OCTOBER 30, 1992

Business Insurance

Reporting weekly for corporate risk, employee benefit and financial executives/ $25.00 a copy; $80 a year

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ANNIVERSARY SPECIAL

25

THE PEOPLE • THE EVENTS • THE TRENDS

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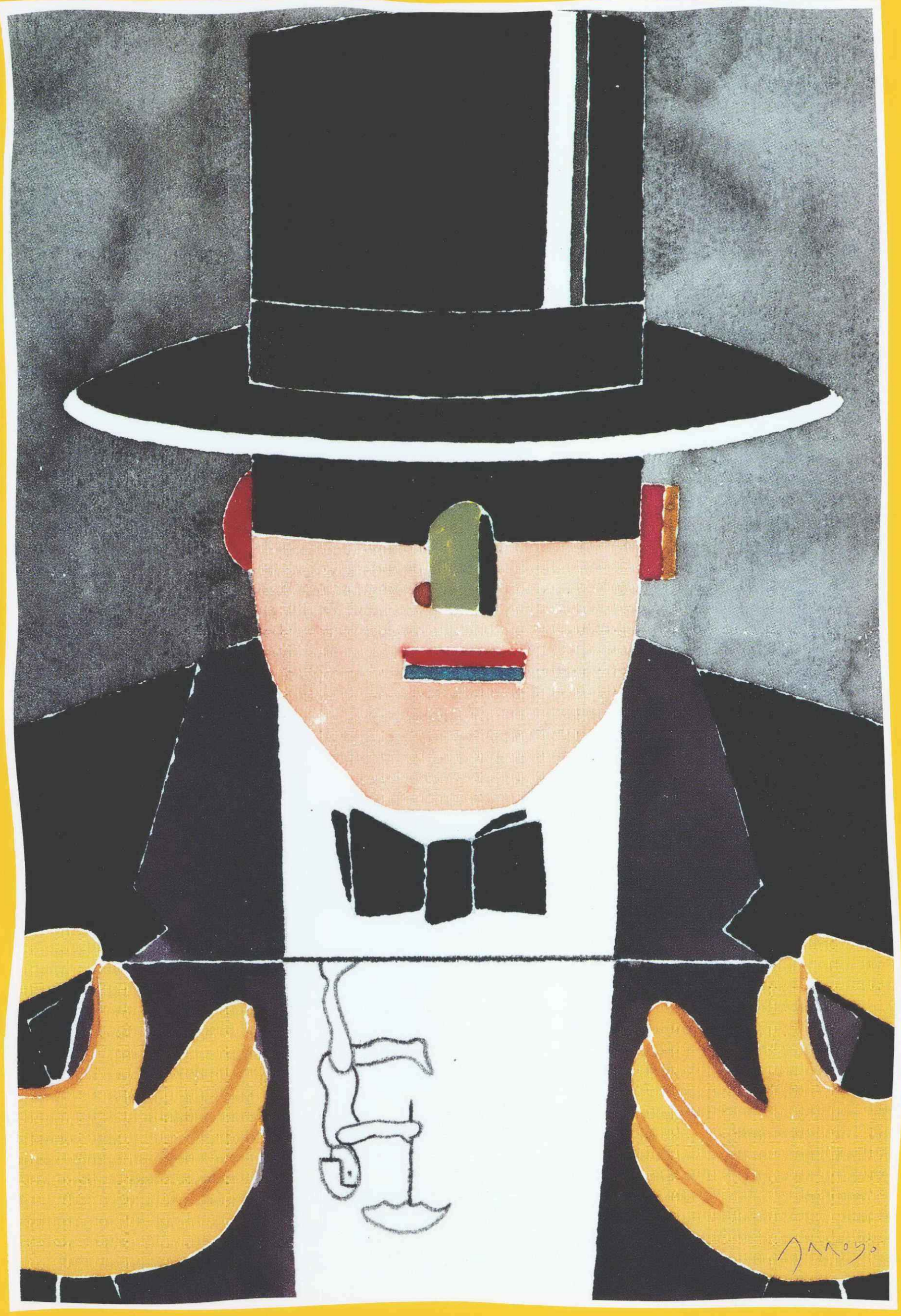
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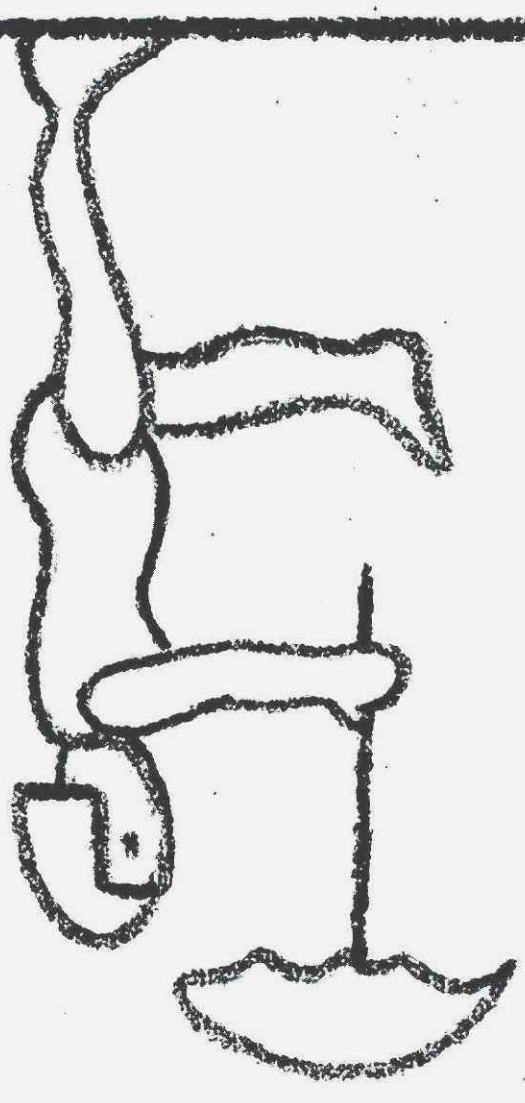
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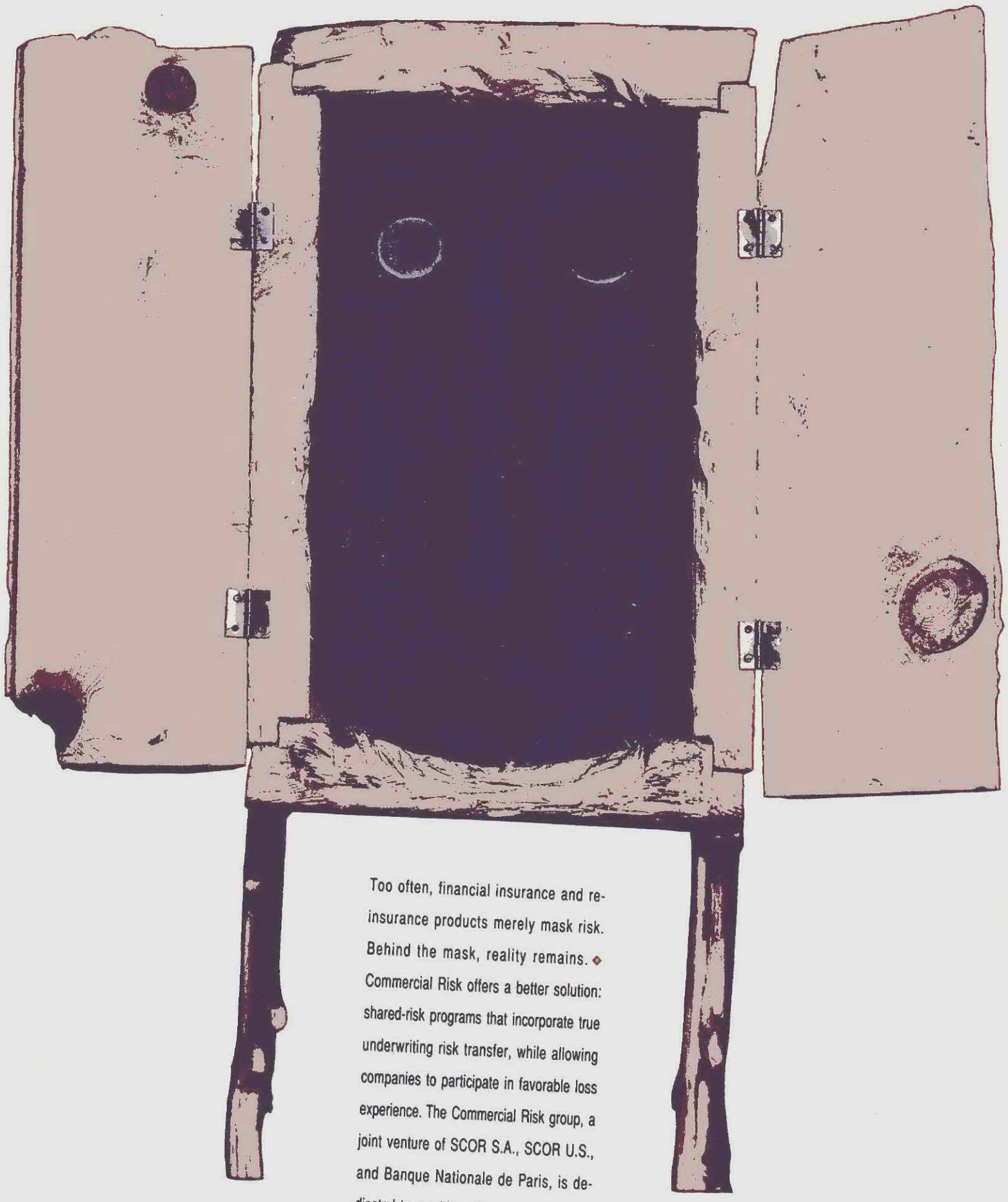
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CONTENTS

Features

20 Doctor, the Patient Is Critical
The U.S. health system is at a crisis stage; how did it get there?

38 No Longer an 'Alternative'
Captives, self-insurance have changed the shape of risk financing

58 What Comes Down Must Go Up?
The rhythm of the property/casualty cycle may be changing

66 Benefit Managers' Balancing Act
Employers offer a higher level of benefits—at a much higher cost

84 Handshake Agreements No More
Neither insurers nor policyholders are victors in coverage disputes

89 A Picture's Worth a Thousand Words
A gallery of barbs and brainstorms from *BI*'s editorial cartoonist

98 Extinguishing Loss Control Apathy
Technology has advanced more quickly than safety awareness

103 London: Then and Now
Catastrophe losses, capacity crunch made headlines in '67

112 New Kid on the Block
Corporate America adopted managed care to control costs

117 Whaddya Know?
Test your knowledge of the events of the past 25 years

121 From Deliverymen to Problem-Solvers
Brokers now stress service to policyholders, not just sales

126 Risk Managers of the Year
Award-winning professionals discuss what it takes to excel

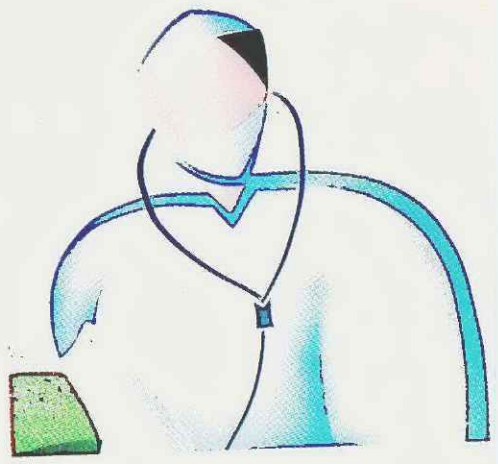
136 Workers Compensation Woes
A sound concept now is beset with overwhelming problems

145 Earth, Wind and Fire
Increase in catastrophe losses spells disaster for insurers

152 A Laughing Matter
Celebrating our 25th anniversary with a smile



Page 145



Page 20



Page 126



Page 89

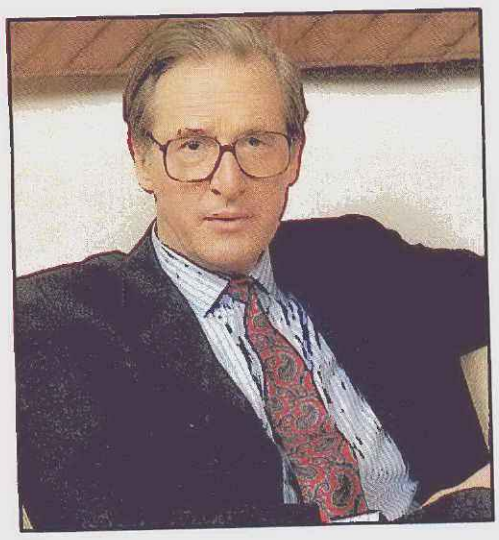


Page 84

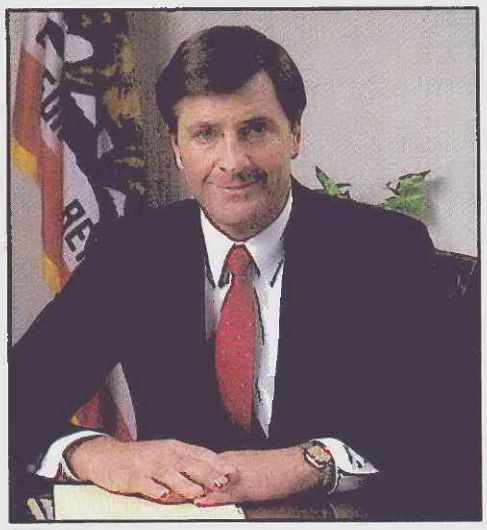
Columns

4 James M. Burcke
6 Kathryn J. McIntyre
8 Alfred Malecki
9 Rance Crain
12 Jerry Geisel

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Page 29



Page 132



Page 146

Conversations With:

26 Alain C. Enthoven

29 Sen. John D. Rockefeller IV

32 Dr. John M. Burns

50 James V. Davis

54 Steven M. Gluckstern

63 Rolf F. Hueppi

78 Harry Conaway

80 Fred Hamacher

88 Judge Jack B. Weinstein

92 Joan T. Claybrook

96 Jean Evans

100 Michael Burke

104 Richard Outhwaite

108 Theodore Benna

115 Dr. Paul Ellwood

116 Dr. Robert J. Becker

120 G. Robert O'Brien

124 Robert Clements

131 Douglas Barlow

132 John Garamendi

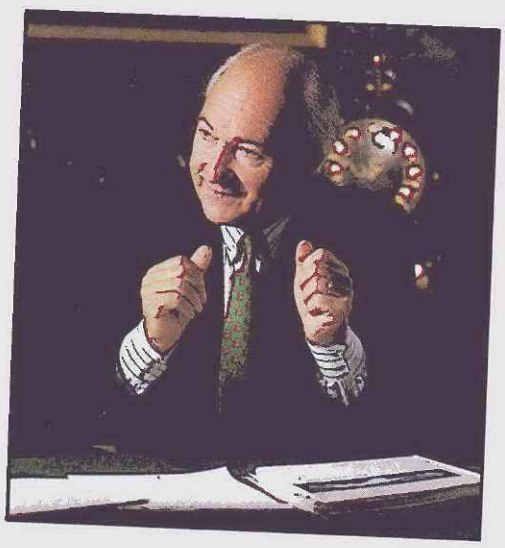
138 John F. Burton Jr.

142 E.J. Leverett

144 Robert E. Vagley

146 Diana J. Scott

148 Patrick Peugeot



Page 63

Looking Back

16 1967

27 1968

30 1969

36 1970

46 1971

52 1972

56 1973

62 1974

64 1975

73 1976

82 1977

90 1978

94 1979

101 1980

106 1981

110 1982

118 1983

125 1984

129 1985

134 1986

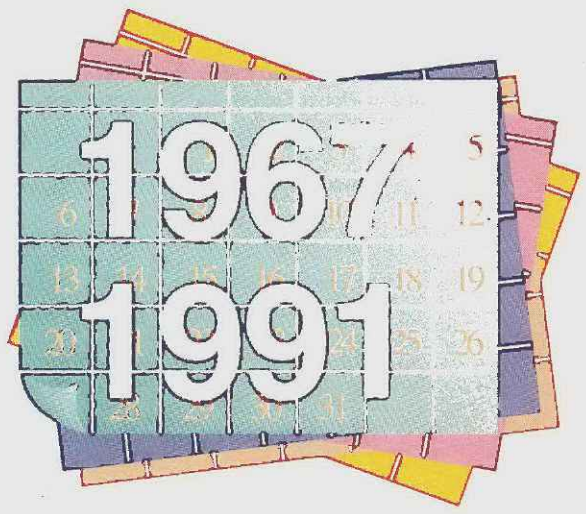
139 1987

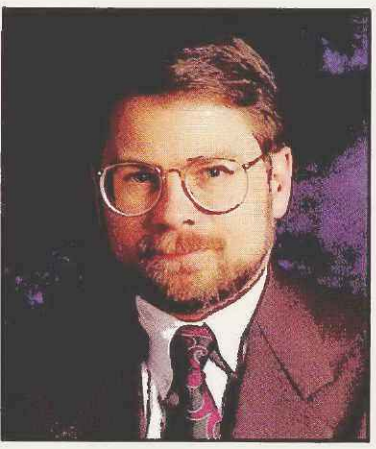
143 1988

147 1989

149 1990

150 1991





James M. Burcke

Our Anniversary Gift to You

You may have noticed by now that this is no ordinary issue of *Business Insurance*. The cover looks a little strange; there's no news on the front page. . . .

