo Associates Inc.	6450 Transit Road, Depew, N.Y. 14043	716-856-3065	716-857-8057	www.lovullo.com
8	Arlington/Roe & Co.	8900 Keystone Crossing, Suite 800, P.O. Box 80803, Indianapolis, Ind. 46280	800-878-9891	317-554-8551	www.arlingtonroe.com
9	Entertainment Brokers International	10940 Wilshire Blvd., 17th Floor, Los Angeles, Calif. 90024	310-824-0111	310-824-5733	www.ebi-ins.com
10	Freberg Environmental Inc.	1451 Larimer St., Suite 200, Denver, Colo. 80202	800-377-4152	303-623-8101	www.feinsurance.com

*BI estimate. ** 8% of revenue is as an underwriting manager
Source: BI survey. Researched by Kevin Edison and Karen Tucker

2006 premium volume	% change	2006 gross revenue	% change	% MGA	% Wholesale broker	% Lloyd's of London coverholder	Total employees	Principal officer
\$700,000,000	7.7	\$175,000,000	2.9	60	30	10	854	Alan J. Kaufman, chairman/president/CEO
\$683,183,354	118.5	\$478,369,184	100.1	67	33	0	3,689	Martin P. Hughes, chairman/CEO
\$239,635,146	0.2	\$12,460,853	5.5	100	0	0	159	Luis Miranda Casanas, president
\$221,101,691	-0.4	\$47,736,000	-0.5	93	7	0	282	Ross T. Smith, president/CEO
\$210,253,117	-4.4	\$20,100,000	2.0	60	37	3	135	Mark P. Maher, president
\$162,000,000	2.5	\$23,652,000*	2.5	89	0	3	74	Thomas J. Kennedy, chairman/CEO
\$133,468,467	3.9	\$19,486,396*	3.9	82	16	2	82	Leonard T. LoVullo, president
\$105,000,000	8.5	\$11,500,000	2.9	62	35	3	129	James A. Roe, president
\$85,500,000	21.3	N/A	0	90	10	0	60	Jack Cave, managing partner
\$70,000,000	16.7	N/A	0	90	0	10	N/A	Michael J. Hill, president

if so, whether that reform is being implemented even-handedly.

Contingent commissions comprise additional remuneration paid by insurers to agents, brokers and managing general agencies based on reaching a minimum premium volume or achieving an overall loss ratio below a certain threshold. While contingent commission agreements have been in place for decades, more recent consolidation enabled certain brokers to gain unprecedented market power when negotiating with insurers, due in part to these arrangements.

UNPRECEDENTED POWER

The top four brokers, who together dominate insurance placements, negotiated comprehensive placement agreements that entitled them to payments directly from insurers based on factors such as business volume, renewal rates and profitability. Smaller brokers continued with less sophisticated contingent commission agreements.

Although agents and MGAs also received contingent commissions, regulators paid extra attention to brokers' contingent commissions because regulators saw brokers as representing policyholders rather than insurers. From the regulators' perspective, contingent commission agreements between brokers and insurers called brokers' loyalties into question.

In early 2005, regulatory pressure mounted to the point where certain large brokers announced they no longer would accept contingent commissions from insurers while, at the same time, a few large insurers said they no longer would pay contingent commissions to brokers. The decision to walk away from these profits represents a major change in the broker compensation structure.

Interestingly, however, many smaller brokers did not make the same commitment, which raises questions as to whether there is now a level playing field.

In addition, regulators lodged allegations that some brokers had colluded with insurers to rig bids, fix prices and steer clients to the insurers with the most lucrative contingent commission

A solution without a problem?

By Key Coleman
and John Bonaguro

More than two years after a series of allegations surrounding contingent commissions rocked the insurance industry, the industry finds itself in a paradoxical situation with surprisingly little clarity.