We at *Business Insurance* wanted to do something a little different to celebrate our 25th anniversary. While we have taken note of our previous milestones—our 10th anniversary in 1977 and our 20th in 1987—by publishing special sections within regular weekly issues, we decided to pull out all the stops this year.

So here's an anniversary gift from us to you: a special issue in addition to your regular weekly copy of *BI*.

When I started to plan this issue, I must admit I did what the editor of any other publication would do: I grabbed every other anniversary issue I could find with the intent to borrow the best ideas.

Through my "research," I discovered that newspapers and magazines commonly take one of two approaches when celebrating an anniversary: Some focus on the publication's own history (I call this the pat-on-the-back approach), while others review every event that occurred during the past however-many years (the Cliffs Notes approach).

I quickly rejected the former. While we have an interesting story to tell, that's not why you subscribe to *BI*. Except for the thoughts from Kathryn J. McIntyre, Alfred Malecki, Rance Crain and Jerry Geisel on the next several pages, you won't read much about us.

You can read about the past: Scattered around this issue are snapshots of each of the past 25 years that we've called "Looking Back." If it is indeed true that you can learn a lot about the present and the future from looking at the past, you'll want to read these. I never realized New York was considering limits on fronting programs—in 1978. And, I had forgotten there had been a big push for national health care—during the Nixon administration.

But we wanted to do more than simply review the events of the past 25 years.

To dig deeper into the world of risk management and employee benefits over the past quarter century, individual *BI* reporters spent months interviewing movers and shakers. The result of their efforts are analytical articles that put in perspective the biggest trends since 1967: the health care cost explosion, the evolution of risk financing alternatives, the crisis in workers compensation, the often-heated legal battles between policyholders and insurers, to name just a few.

In addition, you'll find in-depth interviews with 25 people who have made their mark on risk management, employee benefits or commercial insurance over the past 2½ decades. You undoubtedly will have heard of some; others may not be as familiar. You will find that all 25 are thoughtful, incisive and very opinionated—even if you don't agree with all of their opinions!

Finally, you'll find surprises along the way. Some might make you laugh and others will make you think.

By looking back this way, we hope we can make the future a little bit clearer.

While trying to condense "the people, the events and the trends" of the past 25 years was a tough job, I am very happy to say the *Business Insurance* staff was up to the task.

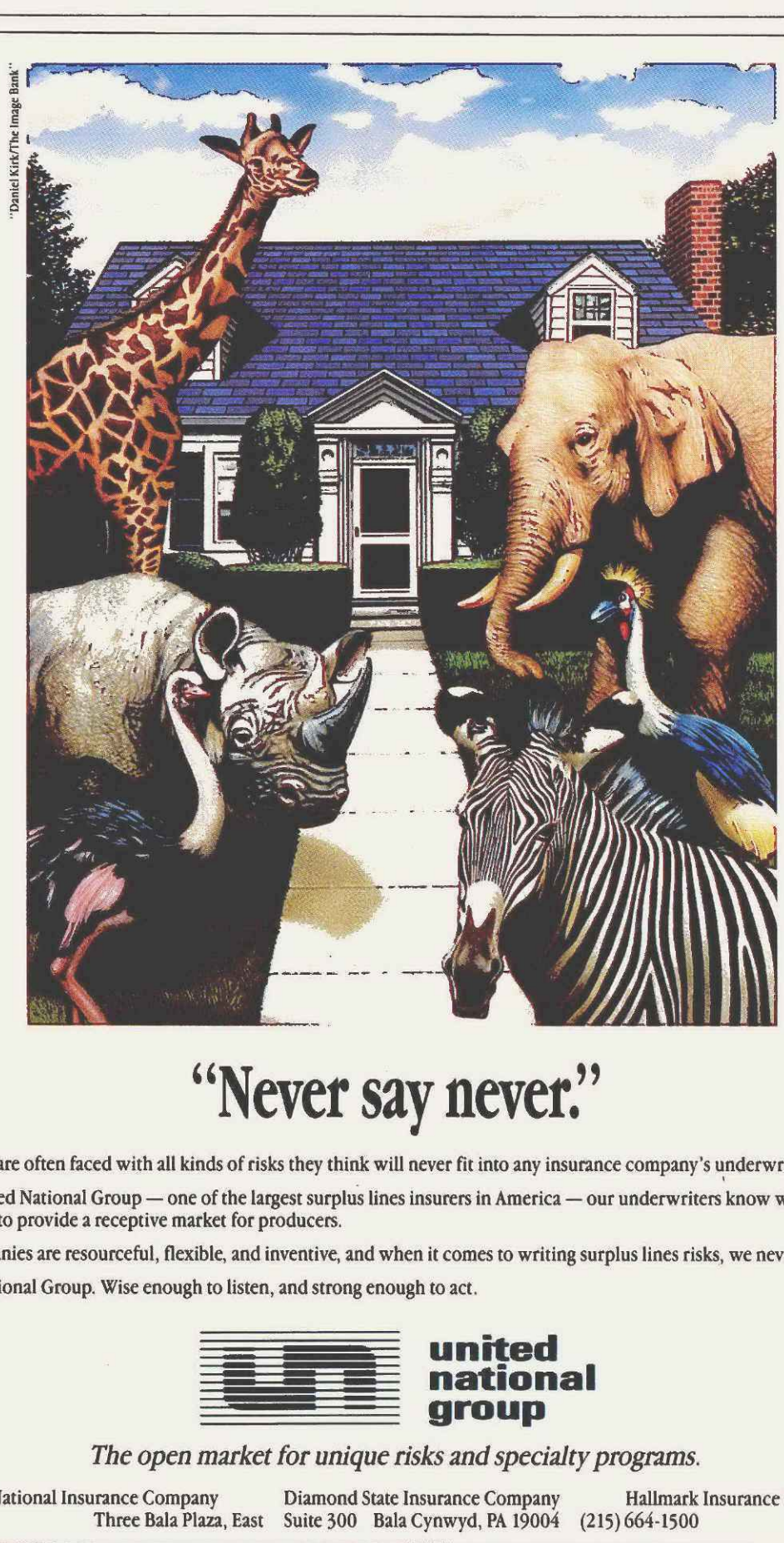
It's difficult for any journalist to report on a specialized industry, and risk management and employee benefits are no different in this respect. Reporters and editors cannot thoroughly cover the news unless they truly understand the issues. *Business Insurance* is fortunate—maybe "blessed" is the better word—to have those kinds of reporters and editors on staff.

The 31 editorial staffers listed on page 2 of this issue have a combined total of nearly 175 years of experience at *Business Insurance*. Two—Kathryn McIntyre and Jerry Geisel—have been with *BI* more than 15 years, while three others—Stacy Shapiro, Douglas McLeod and myself—have been on the staff for more than 10.

I think you'll be able to gauge the *BI* staff's experience and their understanding of the issues by the quality of the articles and interviews in this issue.

So, I hope this is not a "special" issue in one respect. *Business Insurance* strives to report the news fairly, accurately and clearly each week. While I'm proud of our anniversary issue, I'm just as proud of every other issue delivered to your office or home.

Of course, what's really important is what *you* think. I would like to know what you think of our anniversary issue, but I also want to know how we're doing all 52 weeks of the year. I invite you to call or write with your comments and suggestions about how we at *Business Insurance* can do a better job covering the news during the next 25 years. BI



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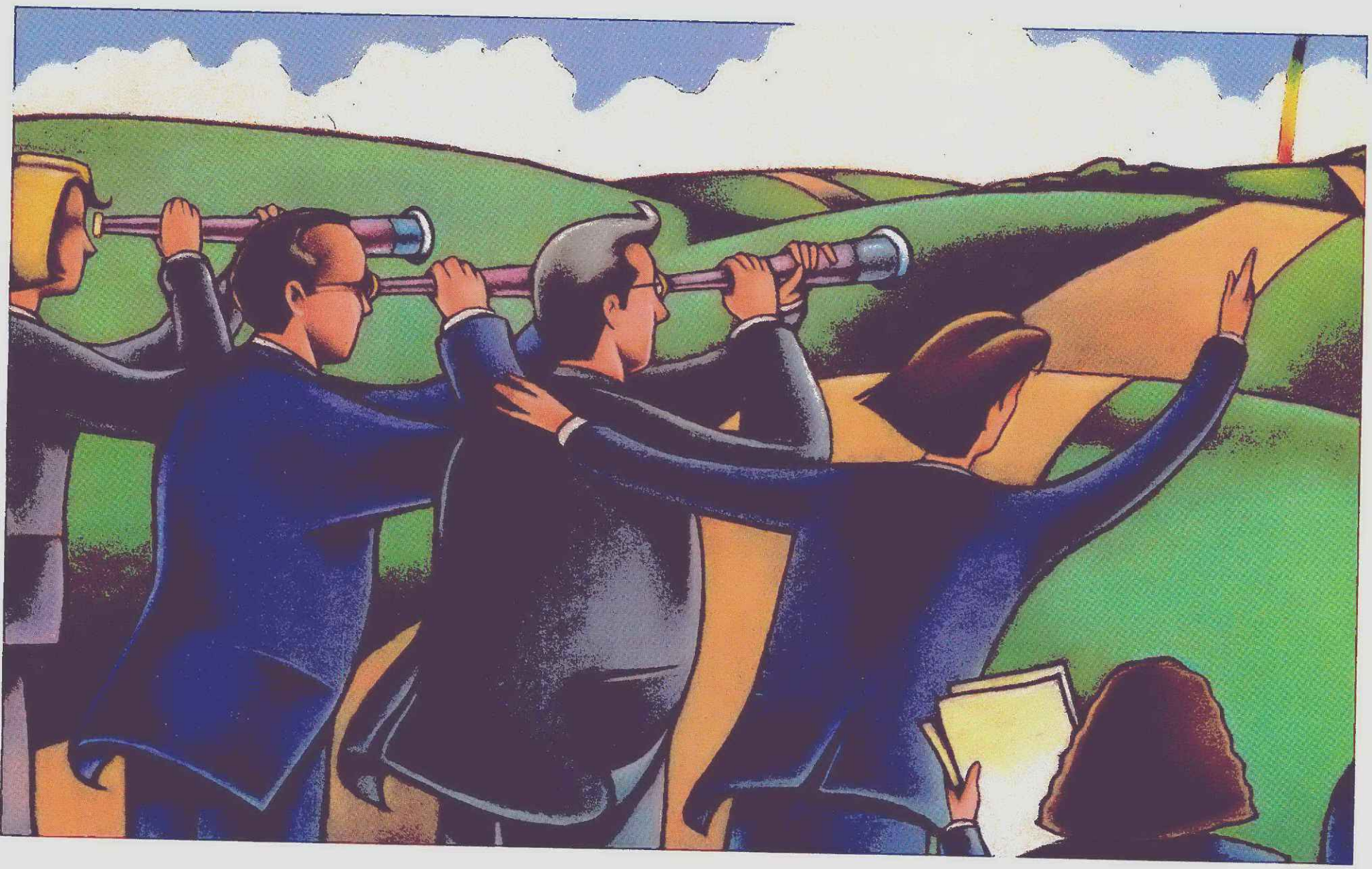
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Kathryn J. McIntyre

Covering the Community

"You can't print that." *Business Insurance* reporters have heard those words repeatedly over the 25 years that we have been publishing this newspaper.

You may even be among the people who have told us that on occasion.

Underinsured losses. The purchase of back-dated liability insurance. Clients switching brokers, insurers or reinsurers. Shake-ups in managements. The mismanagement of insurers into insolvency. Brokers and underwriters ripping off the system.

Many would prefer that the details of these stories never see print.

But we *do* print what some people don't want us to print, which I believe is an important reason why we're fortunate enough to be celebrating our 25th anniversary with this special edition.

As G.D. Crain Jr., the founder of our company, Crain Communications Inc., and creative genius behind *Business Insurance*, once wrote: "We have only one test by which our editors, reporters and correspondents are guided: First, is it news, and second, are the facts given accurately and fairly?"

In our 25 years of publishing, we have tried to always pass that test.

It wasn't always easy, especially in the early years of *Business Insurance*. We were regarded with suspicion, and as a result, we did not always have access to the people who knew the most about an event or an issue we were reporting.

Eventually, the persistence and professionalism of *Business Insurance* reporters won the trust and cooperation of the people we needed to become a more insightful and more valuable publication.

We're often asked how we define "news." Our answer: Whatever the executive responsible for risk management or employee benefits needs to know on Monday morning to do his or her job better.

We see ourselves as a community newspaper. Instead of being defined by geography, the community that *BI* serves is defined by its common interests in risk management, employee benefits and commercial insurance issues.

Just as a community newspaper covers its citizens, *Business Insurance* covers its readership. We report on the triumphs and the failures, moments of glory and moments of embarrassment, great leaps forward and backward stumbles.

This community certainly has had its share of all of these over our 25 years of publication, many of which are chronicled in this issue. And this community can be proud that its triumphs, moments of glory and great leaps forward have outpaced the failures, embarrassments and setbacks.

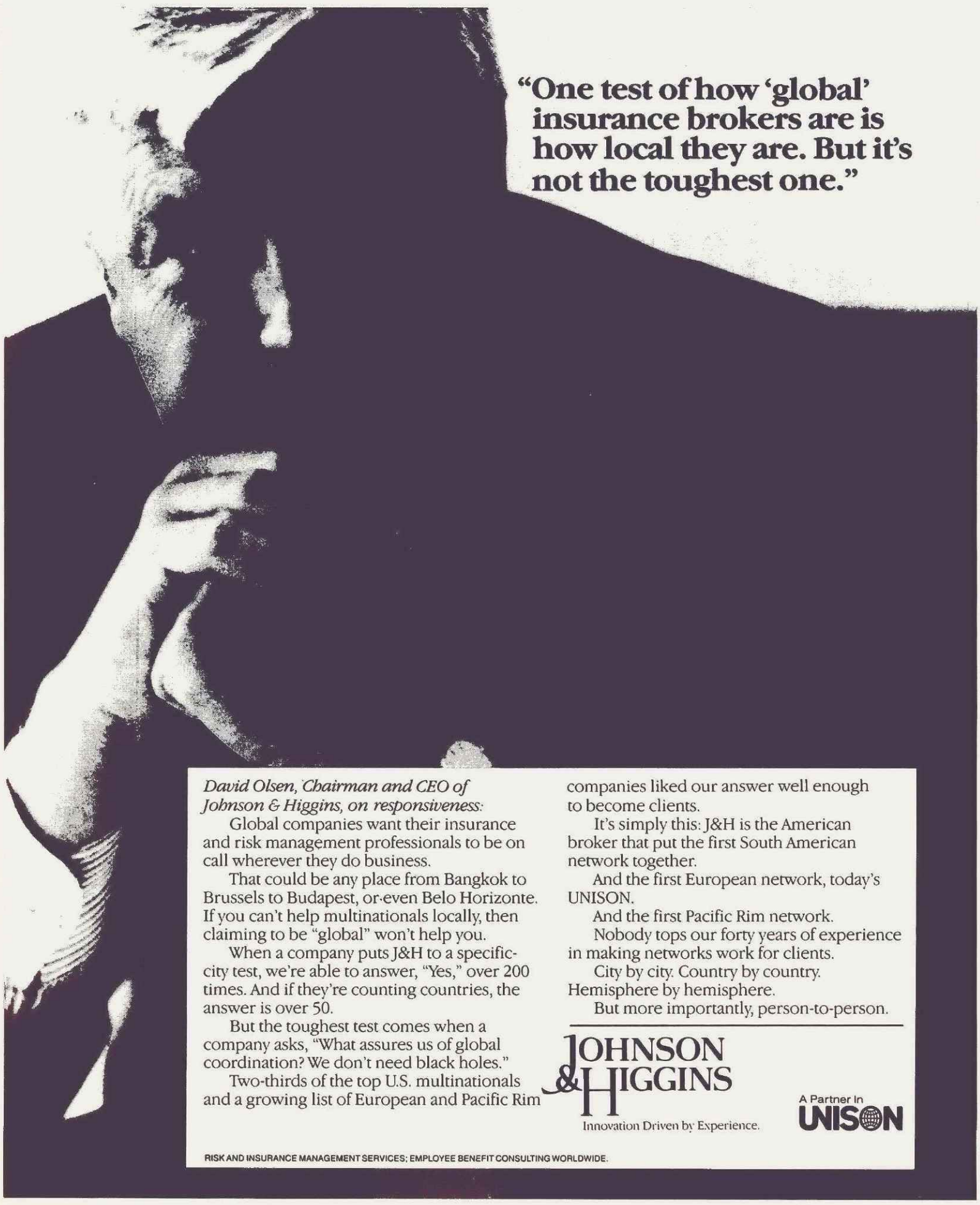
The success of the alternative risk financing market, for example, far outshines the failures of captive insurers that underwrote unrelated business and went broke. Women advancing in risk management, reflected in Cheri Hawkins' election as the first woman president of the Risk & Insurance Management Society Inc. in 1990, left behind the era when women were expected to file insurance policies, not manage risk. The nomination of Douglas Barlow as the first risk manager in the Insurance Hall of Fame in 1990 left no doubt that risk management is far more than buying insurance.

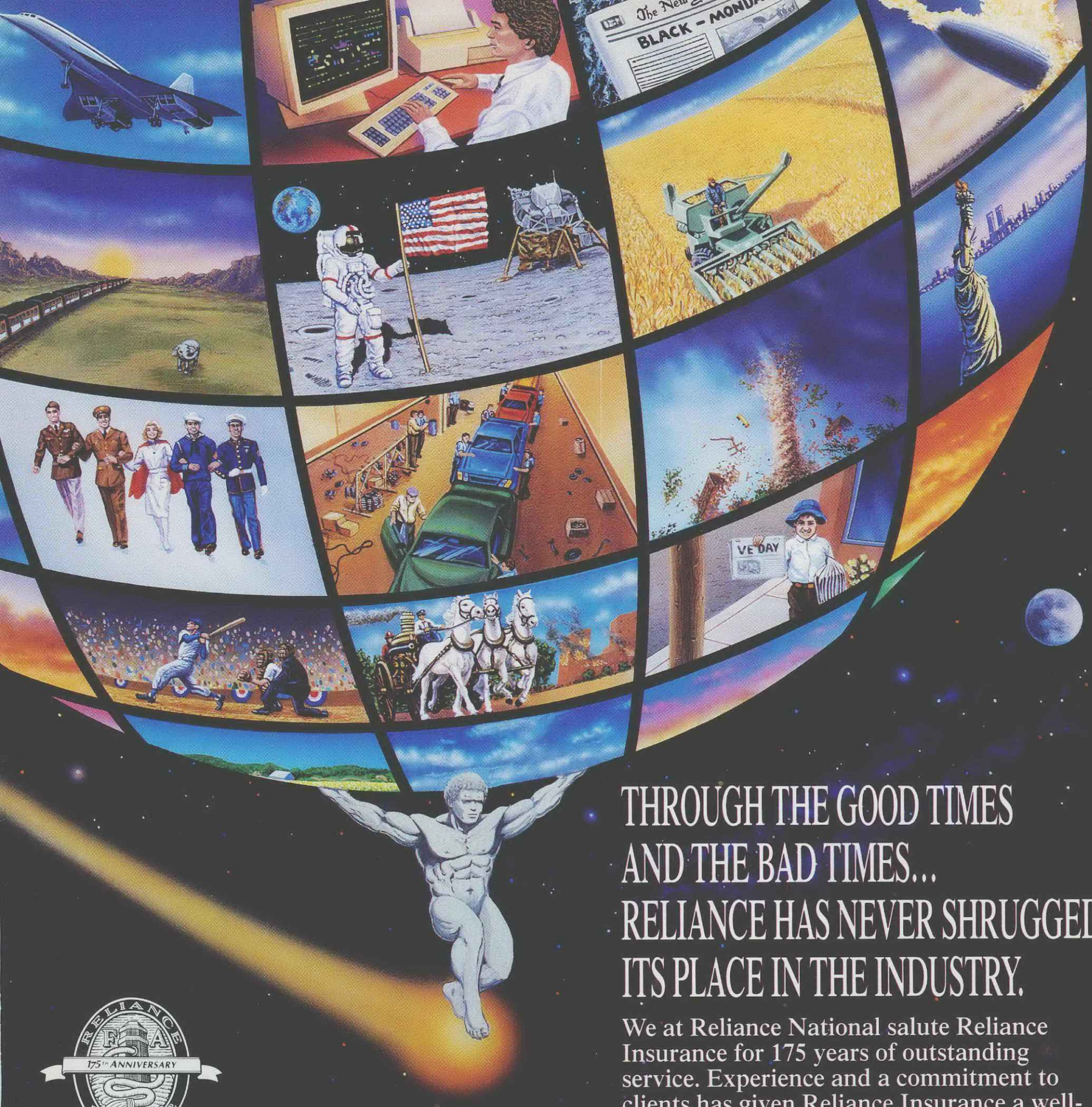
Employee benefit managers, meanwhile, have succeeded in driving the development of managed care, which certainly will be a key component in solving the problem of our nation's uninsured. Creative employee benefit managers introduced 401(k) plans and then fought against their repeal during the Reagan administration, guaranteeing more Americans would save for a more comfortable retirement. Work and family benefit plans promoted by far-sighted benefit managers are responding to the needs of two-career couples who must balance their work and family responsibilities.

As we look ahead to the next 25 years and beyond, we expect many of the general issues will be similar—seeking efficient risk financing, maintaining fair and affordable employee benefits, providing safe and productive work sites. The complexities of the challenges, however, will grow, and the solutions will be more creative.

Indeed, the increasing complexity of the issues at hand, the growth in the professionalism of executives in risk management and employee benefits, the restructuring of the commercial insurance business and the new leaders emerging make this an exciting community for this newspaper to serve.

As we celebrate the 25th year of our publication, we know we'll continue to hear, "You can't print that." But we pledge we will, if it's news. And when we print it, we promise it will be fair and accurate. BI





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Alfred Malecki

2½ Decades of Milestones

In the fall of 1966, my boss at Advertising Age asked if I would be interested in becoming advertising director of an insurance periodical to be started by our company, Crain Communications Inc. Since I knew next to nothing about insurance, I quickly said yes.

Over the years, I have had no reason to regret my decision.

G.D. Crain Jr., the company's founder, had years ago hatched the idea of a news service for buyers of insurance, realizing that practically all insurance periodicals were aimed at industry professionals, not policyholders. Rance Crain, G.D.'s son, was chosen to be the first editor.

Rance and I set out to investigate advertiser interest. Our credentials as successful and reputable publishers were known to insurance executives who placed advertising, most of whom were Advertising Age readers. Rance was a senior editor at Ad Age and I eastern advertising manager. We had no trouble getting appointments.

But the first two executives we saw were extremely negative. They questioned the need for yet-another insurance magazine, as well as our ability to obtain enough news to fill a biweekly.

We persevered and found an underlying dissatisfaction with the quality and editorial integrity of much of the insurance press of the time. We also found that those magazines had little to offer risk and benefit managers. And we found that there was a large enough advertising potential to give our investment a good chance for success. We talked endlessly to industry executives, and the more we heard, the better we thought our chances were.

The board agreed. Sid Bernstein, the company's president, shook my hand and said, "Congratulations. You are our new advertising director. How many ad pages can you sell the first year?"

We had not considered this question since no advertising prospect list had even been drawn up. When I hesitated, Sid suggested that as ad director, I should have some idea. "200, 300, 400, 500 pages?" he asked.

So I chose 400. In our first full publishing year, we had 442 ad pages.

Our first regular issue was dated Oct. 30, 1967. Some advertisers were not used to our brash, aggressive and sometimes confrontational style of journalism. One of the largest—which had committed a full schedule of ads for 1968—canceled almost immediately over a somewhat unfavorable story.

But, we stuck to our guns and eventually gained the respect of the insurance community without sacrificing our editorial integrity.

By the end of 1969, we had lost a substantial amount of money, having staffed the magazine well and having spared no expense on reader and advertiser services. *BI* dominated the agendas of monthly board meeting.

Once, G.D. Crain, who had expected much faster success, was about to abandon the project when Sid Bernstein interrupted: "Of course we will continue to publish *Business Insurance*, but we will make adjustments in the budget and cut our costs."

Sid's timely intervention saved *BI* from the ash heap of history.

I was appointed publisher as of Jan. 1, 1970, and we nearly broke even that year. We made back our entire investment in the next two years.

As I look back over the years, there are some milestones worth mentioning. When Rance left as editor to become corporate editorial director, I appointed then-Managing Editor Richard Bjorklund to the editor's post. When he left the company, Steve Gilkenson, who headed the eastern editorial staff, succeeded him. Steve was succeeded by Susan Alt, who had been managing editor, when he became publisher of Pensions & Investments, a direct offspring of *BI*.

In 1980, we doubled *BI*'s frequency to weekly. Kathryn McIntyre had joined the staff three years earlier. Because of her talent, she quickly rose to managing editor. When Susan Alt resigned at midyear to become a consultant, I appointed Kathryn editor. Kathryn's contribution to the editorial quality, timeliness and accuracy has been widely recognized in risk management, employee benefits and insurance circles.

Also in 1980, Associate Editor Stacy Shapiro volunteered to move from Chicago to London to cover that market, rationalizing that the correspondent we had used could not cover the market as well as a full-time staff reporter. She moved in 1981, and the rest is history.

Likewise, we pioneered coverage of insurance in Bermuda.

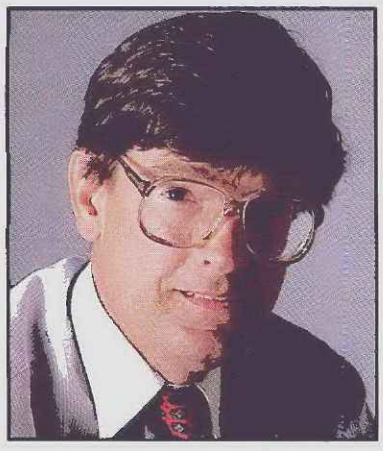
Our Risk Manager of the Year Award is one way we try to earn greater recognition for risk managers from top managements as well as the brokerage and underwriting communities.

I retired from Crain at the end of 1991. Kathryn has succeeded me as publisher, Jim Burcke has succeeded Kathryn as editor and many others have been promoted. They also created a new position of editorial assistant, giving credence to the old saying: "In a well-run company, when the president resigns, they hire an office boy."

I see a perpetuation of the *BI* culture I nurtured and under which we tried as much as possible to promote from within. And, that's the way it should be. BI

Sunday Afternoon Workers' Comp

Access the Alternatives with



Rance Crain

BI: From the Beginning

While we celebrate the 25th anniversary of *Business Insurance*, the idea for the publication goes back 75 years.

My father, G.D. Crain Jr., was a reporter and editor for the old Louisville Herald in the early 1900s. Using some of the contacts he made at the Herald, he started a business news service that acted as the Louisville correspondent for more than 100 business publications.

One of the publications Dad wrote for was the Western Underwriter, now the National Underwriter. Working for the Western Underwriter gave Dad a bonus: the idea for a new publication, an idea he kept on ice for 50 years.

Dad thought it was unfair that corporate insurance buyers didn't have a publication edited for them. The *sellers* of insurance had their own publications; why not one for the *buyers*?

Cut to a cold winter day in Chicago in 1966. I was working as a reporter for Advertising Age in New York and was home for the holidays when Dad asked me, "How would you like to be editor of a new insurance publication?" I thought it offered a good chance for advancement, so I enthusiastically accepted.

I will be the first to admit I knew nothing about insurance (I spent the first day on the job trying to learn how to spell Marsh & McLennan). But many of the publishing principles I learned would come into play.

Most insurance publications of the day covered only personnel changes, speeches, and mergers and acquisitions. We set out to reflect how developments in the world at large affected insurance buyers.

Looking back, some things haven't changed much since we started. Our opening editorial talked about the capacity crunch created in the aftermath of Hurricane Betsy. John D. Phelan, president of American States Insurance Cos., at the time predicted: "If Hurricane Betsy cost $600 million in 1965, then certainly we must expect a billion-dollar storm in the 1980s or '90s."

I'm very proud of the lineup of contributing editors we put together, including Bion Francis of Crucible Steel, Donald Berry of Borden Co., Charles Levinson of the Port of New York Authority, Carl Vogt of General Tire & Rubber and Ross Cowan of Fireman's Fund. Their writings on varied insurance topics helped give our fledgling publication credibility and respect.

We got letters, lots of letters. R.C. Wall of Firestone Tire & Rubber Co. wrote: "We are quite impressed with *Business Insurance*, especially due to the fact that the newspaper format allows you to present the insurance news in a much more spectacular manner than is done in the normal industry-type magazine."

A bit too spectacular for some readers. I took more than one irate phone call from readers accusing us of taking what they said and blowing it up in a headline. Risk managers weren't accustomed to dealing with reporters and didn't realize that we take the most important thing our sources say and build a story around it.

We went under the assumption that everything had an insurance angle. Because most of our reporters had general news backgrounds, they were good at finding the insurance angle in events like the World Series or a hit stage play or Expo '67.

Robin Menz (now Robin Suhrbier and living in Cohasset, Mass.) was the first person I ever hired. She was a reporter on the Newport News, Va., Daily Press. "The only thing that scared me was wondering what this insurance stuff was all about," Robin remembers. "As far as I knew, the only insurance which existed was car insurance. But I figured I would learn, and I was very relieved when I saw that Rance didn't know much more than me."

Our reporters made a great team. There was George Young, a street-smart, hard-nosed guy with a sardonic sense of humor; Bill Guest, a dapper Englishman who worked for a San Francisco brokerage—I remember he almost broke down our doors saying, "This job is made for me," and it was; Lou Haugh, who wrote about marketing for the Chicago Tribune—he's now a successful sales executive; and Dick Bjorklund, our managing editor who somehow kept our paper coming out on time. Later, we hired Steve Gilkenson, the TV critic for the Providence Journal, as our Eastern editor. They did an outstanding job.

Sometimes we made things hard on ourselves. Earlier on, our marketing people put out a brochure that said, in effect, that no publication, "with one minor exception," covered insurance from the buyer's perspective. That "one minor exception" was the magazine published by the then-American Society of Insurance Management. Ron Judd, managing director of ASIM, took serious exception to our statement. Ron and I had more than a few friendly disagreements, but I think we ended up with great respect for one another. And there's no question he contributed greatly to the professionalism of risk management.

Robin believes that we "put insurance in the news and opened up the doors of corporate risk managers, safety directors and benefit managers. . .We provided a whole new realm of information geared to the corporate buyer of insurance."

And we had whole a lot of fun doing it. Thanks to everyone who helped us along the way. BI



It's Sunday afternoon, and while some rest, others go to work. What is viewed as a game to spectators is, in fact, serious business to those involved.