Brokers, agents and insurers strive to balance profitability with permissibili-

ty as policyholders wonder how they actually benefited from reform efforts. While some brokers and insurers have changed their prior practices, others have merely adopted fortified disclosure.

Clearly, these costly regulatory inquiries caused painful restructurings and layoffs at the major insurance brokerages. It is unclear, however, whether they provided meaningful reform and,

programs.

In late 2004, the National Assn. of Insurance Commissioners reacted to industry events by establishing the Broker Activities Executive Committee Task Force. The goals of the "EX" Task Force are to increase the transparency of brokers' compensation and assist in the continued monitoring and analysis of industry events.

The NAIC model act for producers, the Producer Licensing Model Act, provides guidance for intermediaries. Interestingly, the PLMA does not distinguish between agents and brokers. Instead, the model refers to "insurance producers," which it defines as persons required to be licensed under the laws of a state to sell, solicit or negotiate insurance. The original version of the PLMA did not prohibit the payment of contingent com-

missions to producers.

Today, it appears that brokers are following two different paths when it comes to contingent commissions. Most large brokers have stopped taking contingent commissions, but smaller brokers continue to accept them, with perhaps a bit more disclosure.

The financial impact on the large brokers has been substantial.

In 2005, brokers' consolidated net income, as reported in the Fitch Insurance Broker Index, declined by an average of 22%. While profits of most of the largest brokers improved in 2006, the regulatory hurdles remain large.

These large brokers have been trying to raise commission rates and implement new pricing structures that will help make up the difference. Without such revenue enhancements, these

intermediaries will clearly be working at a competitive disadvantage as compared with smaller and mid-size brokers.

On the other hand, given the size differential, it is unlikely that these smaller brokers will be able to use this advantage to gain any signif-

icant market share on large corporate accounts. Still, there is no question that the growth of large brokers will be constrained going forward.

UNEVEN ENFORCEMENT

From an insurance company perspective, the lines are not much clearer. While some companies have been forced to stop paying contingent commissions, others continue.

Another cause of concern is the so-called "65% rule."

At least two large insurers have agreed in settlements with regulators to stop paying contingent commissions on lines of business in which insurers that represent 65% of the gross written premiums for that line either have not been paying such commissions or agree to similar settlements.

Administering and monitoring of the "65% rule" could become quite cumbersome. More important, this particular rule, by definition, would be enforced unequally.

Meanwhile, in spite of the regulatory changes, debate continues about whether contingent commissions are a legitimate form of broker compensation. Many in the insurance industry insist that contingent commissions were never the problem.

Defenders of contingent commission arrangements say allegations of steering and bid-rigging abuses caused the industry to abandon an otherwise acceptable practice. Insurance buyers, on the other hand, wonder if and when the reduced commission structure will result in lower premiums.

MORE TRANSPARENCY

Without question, however, the industry has moved in the direction of greater fairness and disclosure. While there is disparity between the large and small brokers, it seems that virtually all brokers now provide more information about practices that might be perceived to sway their loyalties.

At the same time, most insurers have undergone stringent Sarbanes-Oxley Act testing, ensuring that their quoting practices are appropriate and uniform. Finally, corporate risk managers are more sophisticated in their dealings with intermediaries.

It is worth noting that these corporate risk managers still value advice from large brokers. In spite of the allegations hurled at brokers in the past few years, it appears the vast majority of commercial customers have stayed with their original broker since the contingent commission inquiries started.

These corporate insurance buyers seem to be the chief beneficiaries of improved disclosure of broker compensation arrangements. Greater disclosure now enables them to weigh their intermediary's incentive structure against their own objectives and make informed decisions. ■

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Mr. Bonaguro



Mr. Coleman

missions to insurance producers.

The EX Task Force amended the PLMA in December 2004 in an effort to increase the transparency of brokers' compensation. The PLMA, as amended, applies to all insurance producers who receive compensation from the customer, but it specifically exempts reinsurance intermediaries, MGAs, sales managers and wholesale brokers who only act as intermediaries between the insurer and other producers.