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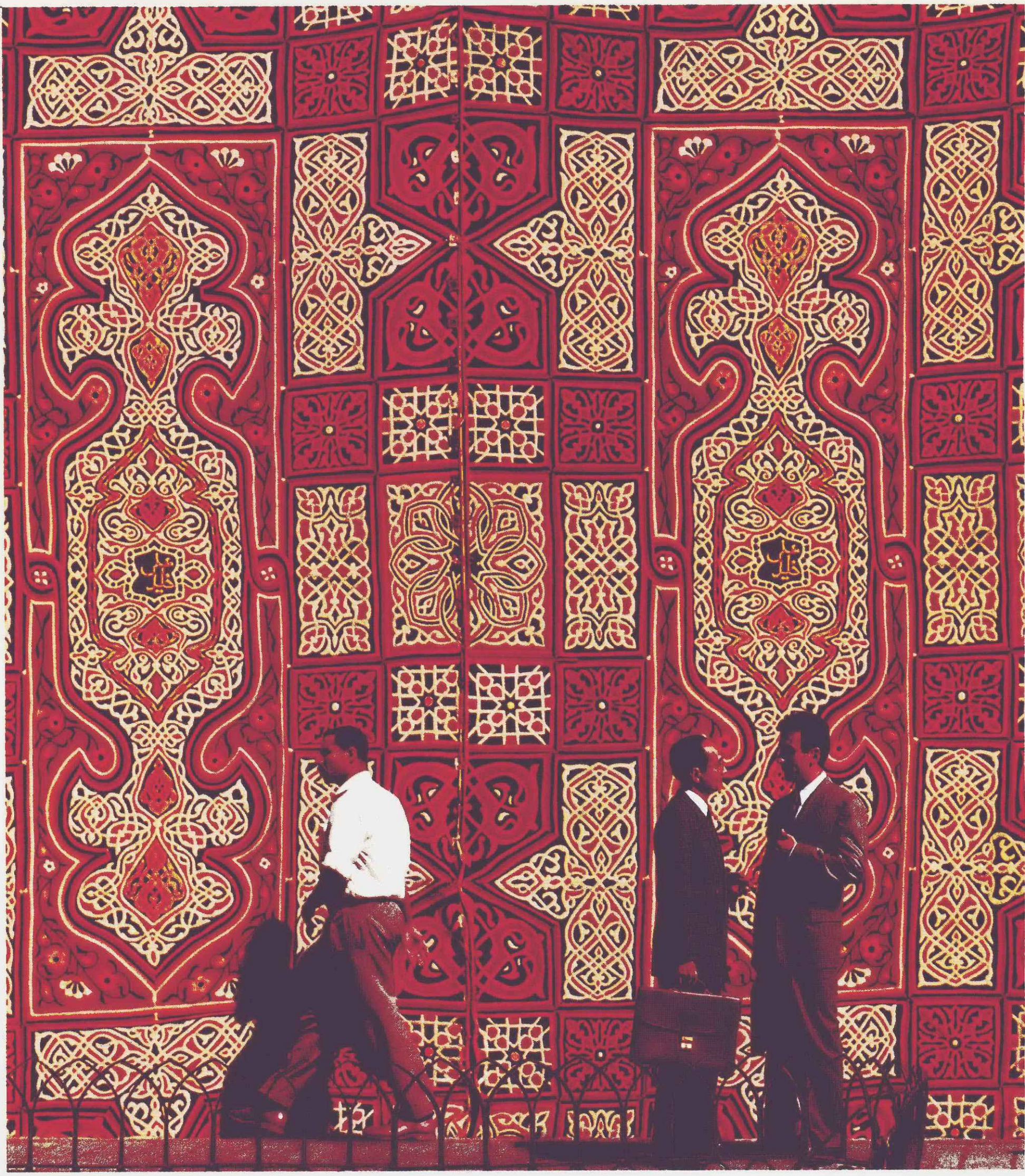
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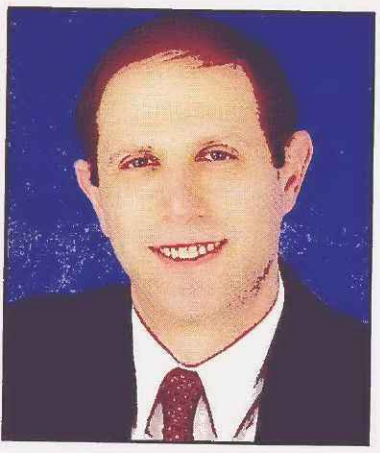
WHEREVER YOU DO BUSINESS AROUND THE WORLD, WE'RE PART OF THE LOCAL FABRIC. *At the AIG Companies, our business takes us from the canyons of Wall Street to the marketplaces of East Asia to the bazaars of the Middle East. But there's more to being global providers of insurance than just being a long way from home. AIG traces its roots*



to Shanghai in 1919, and today our network stretches across 130 countries and jurisdictions. We hire local managers who understand the business practices and needs of their own markets. If you're a multinational company doing business in today's fast-changing world, you need our unique global reach and global experience.

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Jerry Geisel

Never a Dull Moment

Shortly after I joined *Business Insurance* in 1977 as a reporter in Washington, I had lunch with Dick Fay, a benefits attorney who helped draft the Employee Retirement Income Security Act when he was a congressional staffer.

It was a shame, Dick said, I had just started out in Washington. The real excitement in benefits, he declared, was over with the passage of ERISA in 1974. Now, all that remained ahead was the development and publication of numerous ERISA-related regulations, not a very exciting prospect. Perhaps the news would be more interesting on my risk management beat.

Dick Fay, who died in 1989, was right about so many things—but wrong this one time. The real excitement in covering employee benefit issues in Washington was yet to come.

My very first major benefits story, legislation known as the Pregnancy Discrimination Act, broke soon after I started at *BI*. It was the first of what ultimately became a parade of legislative proposals I would cover.

Covering important legislation always is exciting, but it was especially so in my first few years.

In those days, the legislative process was much more open. It was actually possible, as I can recall with the Pregnancy Discrimination Act, to cover the introduction of the legislation, the hearings on the bill, the committee votes on the bill and ultimately its final passage.

If something wasn't clear, I could quickly reach a committee staffer by phone for an accurate and honest answer.

At some time—it's hard to say exactly when—the process became much more closed. Benefit proposals were tacked onto huge tax and budget bills. They never got the public scrutiny they needed.

The expression "decided behind closed doors" regrettably became the rule, not the exception.

For example, the most important step leading to the enactment of the 1986 tax law—the conference committee deliberations where the final version of the infamous Section 89 provision was drafted—was closed to the public.

To me, it's no surprise that so much bad benefits legislation is enacted that must be fixed after the details become public. Proposals debated behind closed doors don't get the analysis and comments from the group they most often affect: employers.

If the legislative process were more open, there would be no need for the "Gucci Gulch," named for the expensive footwear of the lobbyists who line the corridors of the Longworth House Office Building.

But I don't mean to be all gloom and doom. Certainly, there have been encouraging developments.

In 1977, employers really didn't have strong organizations representing them on benefit issues in Washington. Now several groups voice employers' concerns. I don't think a Section 89 could sail through Congress today virtually undetected.

While the issues have become more complex and trying to influence the legislative process has become more difficult, I'm struck by how one person or a handful of people have made a difference.

I've never forgotten the sight of a panting Ed Davey, then executive director of the Assn. of Private Pension & Welfare Plans, rushing through a Senate office building to deliver a strong letter of employer protest over a proposal that would have just about wiped out Voluntary Employee Beneficiary Assns., a popular way of funding health and disability programs.

Then-Finance Committee Chairman Robert Dole, who was trying to push the anti-VEBA proposal through the committee, argued the issue was not controversial. But as a vote neared, Sen. Robert Packwood produced Mr. Davey's letter —delivered just in time—and Sen. Dole backed off.

Reporters are supposed to submerge their own egos, hard as it is, but this is one time I won't.

In late 1977, the nation was in the throes of the product liability "crisis." Claims were escalating, or so some said, at an incredible rate. All kinds of crazy cases were being filed.

One of those cases was about a man who picked up a lawn mower to trim a hedge. He was injured and won a suit against the manufacturer. The lawn mower case made the rounds in insurance and risk management circles and even was cited in national advertising as an example of how unbalanced the legal system had become. User negligence no longer counted.

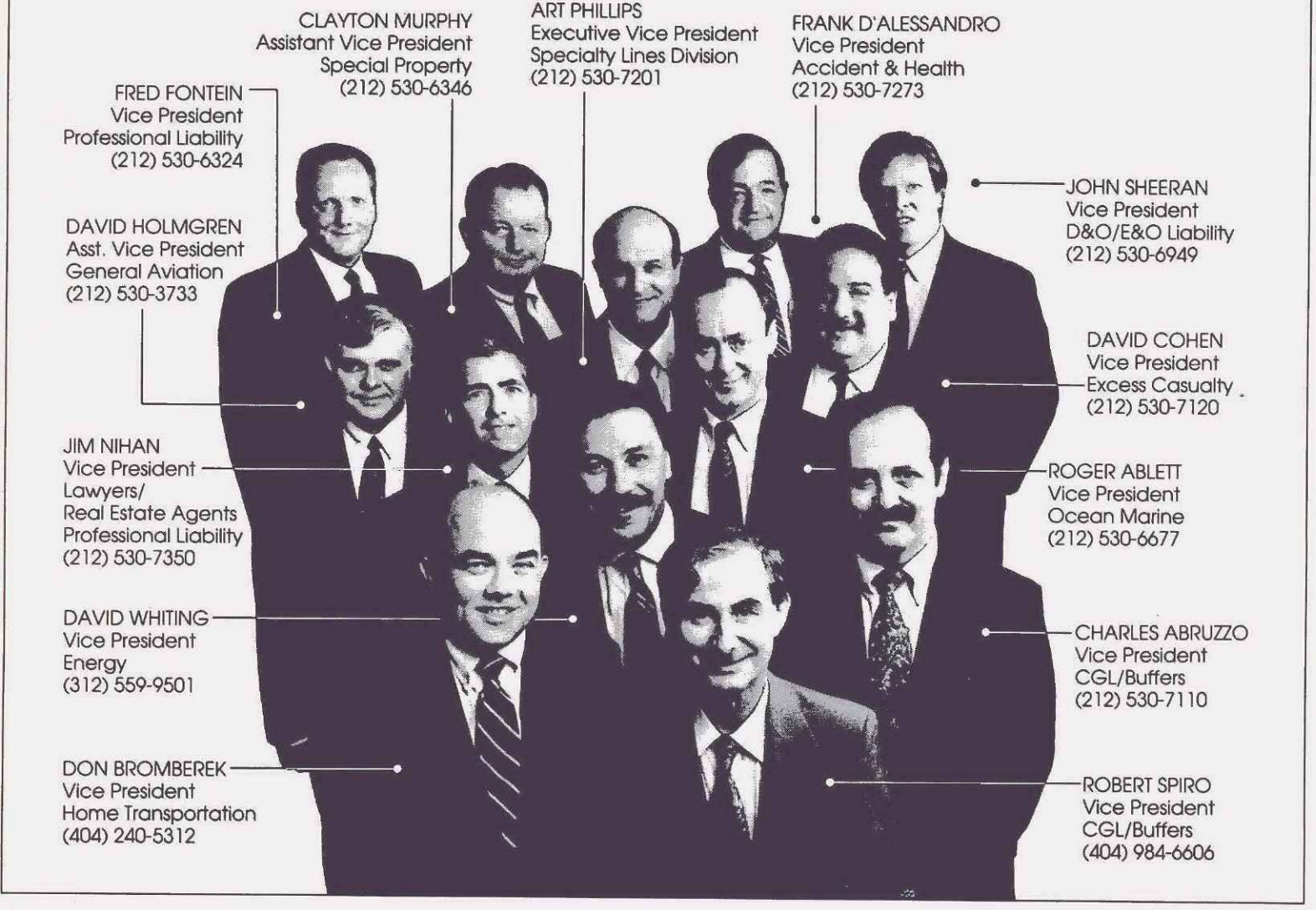
But after a lengthy investigation, I discovered the lawn mower case never existed. The ad citing the case was withdrawn.

The hysteria about product liability suits gradually stopped; I'd like to think my story had something to do with that.

But, of course, I've made my share of mistakes—big ones. One that stands out was covering a benefits conference in late 1981 and doubting a speaker who thought 401(k) plans would one day become enormously popular. I thought IRAs had more potential.

Just as my first 15 years at *BI* proved a lot more exciting than Dick Fay ever would have imagined, I know the next 15 years will be even more interesting. BI

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Looking Back



The **first national prescription drug plan** is included in a three-year contract negotiated between the United Auto Workers union and Ford Motor Co.

Under the plan, which does not take effect until October 1969, all active UAW members and their immediate families—but not retirees or survivors—may purchase prescription drugs from participating pharmacies for $2 per prescription.

In most cases, the balance of the cost will be covered by Michigan Blue Cross & Blue Shield, though in some cases it is covered by John Hancock Mutual Life Insurance Co.

Druggists participating in the plan sell the prescription drugs at a net cost, plus a professional fee (*BI,* Oct. 30, 1967).

* * *

A special committee of the American Society of Insurance Management will meet in Chicago to hammer out final revisions to the **new comprehensive general liability insurance policy.** The committee represents one of the few times a group of insurance buyers has been formed to rewrite a policy.

Buyers have complained that the new CGL form, which replaced the old policy about a year ago, eliminates coverage and contains confusing terminology. For example, they say, the new CGL provides coverage at the time an injury occurs, rather than when the risk first occurs, as was the case under the old policy.

Buyers also say they are covered for physical bodily injury but not emotional injury (*BI,* Oct. 30, 1967).

* * *

The New York General Assembly plans to introduce a **compulsory health insurance proposal** in its next session. The measure, the first to be introduced in any state, would require employers with three or more workers to offer hospital, surgical and medical expense coverage for their employees and dependents.

Both state Sen. Seymour Thaler and Gov. Nelson Rockefeller are planning to introduce bills, and debate on those measures is expected to top the legislative agenda for the 1968 session (*BI,* Oct. 30, 1967).

* * *

The property/casualty insurance industry is facing a capacity crisis because **the cost of future catastrophes will be far greater than ever experienced**, a top insurance company official warns.

John D. Phelan, president of American States Insurance Cos., says the risks of catastrophe losses are expanding "far more rapidly" than the capacity of private insurers. For example, he cited one estimate that the "jumbo jet" of the 1970s may have a potential loss of $184 million in the case of a crash (*BI,* Oct. 30, 1967).

* * *

Curtis Publishing Co. says it has no insurance to pay a **$446,000 libel judgment** awarded to Wally Butts, former athletic director of the University of Georgia.

The company, which publishes the Saturday Evening Post and other magazines, says it has set aside money to pay the award to Mr. Butts, who sued after an article in the Saturday Evening Post alleged he had outlined Georgia's football plays to Alabama Coach Paul "Bear" Bryant.

The publishing company says it has no libel insurance because the coverage is "prohibitively expensive" (*BI,* Oct. 30, 1967).

* * *

Unions, faced with the worst inflation since the end of World War II, are concentrating on wage increases in negotiations with employers, and **downplaying the importance of benefits**, according to Paul Hood, director of employee benefits service for EBS Management Consultants in New York.

Speaking to the Dallas-Fort Worth Chapter of the American Society of Insurance Management, Mr. Hood said he expects continued growth in survivor benefit packages and expansion of medical benefits "when we have a relatively stable dollar."

Mr. Hood cited the current negotiations between the United Auto Workers and the major U.S. automakers as an example of a trend away from employee benefits, noting that the union's demands are focusing on increased wages (*BI,* Oct. 30, 1967).

Continued on page 18

CGL coverage. Rising health care costs. Catastrophe claims. Directors and officers liability. Unfunded pension liabilities.

Sounds like the stories in last week's *Business Insurance,* right?

Wrong. But you're only about 25 years off. These topics were among those in the news in the fall of 1967, when the first issues of *BI* hit the streets.

Throughout this anniversary issue, we've collected snippets of stories from *BI* in each of the past 25 years. When you read them, some events of the past may coming rushing back into your memory. And, you might conclude that the times really haven't changed as much as you thought.

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Our founders, Henry Marsh and Donald McLennan, pioneered the concept of risk management in 1901 and became involved in the largest, most complex risks of the day. Mr. Marsh perhaps said it best when he advised a client, "...your problem is not insurance, it is risk."

Certainly, our early leaders would have saluted another pioneer, *Business Insurance*, for 25 years of success in covering risk management and employee benefits trends and innovations.

During this same period, Marsh & McLennan Companies has been finding innovative solutions for problems created by the changing business landscape. Over the past quarter century, by helping clients manage the complexities of risk and by anticipating and responding to clients' needs, Marsh & McLennan Companies has participated in most major technological and economic developments.

The changing world triggered new dimensions in risk, complex liability coverages and intricate employee benefits issues that demanded sound advice and solutions for our clients. In response, we expanded globally, strengthened our resources and became a worldwide professional services firm.

Today, our services include: insurance broking, Marsh & McLennan; reinsurance broking, Guy Carpenter; consulting, Mercer Consulting Group; insurance program management, Seabury & Smith; and investment management, Putnam—each recognized as industry leaders.