The amended act requires that disclosure of compensation be made before the purchase of insurance or when a producer is processing a policy renewal. The disclosure needs to convey to the clients the factors that influence compensation paid to producers. Even as amended, however, the PLMA still does not prohibit the payment of

Major information technology investments can be a key factor in a company's success in the insurance industry, but for many in the business, various personal technology devices are critical to getting the job done. Again this year, we've asked individuals across the industry to tell us about their most essential Tools of the Trade. Thanks to everyone who responded to tell us about your favorite tech tools. Here's a look at some of the items you mentioned.

TOOL: Gateway Tablet "Convertible" S-7200C Notebook with Sprint-Novatel Broadband Wireless Card

MANUFACTURER: Gateway Inc., Sprint-Nextel

WHAT IT DOES: The Gateway tablets feature a display that swivels 180 degrees and folds flat over the keyboard to create a tablet. The Sprint-Novatel wireless card allows users to enjoy broadband-like data transmission speeds when uploading and downloading data to and from a laptop.



WHY IT'S ESSENTIAL:

"It allows for me to have a 'mobile office' without the standard limitations that handheld gadgets impose, or needing to find an Internet source from some remote location to use it."—Patrick A. Tollefsrud, Associated Financial Group

TOOL: Treo 700wx Mobile Smartphone

MANUFACTURER: Palm Inc.

WHAT IT DOES: All-in-one phone with e-mail, organizer and Web browser; Microsoft Windows Mobile; backlit QWERTY keyboard; one-touch access to frequently used applications.

WHY IT'S ESSENTIAL: "Anywhere access to internal e-mail, contacts, calendar and tasks. Plus, this model allows this synchronization to happen without adding expensive third-party applications like BES and Goodlink."—Chris A. Davis, J. Rolfe Davis Insurance



TOOL: HP Compaq nc6220 Laptop Computer

MANUFACTURER: Hewlett-Packard Development Co. L.P.

WHAT IT DOES: Combines mobility and performance in a thin, light design with enhanced security features, allowing users to enjoy performance and productivity on the road.



WHY IT'S ESSENTIAL: "As it's used with Vodafone Mobile Connect HSDPA/EDGE/GPRS data card and as our Intranet is linked to IP telephony, I can handle all I miss when at meetings and work from home and clear e-mails and phone calls even when on leave."—John Bishop, Alexander Forbes Risk Services Ltd.

TOOL: BlackBerry 8703e Wireless Handheld

MANUFACTURER: Research in Motion Ltd.

WHAT IT DOES: Broadband download speeds using EV-DO technology, GPS and Bluetooth-enabled, QWERTY keyboard, high-resolution screen, access to up to 10 supported personal and/or business e-mail accounts.

WHY IT'S ESSENTIAL: "My No. 1 tool at work is face-to-face interaction. When I can't do that, my BlackBerry allows me to deal with appropriate situations immediately via

phone or e-mail. It's also easier to carry around than a laptop."—Gary Plotkin, Hartford Financial Services Group Inc.



TOOL: HP Compaq TC1100 Tablet Computer

MANUFACTURER: Hewlett-Packard Development Co. L.P.

WHAT IT DOES: Flexible design, lightweight, docking with or without keyboard, magnesium alloy case and high-quality digital pen with tether.

WHY IT'S ESSENTIAL: "Lightweight PC that provides all wireless functions and Internet access while traveling. However, the nicest advantage

is that I can substitute the big stacks of paper reading materials I used to carry around in my briefcase with an easily transported device that is about the size of an 8x11 piece of paper and one inch thick."—David Leonard, RSUI Indemnity Co.



TOOL: Kyocera KPC650 Broadband Access/National Access PC Card

MANUFACTURER: Kyocera Corp.

WHAT IT DOES: High-speed wireless data access; high-performance antenna design; seamless SMS text-messaging capability; fast access to corporate applications, e-mail, virtual private networks and browsers via laptop.

WHY IT'S ESSENTIAL: "It provides access to my computer servers, e-mail and the World Wide Web."—Tom Konopka, Noetic Specialty Insurance Co.



IBM and RSA enter end-to-end agreement

LONDON—IBM Corp. has entered into a 10-year information technology services agreement with Royal & Sun Alliance Insurance Group P.L.C.

Under the agreement, IBM will provide London-based Royal & Sun Alliance end-to-end service integration across all of RSA's third-party technology suppliers. The agreement extends the scope and term of a 2001 agreement between the two companies.

The contract covers the operations and support of RSA's entire IT infrastructure including mainframes, midrange servers, desktop computers and e-business services. RSA expects the arrangement to provide cost savings as well as opportunities for improved operational efficiency and customer service.

Under the arrangement, IBM and RSA will share architectural design authority.

Patent awarded to InsuranceNoodle

CHICAGO—InsuranceNoodle Inc. has been issued a U.S. patent for its proprietary Web-based technology platform that facilitates online application and quoting from multiple insurance companies for a variety of commercial insurance products.

The patent, which is effective immediately, is valid until 2024.

In a statement, Kathryn Emmerson, Chicago-based InsuranceNoodle's chief executive officer, noted that technology is at the core of the company's business and said, "Securing this patent validates the vision of the company and the efforts of everyone internally who developed the technology."

More than 2,500 agencies across the United States use InsuranceNoodle's online technology platform.

Lloyds redefines tech role as developer of standards

By Rodd Zolkov

LONDON—It's been more than a year since Lloyd's of London decided to pull the plug on its Kinnect Internet-based risk data platform, but the effort to promote electronic information exchange continues to move forward in the London market.

When Lloyd's Franchise Board announced in January 2006 that it would cease funding the Kinnect effort, which began life in 2003 as Project Blue Mountain, the board said it saw the market's role going forward as being involved in setting standards rather than in developing infrastructure.

A recent move, then, seems clearly in keeping with that view.

Last month, Lloyd's announced that Michael Smith, manager business process reform (claims and standards), was being transferred from Lloyd's to ACORD to support the Assn. for Cooperative Operations Research and Development's London market standards activities.

Mr. Smith is well acquainted with ACORD's efforts. Prior to his transfer, he chaired the organization's Reinsurance and Large Commercial Technical Steering Committee.

According to Pearl River, N.Y.-based ACORD, which opened a London office in 2001, Mr. Smith has spent the past seven years working on the London-market reform program, focusing on claims processes and accounting and settlement. He's also worked with the electronic standards-setting body to shape and improve the data standards, messages and communication technology that form the basis for London-market business process improvement.

Mr. Smith's 22-year career at Lloyd's has involved all aspects of business and information technology projects supporting the insurance business,

including the introduction of the Lloyd's Claims Scheme.

He also was involved in early experiments with electronic claim files, the introduction of electronic data interchange messages for claims advice, and managing an IT department responsible for supporting and developing the central accounting and claims office support and agreement systems. His earlier career included working for various technology companies.

When Lloyd's announced it was ending the Kinnect effort, the franchise board said, "Lloyd's will continue to work with the market in support of electronic trading. It will provide support in developing standards for peer-to-peer systems and hubs."

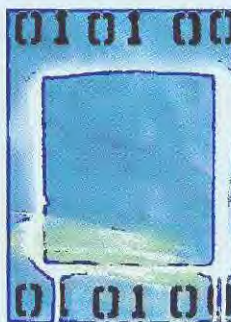
Clearly, that standard setting remains very much on Lloyd's agenda.

ACORD, meanwhile, has become increasingly active in promoting electronic exchange in the London market. In February, the organization announced the opening

of a new testing and certification facility. Using the new facility, ACORD members can test implementations and certify messages for ACORD Document Repository Interface standard adoption.