Our reputation for quality translates into solid financial performance. During the last 25 years, our revenues have grown from $77 million to $2.8 billion, a compound annual growth rate of 15%.

As partners in a unique, global professional services firm, we continue to provide solutions for clients. We congratulate *Business Insurance* on their 25th anniversary and wish them the very best for the future.

MARSH & MCLENNAN COMPANIES

Leaders In Service

Continued from page 16

Large increases in Social Security benefits now being considered by Congress would reduce the level of benefits that need to be provided by private pension plans, an employee benefits expert says.

Robert E. Royes, secretary of the employees' benefit committee at American Telephone & Telegraph Co., told *Business Insurance* that if Congress enacts large increases in Social Security, private employers would be "well-advised to take a look at the total benefits picture to see if too much money is in the retirement area" (*BI,* Oct. 30, 1967).

* * *

Hospital daily service charges have increased far more rapidly in recent years than the Consumer Price Index, causing **increases in the costs of group health and accident insurance**, according to the Bureau of Labor Statistics and the American Hospital Assn.

And, hospitalization costs are expected to rise an additional 25% in 1967 and 1968 (*BI,* Oct. 30, 1967).

* * *

The effective date for a new **Blue Cross & Blue Shield "national account"** with Ford Motor Co. is less than a year away.

The precedent-setting account is to go into effect Nov. 1, 1968, to equalize health care benefits at Ford plants across the country. It was a key part of the recently negotiated three-year contract between Ford and the United Auto Workers union. Under the plan, the health care benefits of all Ford employees nationwide will be under the control of Michigan Blue Cross & Blue Shield.

For workers not covered by Michigan BC/BS, Ford will try to negotiate coverage with local BC/BS plans (*BI,* Nov. 13, 1967).

* * *

The soon-to-be-established National Commission on Product Safety is certain to consider a **federal product liability law**.

A bill to establish the commission has been passed by both houses of Congress. In hearings on the bill J. Herbert Hollomon, acting undersecretary of the Department of Commerce, told the Senate that he would urge the commission to give a top priority to a study of federal legislation on product liability.

Mr. Hollomon explained that state laws on product liability vary greatly, resulting in a complicated legal situation for many manufacturers (*BI,* Nov. 13, 1967).

* * *

An analysis of **accrued but unfunded pension liabilities** saved a unit of Kaiser Industries Corp. $2.5 million on the purchase of another company, a Kaiser official revealed recently.

Walter B. Farrell, vp of industrial and union relations at Kaiser, said that before its purchase about 10 years ago of a large New England operation, Kaiser performed an analysis of the New England company's pension plan.

The plant in question was an old one with many long-service employees and, in keeping with general practice, the owner had not made any arrangements for prefunding pension liabilities.

After allowing for the unfunded liabilities, he said, the purchase price of the operation was revised downward to $6.5 million from $9 million. And, he added that Kaiser began funding for the plan shortly after the acquisition, "and now there are substantial assets available to ensure payments of pensions" (*BI,* Nov. 13, 1967).

* * *

Insurers, corporate buyers and insurance agents are complaining about the **new comprehensive general liability policy**.

Buyers complain that the policy leaves too many holes in coverage, compared with the CGL policy that it replaces. Arlington Beck, insurance administrator for Weatherhead Co., called the policy "regressive" and urged insurers to "get it changed to meet the insureds' needs; no ifs, ands or buts."

Agents also objected to wording of the new policy, including the substitution of the term "occurrence" for the old definition of accident.

Insurers also admit there is some confusion about some of the wording in the new policy (*BI,* Nov. 27, 1967).

* * *

A major government study calls for a private-sector effort to "**reshape. . .the health care system.**"

The report, by the National Advisory Commission on Health Manpower, notes that the government is not big enough alone to improve the nation's health care while holding down costs.

Instead, the private sector—as a major buyer of health care services—must work together to exert pressure on buyers and users to make a more cost-efficient system (*BI,* Dec. 11, 1967).

* * *

The New York Court of Appeals has ruled that a back ailment suffered when a traveling salesman rushed to put on his pants is not a **work-related injury**.

The state's highest court voted 4-3 to reverse a lower-court decision and denied workers compensation benefits to the salesman, who claimed his injury was caused when he fell over backward while rushing to put on his trousers. He had claimed the injury was job-related because he was in a hurry to get on the road for his employer.

"The very same sort of accident could have as easily occurred at his home or at any other place," the court said (*BI,* Dec. 11, 1967).

* * *

A Lloyd's of London underwriter and a Lloyd's broker say that risk managers may find better coverage for their companies if they **travel to London and negotiate the coverage directly**.

"London underwriters sometimes want to see the whites of the insured's eyes," marine underwriter Harold Hill explained.

Richard N. Bowes, director of Willis, Faber & Dumas Ltd., urged risk managers to develop personal, longstanding relationships with underwriters and brokers in the London market and cautioned against unbridled "shopping" of coverage. "Moving from one insurer to another for the sake of a reduced rate may be fine when results are satisfactory, but when they are bad, the market seems to disappear as if by magic and any new terms can be expensive" (*BI,* Dec. 11, 1967).

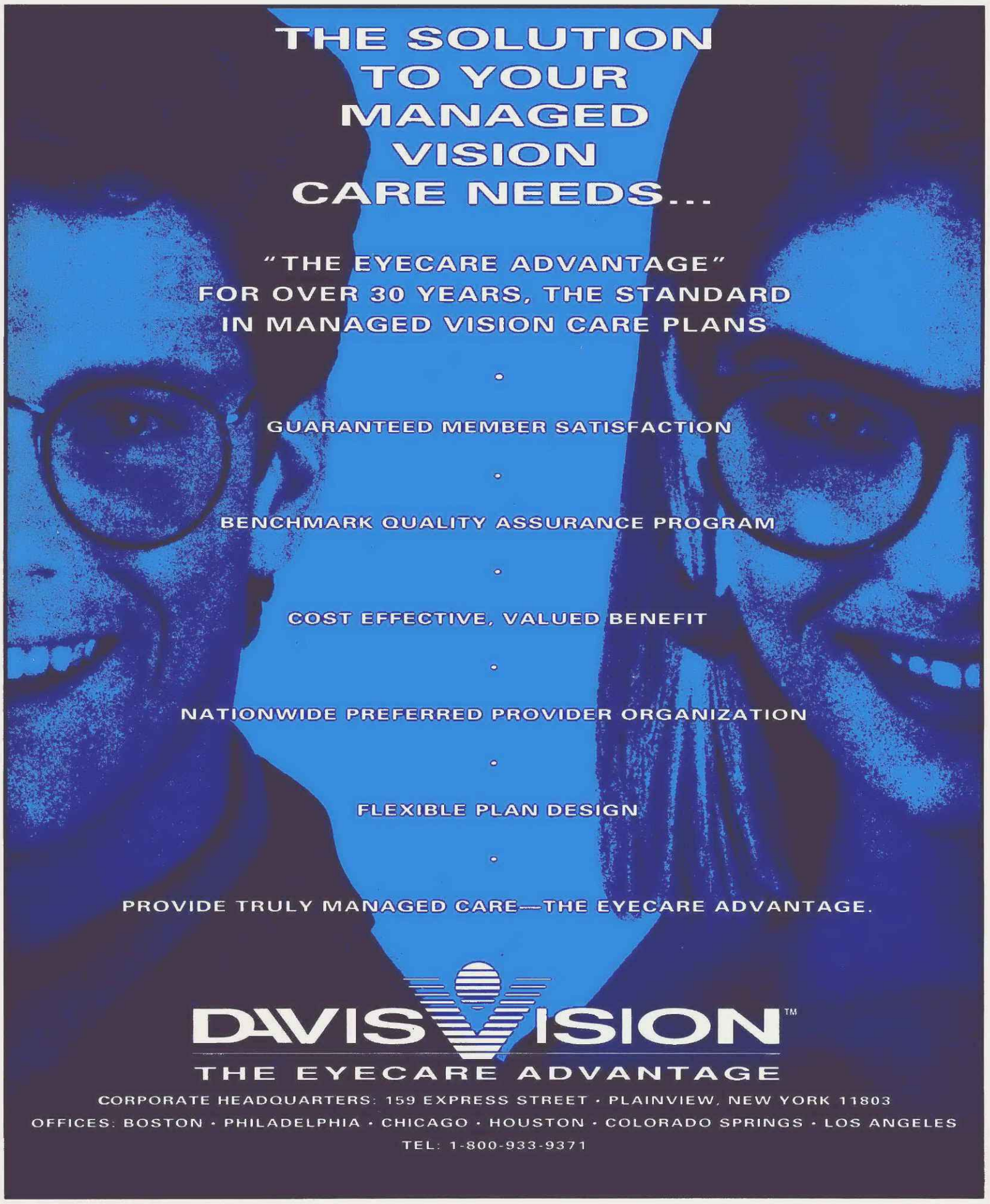
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The **rising cost of medical malpractice claims** are causing an increase in rates for physicians and surgeons professional liability coverage in 30 states and the District of Columbia.

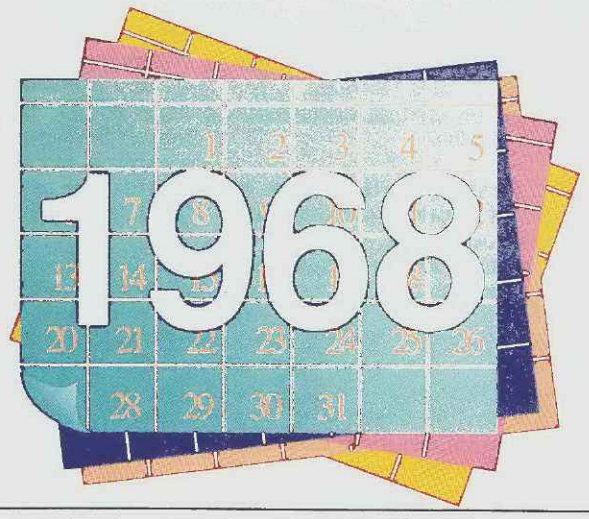
The highest increase will be in Arizona, where rates will increase 50%, reports the National Bureau of Casualty Underwriters Adjustments. Rates will decrease 10% in New Hampshire, the only state to see a drop.

In explaining the increases, the NBCU said that losses and expenses in physicians coverage have amounted to $140 for each $100 in premium from 1959 through 1963.

In addition, the NBCU has set up a new classification of doctors who will pay even higher rates: anesthesiologists, neurosurgeons, obstetricians/gynecologists, orthopedists and plastic surgeons (*BI,* Dec. 11, 1967). BI



Looking Back



Kaiser Aerospace & Electronics has increased **major medical coverage limits to $50,000** from $25,000 as part of its improved benefits package.

The new coverage is underwritten by either the Kaiser Foundation health plan or New York Life Insurance Co. The plan also now extends coverage to mentally or physically handicapped children, regardless of age, if they are dependent on a Kaiser employee for support (*BI,* Jan. 15, 1968).

* * *

An "efficiency survey" authorized by California Gov. Ronald Reagan has determined the state could save $250,000 per year by **streamlining its Insurance Department** operations (*BI,* Feb. 26, 1968).

* * *

The Equal Employment Opportunity Commission has ruled that, effective July 1, 1968, any pension or retirement plan that provides for a sex-based difference in **optional or compulsory retirement ages** violates the 1964 Civil Rights Act.

Other differences in retirement plan provisions based on sex, such as differences in survivor benefits, will be decided on a case-by-case basis (*BI,* March 25, 1968).

* * *

The cost to insurers of a company involved in the manufacture and sale of the drug **thalidomide** could reach $6 million.

In an out-of-court settlement, "very substantial" damages will be paid to 62 children born with various malformations allegedly caused by the drug, which the children's mothers took during pregnancy. As part of the settlements, the children and their families will take no further legal action against its manufacturer, Distillers Co. Ltd. (*BI,* March 25, 1968).

* * *

U.S. businessmen making business trips to South Vietnam are being charged much higher premiums for **accidental death and dismemberment insurance**.

In the wake of the Viet Cong's Tet offensive and the general intensification of the war after Jan. 1, AD&D premiums have increased to $50 per $1,000 of coverage, and can be as high as $75 if extensive air travel is involved. Rates were about $6 per $1,000 of coverage six months ago (*BI,* April 8, 1968).

* * *

Atlantic Insurance Cos. suffered the largest single net loss in its 126-year history in 1967.

The loss, involving the stranding of the **oil tanker Torrey Canyon** in the English Channel, resulted in a net claim to Atlantic of $300,000 (*BI,* April 8, 1968).

* * *

Rioting in almost 100 cities nationwide in the wake of the **assassination of Dr. Martin Luther King Jr.** has resulted in pressure from insurers for additional riot coverage charges on fire and extended coverage policies. The "riot loading" is averaging 2% to 4% in the 12 states that already have approved the charges (*BI,* April 22, 1968).

* * *

The **lack of capacity for petroleum risks** was highlighted recently when Koppers Co. was refused renewal coverage by Insurance Co. of North America after London reinsurers balked at the risk. The reluctance of the London market to reinsure such risks is blamed for the drastic lack of capacity.

Koppers, a chemical manufacturer, found coverage through the Oil Insurance Assn., an oil coverage pool (*BI,* April 22, 1968).

* * *

As more companies become involved with electronic data processing, either renting or buying the equipment, risk managers are looking for ways to protect that investment. The St. Paul Insurance Cos. became the first insurer to offer **electronic data processing coverage** in 1961, and now at least six insurers offer the specialized policies (*BI,* May 6, 1968).

* * *

War and riot coverage rates for cargo risks have been raised in the United States and London for the first time since 1956.

The American Institute of Marine

Continued on next page

The IRI Difference:

$130 Billion in Assets Protects 50,000 Properties In Over 70 Countries

"When someone asks me to discuss some of the thinking behind The IRI Difference," said Wayne Crawford, IRI President, "there are a number of things I could say. One of the most important messages for our customers and their agents or brokers, however, is the financial strength of the IRI partnership.

"We are a unique, worldwide insurance organization comprised of 43 leading insurance companies with an aggregate policyholders' surplus of billions of dollars. These financial resources stand behind our policies which cover 50,000 properties in more than 70 countries.

"IRI is financially solvent because each of our members must maintain an Excellent rating as determined by the A.M. Best Company. This stringent membership provision assures our customers and producers that IRI and its member companies will be here when you need us. This is a major example of The IRI Difference," Mr. Crawford said.



Wayne Crawford, Industrial Risk Insurers

He went on to say, "Other examples include fast and fair claims settlement and custom-tailored policies, to mention a few. I am convinced the companies that provide this kind of service excellence are the ones which will succeed and remain solvent in the decade of the '90s."

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A Conversation With:

Dr. John M. Burns

John M. Burns may have an M.D. after his name, but his ideas about fixing the nation's health care system are pure M.B.A.

Dr. Burns, vp-health management at Honeywell Inc. in Minneapolis, does indeed have a master's degree in business—a 1992 sheepskin, in fact—in addition to his medical degree. This becomes apparent when he voices his opinion on the ills of the health care system.

Quoting business management gurus like W. Edwards Deming, Dr. Burns advocates applying to the health care system the same quality control concepts that have made Japanese manufacturing so successful.

"The key to the health care access and cost issues in the United States is for the leaders to require that the 'product' be defined on standards of necessity, appropriateness, effectiveness and outcomes measurement, and then eliminate reimbursement for those things that should not be done," Dr. Burns says.

"Once you can describe a product, you can have a market system. But with health care, no one has described the product, yet people are claiming market failure."

While Dr. Burns does not support a single-payer health care system, he advocates an integrated system of competing physicians and providers that allows for universal access, with individuals responsible for obtaining health insurance. People with lower income levels would receive subsidies from general revenues to pay for premiums.

Physicians who practice within agreed-upon standards of care should be rewarded for spending time with patients. Health care benefit plans should be geared toward prevention, not "fix-when-broken" treatment. And, employers should be charged with using benefit plan incentives to reward healthy lifestyles and discourage the entitlement mentality.

Dr. Burns, who received his medical degree in 1958, has held corporate medical director posts since 1967—the last 11 years at Honeywell.

Dr. Burns talked with Copy Editor Nancy P. Johnson about what he sees as the culprits in the health care crisis.

* * * *

What is wrong with the health care system from the viewpoint of major employers?

We have an illness benefit, not a managed health care system. No one has described the product. You cannot control costs through benefit design. You must manage quality, and that requires that you describe the product. Quality is defined as conformity to specification. In health care, the specification must require that the health care product is necessary and appropriate.