London-market developers can send ACORD messages to the new facility, which can validate them and send return messages indicating acceptance or errors, streamlining the process, according to ACORD, and increasing certifications and improving communications among business partners.

The ultimate goal of ACORD's new testing facility, as with the organization's other London market initiatives, is to increase efficiency in the market, reduce transaction costs and increase information connectivity between partners in the marketplace. ■





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The big picture: Tech transformation

Over the past decade, the United States has been experiencing a significant surge in productivity growth, nearly doubling its pace since the 1970s. A stock market bubble, terrorist attack and recession notwithstanding, the U.S. economy has enjoyed an accelerating tailwind of businesses producing more per worker per year.

There are numerous examples in various industries:

- **Manufacturing:** A leading truck manufacturer took 102 man-hours to produce a vehicle in 2001; today it takes 48 hours.

- **Retail stock brokerage:** Online trading allows brokerages to process 10 times as many trades per broker per day.

- **Retail:** A large retailer pioneered the use of bar codes, electronic data interchange and then wireless scanning guns to build a 50% productivity advantage over its competitors—and is now leading the implementation of radio frequency identification chips for inventory systems.

- **Banking:** Industrywide, staffing for customer service was reduced by 50% for inquiries handled in call centers and 80% for inquiries online.

In these sectors, new technology—robotics, bar-code readers, sophisticated design software and, of course, the Internet—has played a prominent role in increasing productivity. Some have drawn a causal connection, attributing the last decade's productivity surge to increased investment in—and incorporation of—computing technology.

Yet the property/casualty insurance industry has experienced only modest productivity gains, disappointing for an industry trading in the virtual assets of information and risk, which should benefit the most from technology advances.

The P/C industry has not failed to invest in IT. But on the insurance “shop floor,” underwriters or adjusters are more likely to complain about existing systems impeding their efforts than pointing to them as enhancing productivity.

A series of root causes undermine technology's productivity impact in most P/C organizations, including poor user interfaces that “tax” productivity, system inflexibility that distorts processes, difficult system integration and obsolete platforms generating high

maintenance costs.

The following are clear principals for future insurance IT projects: 1) Include flexibility and extensibility as key requirements. 2) Engage users and user interface experts early in designing or evaluating systems. 3) Select technical architectures designed for integration. 4) Choose nonproprietary infrastructure components that have mainstream adoption.

But these directives are not a roadmap to continuous productivity growth. World-class productivity leaders go beyond these principles through innovative choice and skillful execution of technology initiatives. For them, technology is a tool that enables business innovation.

Studying productivity leaders, a number of patterns emerge:

- **Good data is at the heart of any effective business process.** Productivity leaders first build robust, flexible “systems of record,” then leverage that information across the entire enterprise.

One P/C analogy would be implementing a claims system with a complete and accurate data model before tackling automated fraud detection, system-supported bodily injury evaluation or comparative liability assessments, all of which rely on quality claims data.

- **Lasting structural benefits require core investments extending well beyond the typical three-year planning horizon.** A shortsighted, quick-hit orientation may achieve incremental benefits, but will never bring about the major process changes that boost productivity and create competitive advantage.

- **Technology innovation should not only accelerate existing processes, it should transform them.**

In the P/C industry, many technologies have been implemented with little vision of how they could improve core processes. Instead, technology should be implemented to enable core process innovation.

Across the P/C industry, obsolete systems constrain productivity. That doesn't mean every massive IT project is a good one, but it does imply that tactical enhancement alone is a recipe for mediocrity. Insurers must take a strategic approach that goes beyond just updating technologies that support existing business processes if they want to achieve long-term productivity and profitability.



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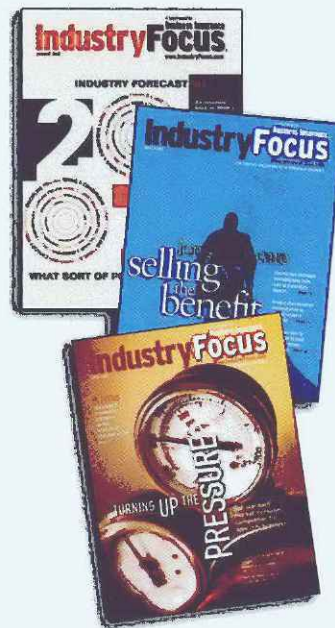
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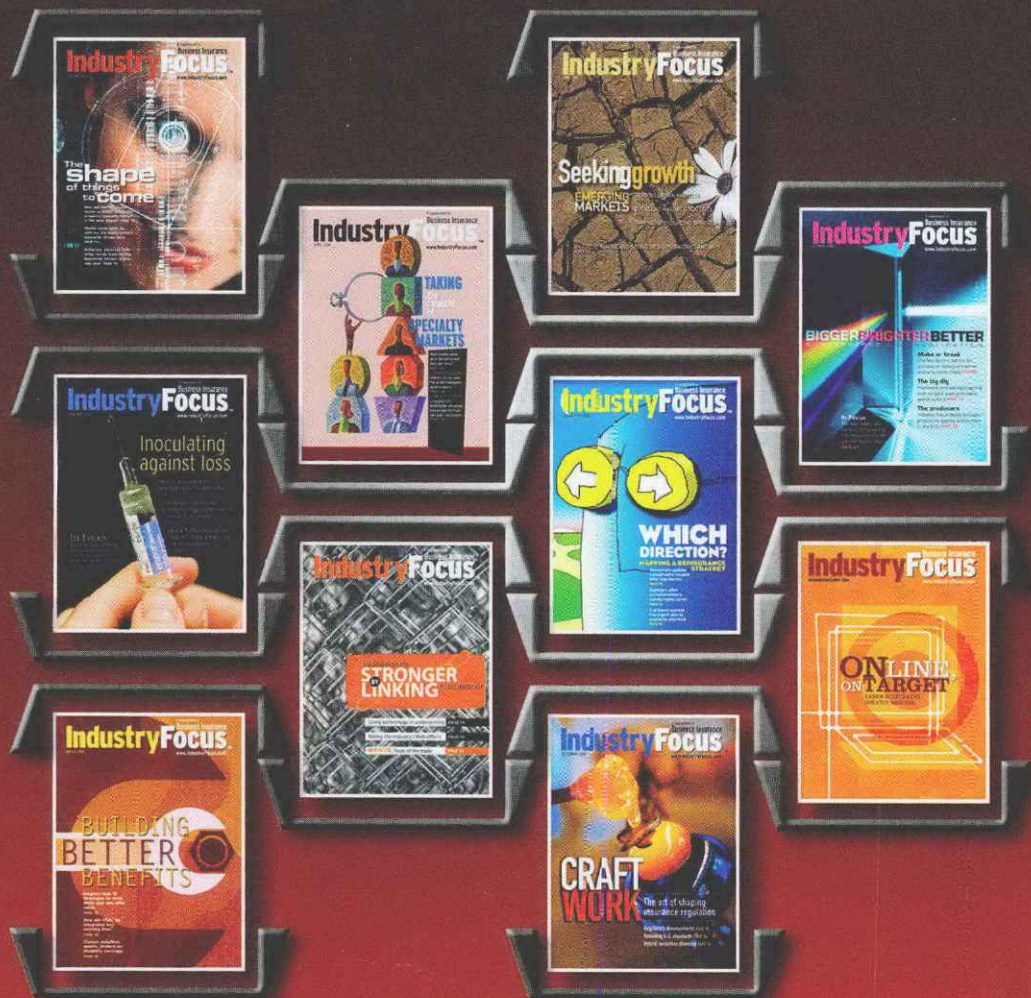
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