Culturally, are we ready for a national health insurance program?

No, because the American people want freedom of choice, and they have an entitlement orientation. Once you put a budget in the national system, what you get is rationing and queues.

What changes have to be made to the health care system?

We need to organize the delivery system and organize the system of care—probably a collaborative public and private system. But the public health infrastructure needs to be redesigned, and we probably need to consolidate the entitlement programs—Medicare, Medicaid, CHAMPUS, Veterans Administration—so that there is a common product.

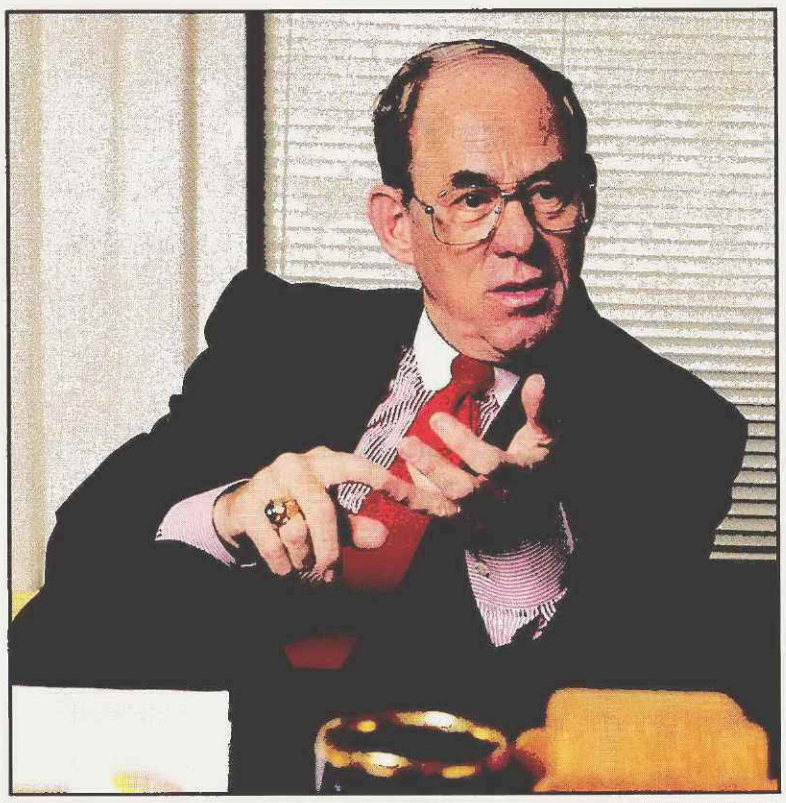


Photo by Peter Beck

Do you think that either a Bush or Clinton administration would push through any health care legislation immediately after being elected?

Nothing significant. I don't think either of them has the foggiest idea about the health care problem. I think if you asked either of them to discuss the subject of unnecessary and inappropriate care, they would stumble on their tie or their tongue or both. They're still talking about access to a system that is fundamentally broken.

Should health care be a political issue?

It is, and it always will be, until the purchaser—the government—finds out the difference between health care benefit access and health care product, and then manages it.

That may be beyond the intellectual capacity of the politicians, but I think there are a few of them, like (Minnesota Sen. David F.) Durenberger, who understand the issues.

Should the government allow states to be laboratories for reform efforts?

Yes, but within certain guidelines. The state 'laboratories' should exclude unnecessary care and set standards of utilization beyond which the physician is required to undergo scrutiny. The basic state effort should focus on describing the product.

Wouldn't this be an extra burden on multistate employers, like Honeywell?

No, because Honeywell is self-insured.

What Honeywell has been doing for about the last four years is declaring that our health benefit policy is based on quality, not on benefit coverage. We have been going to physician groups and getting into a direct contracting arrangement. The reason this effort is successful is because other companies now appreciate the need to require and to work with physicians to establish practice standards and guidelines in an outcomes management system.

Should coverage be tied to employment?

There's nothing wrong with the employer having a total compensation plan that includes health care benefits. But if the competitive market demands only that employers provide wages, then the employer shouldn't be taxed for health care benefits.

The obligation is for the individual to have health care insurance. If you get it through your employer, hooray.

But it ought to be transferable. The only way it can be transferable is if there is an organized system of care.

So if I am unemployed and need continued health care benefits, then because my income falls below a certain threshold the system picks up the premium until I find a job that either covers the insurance itself or provides an adequate income to pay for it myself. But I should not fall through the cracks because I lose my job.

Do employers have a moral or social obligation to employees regarding health care?

Yes, both.

You've been a health care professional for more than 30 years. What is the most important trend or event you have seen in that time?

The emergence of the physician as manager. The current managers don't know anything about health care. Do you think an insurance agent knows what to do with a hot belly (an acute abdomen) in an emergency room? It's a heck of a lot easier to teach a physician how to manage than to teach an insurance agent what to do with a hot belly.

Same thing with a benefit manager. What you need is a physician manager to tell people what the system is—what it should be—as opposed to what is covered, and you get rid of the inspectors.

You eliminate utilization management in a system where the product is defined and is delivered through organized systems. That requires health care professionals to be part of the team. It's slow, but it's coming.

What do you see as the future of mental health care and substance abuse programs? Why the current demand for such services?

We need a tremendous amount of skills-building on the part of beneficiaries—teaching families how to relate to kids, how to manage conflict and communicate.

The emphasis has to be on prevention. We have to encourage the concept of self-responsibility. The devil-made-me-do-it routine doesn't hold.

And we need to provide barrier-free access to counseling services, but only use the medical mental health model for those things that are truly medical. We need to separate behavior and counseling needs from medical mental health. There are medical mental health issues, and some of them require long-term care, which current benefit design frequently excludes.

You need to identify early on those with true medical mental health problems, and get those persons to a medical mental health professional, who develops a care plan that includes compliance requirements on the part of the individual.

Why do health care costs continue to escalate?

Because of the failure to describe the product. We don't require that the introduction of new care or new technology be proven effective, and we don't set the clinical conditions that must be met to document the need. We have an excess capacity of providers in the system and a distribution problem to boot. Plus, we have the government that's cost shifting.

There's plenty of blame to go around.

Rocketing health care cost increases are variously blamed on insurers, physicians, hospitals, careless consumers, and middlemen like utilization review firms, pharmacies, etc. Where do you place the blame?

I only have 10 fingers, and I'm sure we have more than 10 stakeholders.

One of the major blames has to rest squarely with American business and the government for the failure to buy on the basis of the product rather than on benefit coverage. We have allowed benefit consultants and the benefit orientation to influence consumer behavior as well as provider behavior.

The variation in practice styles now is a direct result of the variations in benefit plan coverage. The entitlement orientation of the beneficiaries comes from the providers and the purchasers —government and big business.

Over the last few years, we have seen double-digit increases in health care costs. Can such increases be held down to the annual rise in the Consumer Price Index?

Absolutely. There's no reason why health care costs should escalate any more than the general CPI if you price the product, describe the product and you have a true market.

Can managed care by itself hold down health care costs to a reasonable level?

Absolutely not, because the current 'managed care' is an inspection utilization system. All it does is grow a new cadre of inspectors. The more inspectors you have, the poorer the quality. There's 7.5 million inspectors in the current system. Utilization review people are growing at 8% per year, and that's by definition poor quality.

How do you define managed care?

Managed care is defined as physicians who have a common employer or common organization; who define themselves according to primary and secondary specialties; who meet on a regular basis to review literature and to determine the practice standards and guidelines and outcomes measurements system. This is truly managed, not inspected.

Have PPOs and HMOs failed employers?

Not to the degree that employers have failed to recognize what they are buying. PPOs are discount fee-for-service with inspection utilization. They buy on the cheap and then make it up in volume.

HMOs—if they're staff model —tend to have a consistent practice style. But if it's an IPA, it's fee-for-service medicine in drag, with risk-shifting.

How will health care be delivered 25 years from now?

I don't have the foggiest idea, but I hope it is more according to what *should* be done rather than according to plan coverage. BI

TOWARD THE TWENTY-FIRST CENTURY

All of us at Aon congratulate *Business Insurance* on Twenty-Five Years of Successful Publication.

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The success of *Business Insurance* over the years has been due to the integrity, experience and excellent journalistic skills of Alfred Malecki, Kathryn J. McIntyre and all of their talented associates who have worked to produce the magazine, week after week.

The success of *Business Insurance* is also due to its unfailing commitment to its readers around the world — risk managers, underwriters, pension and benefits specialists and insurance brokers. They all rely on *Business Insurance* every week for accurate and timely information.

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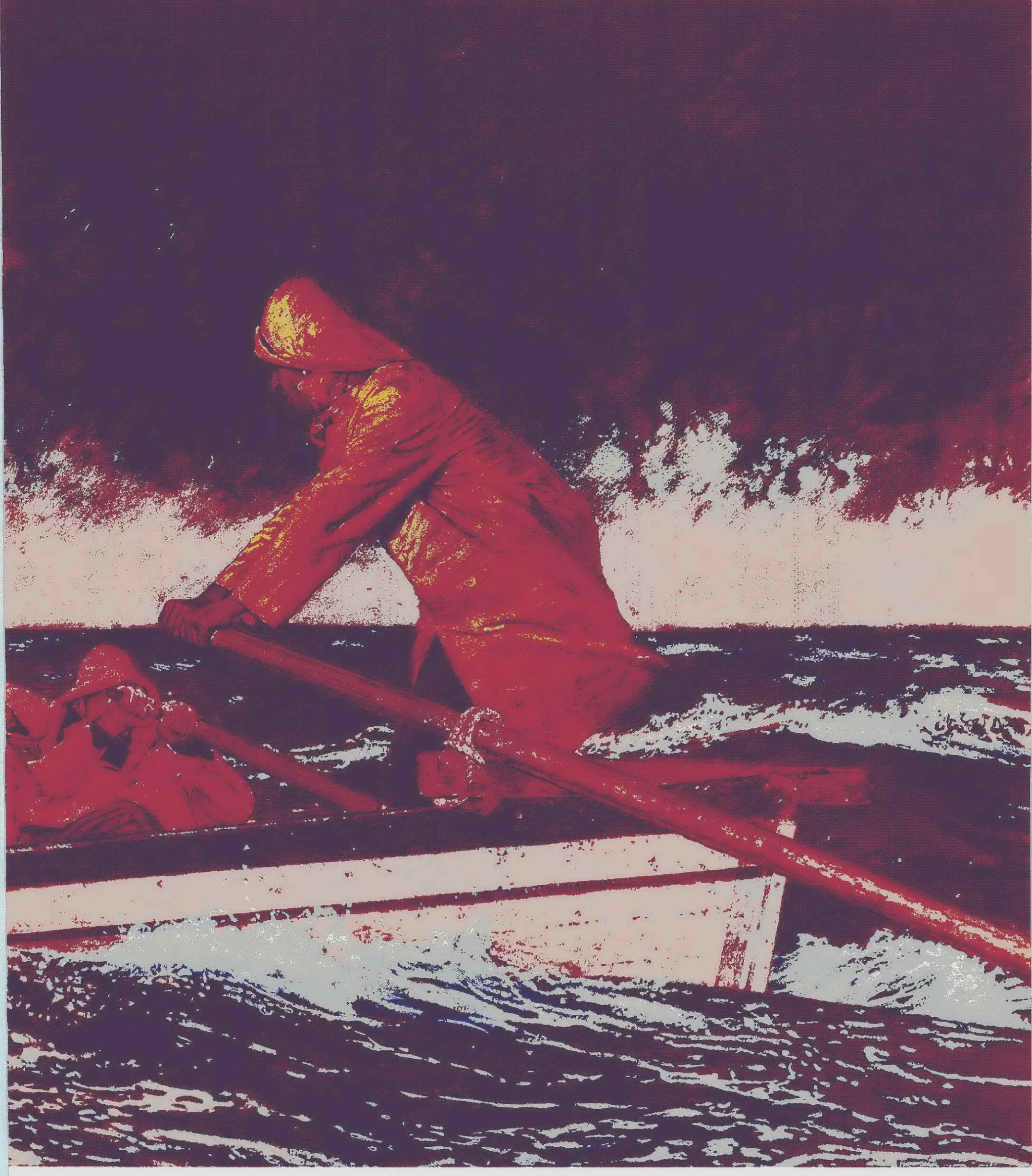


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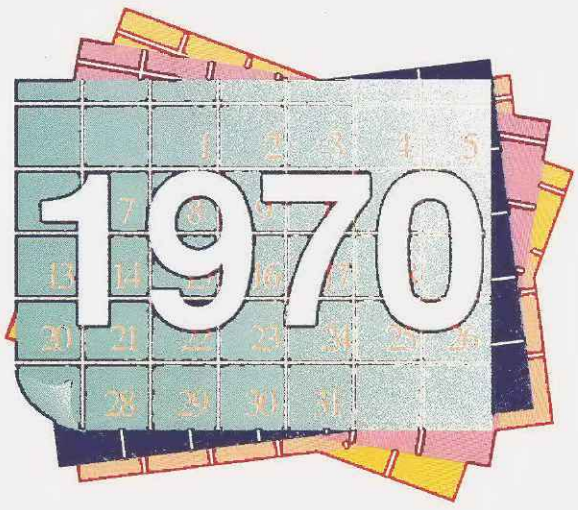
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Looking Back



The insurance for the new **Boeing 747 airliners** is "vertical coverage," meaning that each of the three major underwriters has a quota share of the risk from the first dollar on up.

All prior airplane coverage has been "horizontal," meaning that one insurer's liability starts after the limits of the prior insurer's liability have been reached (*BI*, Feb. 2, 1970).

* * *

A **fire at the Columbia Pictures** ranch in California caused between $1 million and $3 million in damage, destroying Western street scenes with false-front buildings that were used as sets for the movies "High Noon" and "Cat Ballou."

Columbia says the losses were covered by a $12 million property policy (*BI*, Feb. 16, 1970).

* * *

A recent report prepared for the Civil Service Commission says that **health insurance premiums for federal employees will rise between 10% and 35%** every two years between now and 1976.

The report says the increases probably will average between 20% and 25%. And, because federal workers' health care plans are considered to be industry bellwethers, experts note that premiums for non-government plans can be expected to increase a similar amount (*BI*, March 2, 1970).

* * *

The National Council on Compensation Insurance estimates that **workers compensation premiums increased 11%** to $3.5 billion in 1969.

The NCCI says the average rate level nationwide is up 3.3% as a result of 51 separate rate revisions filed in 40 separate jurisdictions.

The NCCI also has announced a new facility, the National Workmen's Compensation Reinsurance Pool, developed by the NCCI to provide complete reinsurance for insurers writing assigned risks. Since it opened Jan. 1, 318 insurers have subscribed to the pool (*BI*, March 16, 1970).

* * *

Insurance managers are finding a new problem: **workers compensation noise claims**. Especially troublesome are claims related to hearing loss caused by long-term exposure to noise.

While workers comp statutes were designed to compensate workers for only sudden accidents, the laws have been interpreted recently to compensate workers for many occupational injuries, including long-term exposure to noise. And that is presenting a whole new area of liability, risk managers say (*BI*, March 30, 1970).

* * *

Health insurers generally agree that group and individual **health plans will cover the costs of abortions** if a liberal law on the procedure is enacted in New York.

The most liberal abortion law in the country appears on the way to passage, and the insurers agree that they will have to cover whatever abortions are allowed if the bill becomes law. As one insurer put it, "I don't see how the hell we could exclude it from coverage" (*BI*, March 30, 1970).

* * *

A House subcommittee has voted in favor of a strong **occupational health and safety bill** that basically would leave employers with the legal obligation to provide a "safe and healthful workplace."

The bill was drafted by the Democrats, and Republican members of the Subcommittee on Education and Labor boycotted the vote. Even if the bill makes it through the full House Labor Committee and the House Rules Committee, it will face a very tough fight in the full House (*BI*, April 13, 1970).

* * *

Representatives of labor have charged that employers inaccurately and deceptively reported workplace accidents.

In a recent field hearing of the Senate labor subcommittee, labor leaders charged that the 1969 **workplace injury and death toll actually was twice as high as reported by employers**.

A group of steelworkers from New Jersey told the Senate panel: "You have guys with crutches or with their arms in slings being brought to work so that your lost-time report is not a true picture of the accident rate" (*BI*, April 27, 1970).

* * *

A New York City official has proposed that manufacturers be assessed a "product safety tax" that would be used to fund a system to compensate victims of **product safety-related injuries**.

Bess Myerson Grant, New York's commissioner of consumer affairs, found qualified support when she made her suggestion at an American Management Assn. briefing (*BI*, April 27, 1970).

* * *

All U.S. liability insurers have decided to **exclude from pollution coverage** any U.S. corporation that knowingly pollutes the environment. Lloyd's of London also has taken that position.

Continued on next page



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Continued from previous page

The Insurance Rating Board is preparing final wording for the policy exclusion and will file the wording with state insurance departments. Mutual insurers, through the American Mutual Insurance Alliance, are expected to follow suit (*BI,* May 11, 1970).

* * *

Despite the fact that employees of Theodore Hamm Brewing Co. can choose between a **beer break** and a coffee break, the company has an excellent safety record.

Hamm's lost-time injury record averages from three to six per million man-hours worked, which is much better than the brewing industry's record of 17.68 per million man-hours (*BI,* May 11, 1970).

* * *

Robert Finch, the secretary of health, education and welfare, has urged that the country move slowly on a program of **national health insurance**.

In presenting the Nixon administration's position, Mr. Finch said moving too quickly "would invite literal chaos" (*BI,* May 25, 1970).

* * *

During 1968, employers spent an average of 6% of total compensation costs, or 24 cents per hour, on **retirement plans**, making pensions the single largest non-wage cost.

The survey by the Bureau of Labor Statistics also reveals that employers spent 15 cents per hour, or 3.7% of total compensation, on health care and insurance programs (*BI,* May 25, 1970).

* * *

Kent State University has no liability insurance to cover the deaths of four students and the injuries of six others who were shot by National Guardsmen during disturbances there May 5.

School officials explained that as a state university, the school comes under the state's doctrine of sovereign immunity. Any claims filed would be handled by the state, officials say (*BI,* May 25, 1970).

* * *

A bill recently passed by the House that calls for **automatic cost-of-living increases in Social Security benefits** also will encourage the growth of health maintenance organizations.

The bill permits Medicare beneficiaries the option of having their health care provided by an HMO, in a move designed to stimulate the formation of physician group practices (*BI,* June 8, 1970).

* * *

A research committee supported by several large insurance companies has suggested that an **American version of Lloyd's of London** may help ease U.S. capacity problems.

The committee's report stressed that underwriting methods used by such a "centralized facility" would be compatible with current underwriting methods and that the facility would be a supplementary source of capacity for U.S. commercial risks (*BI,* June 22, 1970).

* * *

President Nixon's task force on aging has recommended that an independent pension commission be formed to protect employees' rights and that a **voluntary system of pension portability** be devised for employees in occupations in which conventional group pensions are rare (*BI,* July 6, 1970).

* * *

A United Steelworkers Union local in Pittsburgh has agreed to withdraw a suit charging antitrust violations against Ling-Tempco-Vought Inc. in its proposal to acquire Jones & Laughlin Steel Corp., after personal assurances from LTV officials that they would not "raid" the union **pension plan**.

The union brought the suit in the wake of rumors of layoffs, plant closings and raids on the pension plan if Dallas-based LTV succeeds in its acquisition plan (*BI,* July 6, 1970).

* * *

A British court is expected to award as much as $15 million in damages to more than 300 children who suffer from limb deformities that were caused when their **mothers took the drug thalidomide during pregnancy**. Insurers are still not sure how much of the cost they will bear.

One marketer of the drug, Distillers Co., already has paid $2.5 million to thalidomide victims. As part of the litigation, a trust fund is being set up for 250 children, which may call for an additional $12.5 million (*BI,* Aug. 17, 1970).

* * *

The U.S. government and underwriters at Lloyd's of London apparently share hull coverage for a **Pan American 747 that was blown up by Palestinian hijackers** in Cairo.

Apparently, part of the loss is covered by a war risk policy written in the London market, and part is covered by the federal government under a program of war risk indemnification for airlines flying the jumbo jets internationally.

The federal government apparently got into the market for war risk coverage after airlines complained that the London market no longer would fully cover 747s flying to the volatile Middle East (*BI,* Sept. 14, 1970).

* * *

Enormously high court verdicts are **sending medical malpractice premiums through the roof**.

For example, an insurer that writes coverage for almost half of the physicians in New York state raised premiums 55% in 1969 and 70% in 1970, and physicians pay at least $2,000 per year in malpractice premiums. Doctors in high-risk specialties in California pay even more—$7,500 to $12,000 a year (*BI,* Oct. 12, 1970).

* * *

The United Auto Workers, in a major victory, has succeeded in including the principle of **"30 and out"** in its new three-year contract with General Motors Corp.

Under the new contract, GM has agreed that years of service, not age, should be the factor for determining employee pension benefits. GM employees will be eligible to retire with a pension after 30 years of service at age 58, and a reduced pension at less than age 58 (*BI,* Nov. 23, 1970). BI



No Longer an 'Alternative'

Captives, facilities, self-insured programs blossom into important risk-financing tools

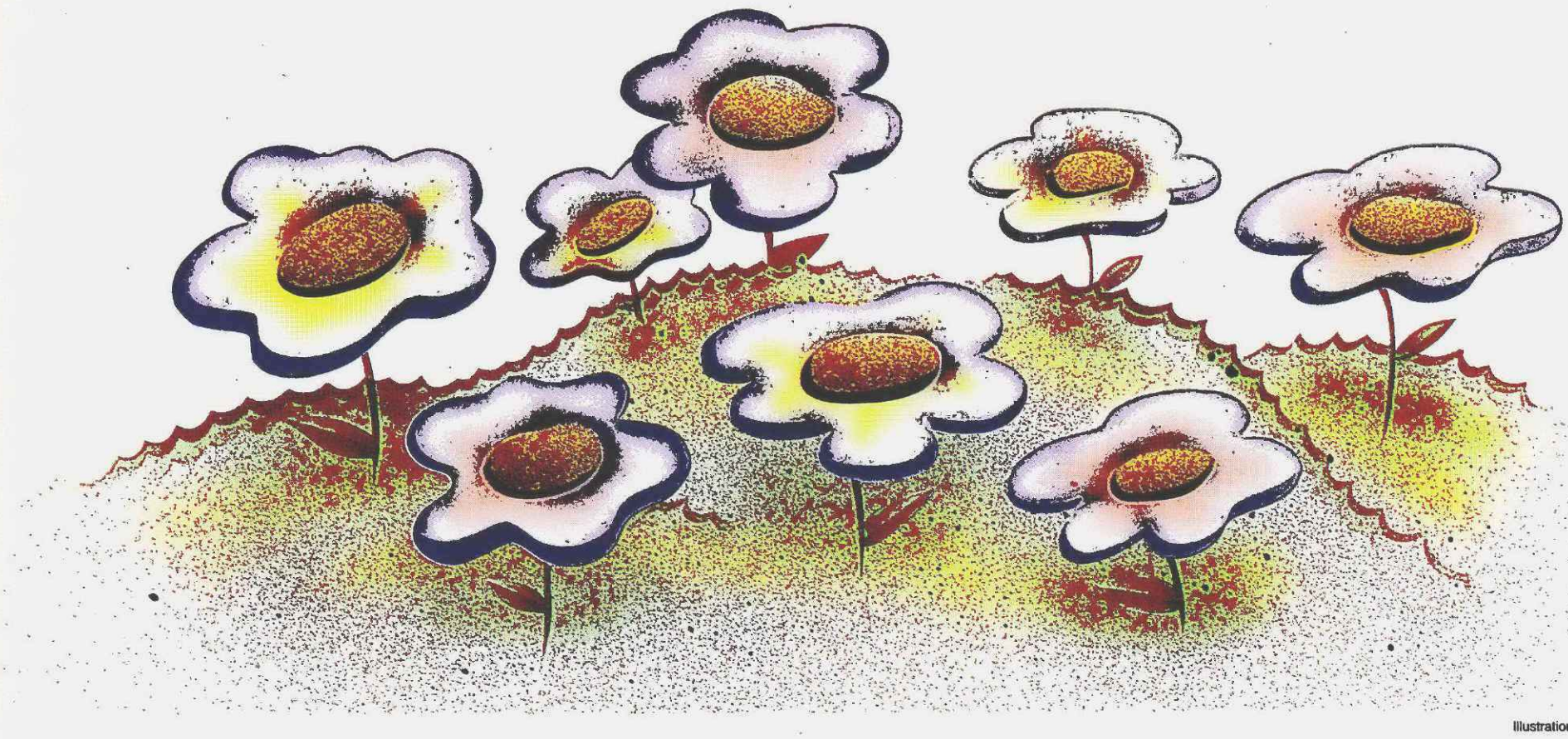


Illustration by Tony Griff

Alternative risk financing is no longer an "alternative." Rather, it's become mainstream.

Comprising about one-third of today's commercial property/casualty market, the so-called alternative market now controls nearly $50 billion in annual premium equivalents.

Few would have have predicted that the handful of captive insurers and self-insurance mechanisms launched by innovative risk managers in the 1960s would blossom into a multibillion-dollar industry.

"Twenty-three years ago the alternative market was just 5% of the total property/casualty premium," said Donald J. Krutek, senior vp of Johnson & Higgins in Chicago.

At that time, "all the insurance carriers thought it wouldn't last, that it was a fad that would fade. They thought it was their birthright to collect and hold premiums," he recalls.

While some high-risk companies, like oil and gas firms, have used captives and other self-insurance mechanisms for more than 30 years and many companies formed captives in the 1970s, the hard insurance market of the mid-1980s solidified alternative risk financing as a force that rivals commercial insurance.

"The 1985-86 availability/affordability crisis really etched its way into risk managers' memories," said Jon Harkavy, general counsel to Vermont Insurance Managers, a captive manager in Arlington, Va.

Nearly 200 new captive insurers were formed in Bermuda in 1985 and 1986. Seventy-five were formed in Cayman over the same period. And, 36 captives were formed in Vermont in 1986 alone—more than had been formed over the previous five years.

Today, there are nearly 3,000 captives worldwide, up from about 1,700 a decade ago.

Some companies frustrated with the insurance crisis went a step farther and formed what were then-known as policyholder-owned liability insurance "facilities." Of the two best-known, X.L. Insurance Co. Ltd. is now publicly traded, while ACE Ltd.—still policyholder owned—has almost $2 billion in assets.

While both have become huge forces in the insurance market, they also have refused to compete with commercial insurers, preferring to lose business if necessary rather than to give in to the insurance cycle.

In addition, many smaller facilities formed during the mid-1980s—like Bankers Insurance Co. Ltd., Energy Insurance Mutual Ltd. and PRIMEX Ltd.—have continued to prosper.

The 1986 amendments to the Risk Retention Act helped spur captive formation in the United States. Under the law, policyholders with similar risks can band together to form risk retention groups, which are essentially group captives. More than 70 of these groups have been formed.

Add those to the thousands of companies that self-insure their workers compensation and other exposures without a captive or other type of formal mechanism.

Despite the current soft property/casualty market, risk managers are still developing alternative risk financing programs in anticipation of the next market hardening.

The self-insurance movement was begun by risk managers in the 1960s. The risk managers, who had previous experience in the insurance industry, already understood how risk financing worked and began to apply it to their individual corporate exposures.

"Once people began to understand all the pieces, they began unbundling them, so that the risk financing method chosen matched the reason the risk financing was needed," Mr. Krutek explained.

The rest, as they say, is history.

But the story isn't over yet. Despite the current soft market, many companies are still forming captives because "they don't want to be caught unprepared again," said Mr. Harkavy. Forming a captive now "will give them more leverage and maneuverability when the next hard market hits."

While many existing captives were formed because commercial insurance was either too expensive or unavailable, future captives will be formed to let their owners play a larger role in loss control and to insulate them from market fluctuations, predicts Robert Brian, senior vp with Conning & Co. in Hartford, Conn.

Pamela Davis, president of Non-Profits Insurance Alliance, a liability risk sharing pool formed in Santa Cruz, Calif., in 1989, agrees: "Many companies form captives because they believe they are better risks or can be taught to be better risks through loss control. They want more control over their insurance destinies."

"The major driving force of the alternative market is the ability to control your own risk financing and to provide incentives to loss control," concurs H. Felix Kloman, a principal at Tillinghast in Stamford, Conn.

"It's a simple application of an age-old concept: If you're close to the risk, you'll have better results," said Mark Hinkley, senior vp at Transamerica Reinsurance Co., also in Stamford.

"Good captives allow for innovation. As an owner, you're close to the strategy, the opposition and your loss exposures. You can identify remedies much faster than if you're insured," Mr. Hinkley explained.

And a captive can always come in handy, even during today's soft market, points out Arthur Deters, chief executive officer of International Risk Management Group Inc. in Bermuda, a captive management firm.

"There is seldom an overall soft market. Even now, with a reasonably soft market for property and marine insurance, property catastrophe reinsurance is hard, and workers compensation is a disaster," Mr. Deters said.

"Companies with advanced risk management programs look at captives as being one of the major, if not principal, elements of the program," he said.

"A captive is not a single-purpose tool like a butcher knife. It's more like a Swiss army knife with various kinds of blades, screwdrivers, scissors and a corkscrew," Mr. Deters said.

Captives also are worthwhile because they can return more than 85% of premiums to participants with good loss control, according to Conning's Mr. Brian.

"Commercial insurance isn't efficient. It's money out the window," he said. On the other hand, "captives are effective in purchasing reinsurance and can reduce administrative costs."

The initial captive push came in the late 1960s from sophisticated risk managers who realized there were some risk-financing tasks that could be handled in-house, recalls John A. O'Connell, former risk manager for Holy Cross Shared Services in Notre Dame, Ind., who established Havican Insurance Co., a Colorado captive, in 1976.

However, "nobody knows what the first captive was," said IRM's Mr. Deters. "I did my master's thesis on it" and still cannot say with any certainty.

One likely candidate is Mahoney Insurance Co., a captive owned by Youngstown Sheet & Tube Co., which was formed in Ohio in 1938, though it was never activated, said Mr. Deters.

While early formations were few and far between, at least one visionary recognized the potential of alternative risk financing: Fred Reiss in 1958 formed a company, American Risk Management, to promote and manage the formation of captives.

"Before 1967, about the only companies with captives were the big oil companies and those aligned with Fred Reiss," recalled Duane E. Allen, president of Applied Risk Insurance Services in Rancho Santa Margarita, Calif., and risk manager of Hanna Mining Co. from 1966 to 1984.

By 1967, the Reiss organization was managing about 50 of the approximately 100 to 350 captives thought to be operating at the time, recalls Mr. Deters of IRM, which was formed by Mr. Reiss.

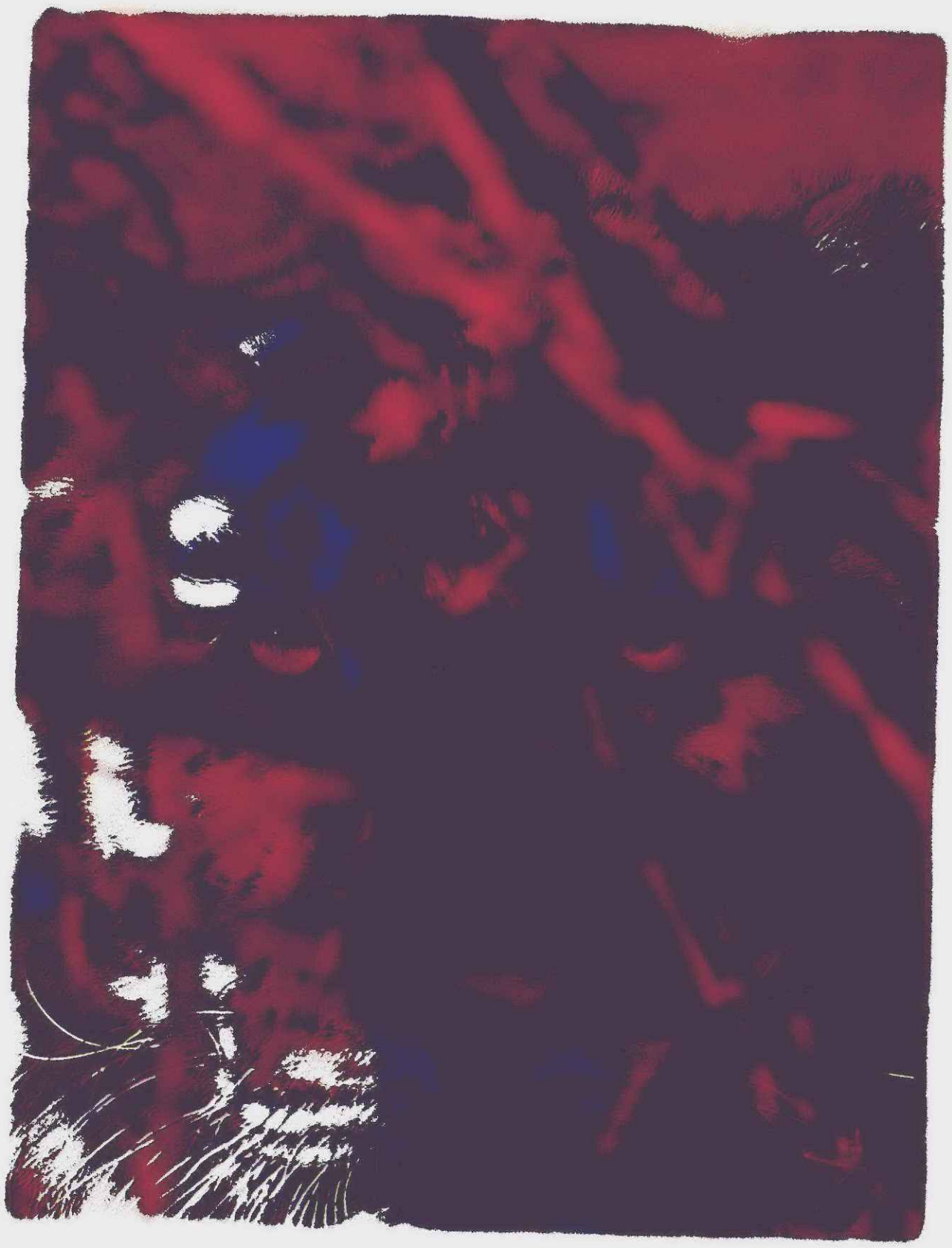
While the group's services broadened in the mid-1960s to encompass other facets of risk management, "its focus stayed on captives throughout the Reiss era," Mr. Deters said. That era ended in 1988 when Mr. Reiss sold his business to Swiss Reinsurance Co.

Although the biggest surge in captive growth didn't occur until the hard market of the mid-1980s, a number of captive insurers sprouted up after the medical malpractice insurance crisis of the mid-1970s, Mr. O'Connell noted. "At that time a lot of captives got a big push," and "medical malpractice provided the jump-start."

In the early '70s, captives were considered "a completely different way for companies to handle workers compensation, product liability and other general liability risks," Mr. Allen said.

Continued on page 40

By Joanne Wojcik



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Alternatives

Continued from page 38

Hanna Mining formed its first captive, Erieview Insurance Co. Ltd., in Bermuda in 1972 to provide excess workers compensation coverage. It later formed Mountainview Insurance Co. in Colorado as part of a joint venture.

In conjunction with the 1980s captive boom, a host of complementary businesses sprouted up. They provided both support services like captive management, actuarial and accounting services and, most importantly, excess and reinsurance coverage.

"This was a major revolution in the risk management field," said Mr. Allen, who formed an alternative risk consulting business in 1984 after serving as managing director of the Bermuda Risk Exchange.

The Bermuda Risk Exchange was formed by the Bermuda Captive Insurance Companies Assn. in 1980 as a risk-pooling mechanism to finance captives' high excess layers.

It followed Corporate Insurance & Reinsurance Co. Ltd., which the group launched in 1978 for the same purpose.

About the same time, the Reiss organization was developing similar reinsurance pools, "because the insurance industry was anti-captive except for providing fronting services," he explained.

The Reiss reinsurance programs enabled Weyerhaeuser Co. to get its first captive off the ground in Bermuda in 1976, said Cheri Hawkins, assistant treasurer and director of insurance for the Tacoma, Wash.-based wood products company. "When the market hardened, we got innovative very quickly."

Brokers at first resisted assisting captives, fearing that commissions were in jeopardy. "We came dragging our heels a little bit," admits Charles Ruoff, senior vp at Sedgwick James Inc. in New York.

But, by the late 1970s, "brokers decided if they didn't change and appear fond of captives, they would lose a significant part of their business," Mr. Deters said. "Now they're the biggest captive managers around."

And, to gain leverage against competitors, "brokers are spending a lot of time popularizing programs and educating risk managers in alternative financing programs," said James V. Davis, chairman of Willis Corroon Corp.'s Advanced Risk Management Services division in Nashville, Tenn.

In the 10-year period that began in the late 1970s and ended in the late 1980s, "our firm has had a tenfold increase in the number of people dedicated to alternative market services," said Mr. Ruoff.

Still, "throughout the early period—the late 1950s to the 1960s—the only ones who looked favorably on captives were the reinsurers, though they won't admit it today," said Mr. Deters.

"Reinsurers in that period had a broader world view of business; they were not so parochial in their thinking. They saw captives as unconventional, but intriguing. They were captivated by the ability to assess risk, to have a greater direct influence over pricing at the retail level," Mr. Deters said.

Captives came of age after the hard market of the mid-1980s, when insurers forced policyholders to assume bigger portions of their risks.

"I warned them at the time that they would lose this primary business forever," but they were skeptical, recalled Mr. O'Connell of Holy Cross Shared Services.

Of the more than 100 companies that Mr. Davis has helped convert to self-insurance over the last 15 years, only one has ever returned to the standard market, he said.

While at first policyholders felt uncomfortable self-insuring a large portion of their exposures, many now assume huge retentions without batting an eye.

"The last hard market forced more companies to assume more risk, and they found they actually slept at night," Mr. Harkavy said.

After a while, policyholders with higher comfort levels started to delve into other coverage areas, folding workers compensation, excess and other liability coverages into their existing captives, Mr. O'Connell said.

"We began with small amounts, and, as the market improved, we kept adding in more and more coverages," he recounted. "By the time I left last year, we were buying very little in the primary market—only excess. We just kept moving the layers up."

"We definitely do not put as many dollars in the outside market anymore," agreed Ms. Hawkins.

As a result of such moves, "Captives have reached the point where they are a market to be dealt with. It gives risk managers a bargaining edge," Mr. O'Connell said.

Indeed, "captives are here to stay," he said.

So are the so-called facilities formed by corporations during the hard market of the mid-1980s. While group captives were already an established part of the self-insurance scene, larger facilities—dubbed by some "private insurers"—began to sprout up in 1985 and have prospered ever since.

The formation of the facilities was a direct response by policyholders to insurance availability and affordability crisis.

"The development of the alternative market was a very specific response to the extreme non-responsiveness of the commercial marketplace," observes Edith Lichota, president of Lichota & Associates Inc. of Grapevine, Texas. Ms. Lichota spearheaded the development of Bankers Insurance Co. Ltd. in 1985 when risk manager at Irving Trust Co.

"But it was not our intention to replace the commercial market," she said. "We were trying to stabilize the market."

That goal appears to have been reached: The large amounts of capacity created by the alternative markets may have contributed to the long duration of today's soft market, Ms. Lichota believes.

"Stability and security are the hallmarks of what we're trying to do," said Brian O'Hara, president and chief operating officer of X.L. Insurance Co. Ltd. in Bermuda. "In 1986, there was no capacity in the high excess layers, and a couple of years later there was plenty at cheap prices. But that was ephemeral."

Indeed, at the time that BICL was formed, "the market was getting harder rapidly," Ms. Lichota recounted. "Banks found that D&O coverage was eroding in their hands" as claims submitted to their directors and officers liability insurers were rejected one after another. "We began to think we were buying Swiss cheese."

Ms. Lichota was approached simultaneously by LeBoeuf, Lamb, Leiby & MacRae and The Wyatt Co., both of whose bank clients could not buy adequate D&O coverage.

"Wyatt sent letters to the 100 largest banks and bank holding companies and we held a meeting in Chicago in June 1985, which I chaired," she said. By the fall of 1985, 50 of the banks contacted made contributions to the cost of a captive feasibility study, which

Continued on page 44



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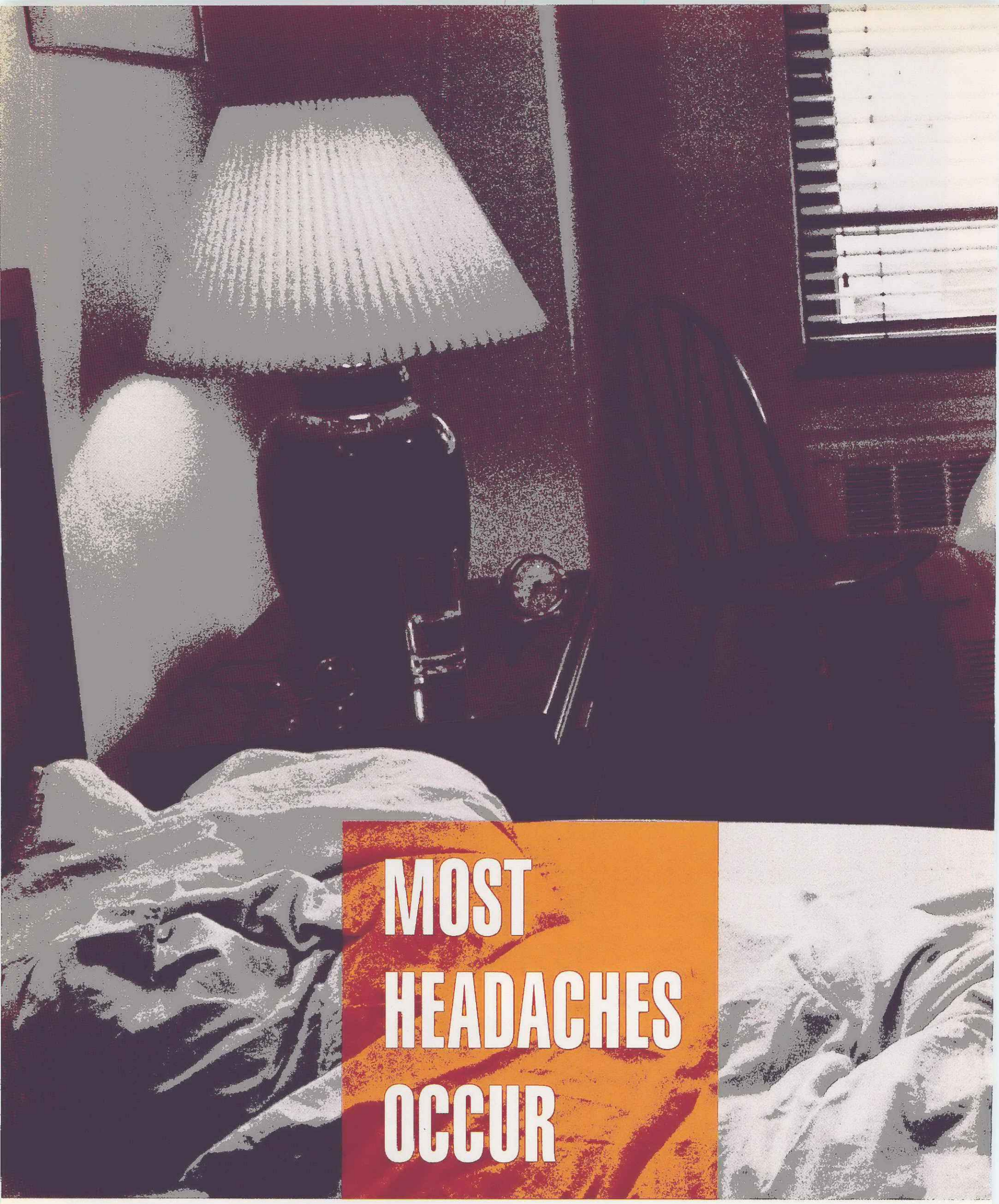
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Alternatives

Continued from page 40
was completed in November.

BICL's first policies were issued in May 1986.

ACE and X.L. were formed at about the same time by large corporations that could no longer find affordable high excess liability coverage, Mr. O'Hara recalled.

ACE was first. It was created in late 1985 by 34 corporate shareholders, assisted by Marsh & McLennan Cos. Inc. and Morgan Guaranty Trust Co., to write general liability coverage excess of $100 million and D&O coverage excess of $50 million.

But, "companies found they couldn't get the underlying coverage necessary to reach ACE's $100 million attachment point," Mr. O'Hara remembers. So along came X.L. in 1986, writing $75 million in general liability limits excess of $25 million, for its 68 initial policyholder/owners. X.L. also writes D&O and professional liability coverage.

Like Ms. Lichota, Mr. O'Hara believes X.L. was formed more to stabilize than to replace the commercial market. The facility is "indifferent" to market swings, holding rates steady based on the risks of each policyholder, he said.

Today, X.L. has about 600 excess liability policyholders, 130 D&O policyholders and 50 professional liability policyholders.

And its original policyholders have profited from their participation: Shares purchased in 1986 for $10 were sold for $25.50 when the company went public in 1991.

About half of X.L.'s original sponsors sold their shares in the initial public offering, which was intended to provide liquidity to those investors, Mr. O'Hara said.

"Many invested to get insurance, but they also made a profit."

As a result of such success stories, Ms. Lichota believes alternative facilities "are here to stay."

"I can't believe that any well-managed organization that put up the money to form an alternative facility would give up the degree of control that it provides them."

While the facilities have been a big success, the alternative risk financing movements did suffer some setbacks. One was the disastrous plunge by some captives into writing non-parent business.

"A lot of captives in the '60s and '70s wrote third-party business to get tax breaks," Mr. Harkavy recalled. "That's how the term 'innocent capacity' started. Captives were a source of excess capacity. They wrote third-party business with little or no underwriting expertise."

But a number of those captives—including Gulf Oil Corp.'s Insco Ltd., Exxon Corp.'s Ancon Insurance Co. S.A. and Ocean Drilling & Exploration Co.'s Mentor Insurance Ltd., to name a few—found that taking on third-party business was more than they could handle. The Mentor liquidation has been a source of controversy for the better part of a decade.

And insurers, like Ideal Mutual Insurance Co., that provided fronting services for such captives also succumbed under the weight of losses on unrelated business, said Edward Lalley, a former risk manager and president of Ideal Mutual.

Ideal Mutual, which was a major source of fronting services in the early 1980s, was seized by New York regulators in the fall of 1984 and liquidated the next year.

"Most risk managers are not good underwriters," noted John Pinner, part-time risk manager for Mattel Co. and president of JGP Risk Management Services in Palos Verdes, Calif.

Mattel started its single-parent captive in 1978 when product liability coverage costs were skyrocketing, but its losses were low by industry comparisons, he explained.

Premiums were driven by "the perception of what a toy could do to a child," he explained.

Mattel's captive, which provides product liability coverage for the toymaker, only writes Mattel risks.

"There's no way I'd take a third-party risk," said Mr. Pinner, despite recent decisions by the Internal Revenue Service requiring captives to write a substantial amount of third-party business for their owners to qualify for a tax deduction. "A tax deduction was not our motivation for forming the captive. It was to provide coverage."

Still, some believe that entering the commercial arena is the next likely step in captives' evolution.

"Today's alternative market is likely to be tomorrow's successful insurance company," suggests Robert Clements, president of M&M in New York.

"Multi-policyholder-owned insurers like ACE and X.L. will ultimately become the conventional market," predicts Brian Hall, chairman of J&H's global captive management group in Bermuda.

Captives likely will follow the same course as the Factory Mutual System insurers, which can be considered early captives, according to Mr. Clements.

The Factory Mutual System began in 1835 when textile mill owner Zachariah Allen established Manufacturers Fire Insurance Co. in Providence, R.I.

Mr. Allen thought he should receive a discount on his fire insurance premiums because he installed a rotary fire pump that eliminated the need for fire-causing stoves among the machinery. He also built a fire wall to isolate the picker room, which was a common location for mill fires.

But his insurer declined the discount, instead explaining that, under the risk-pooling concept, good risks would have to pay for the bad.

"Historical records show that any time the conventional market is seen to be unresponsive to its customers, alternative markets emerge," Tillinghast's Mr. Kloman noted.

Already, MEDMARC Insurance Co., a medical industry association captive formed in Bermuda in 1978, has obtained a license to operate as a commercial insurer in Vermont, where it redomiciled in 1986 following expansion of the Risk Retention Act. It also is seeking approval as an authorized reinsurer in the 40 states in which its members reside, said President Jaxon White.

But Mr. White believes MEDMARC can stay afloat by concentrating on the one line of coverage it knows best: product liability insurance for medical equipment manufacturers.

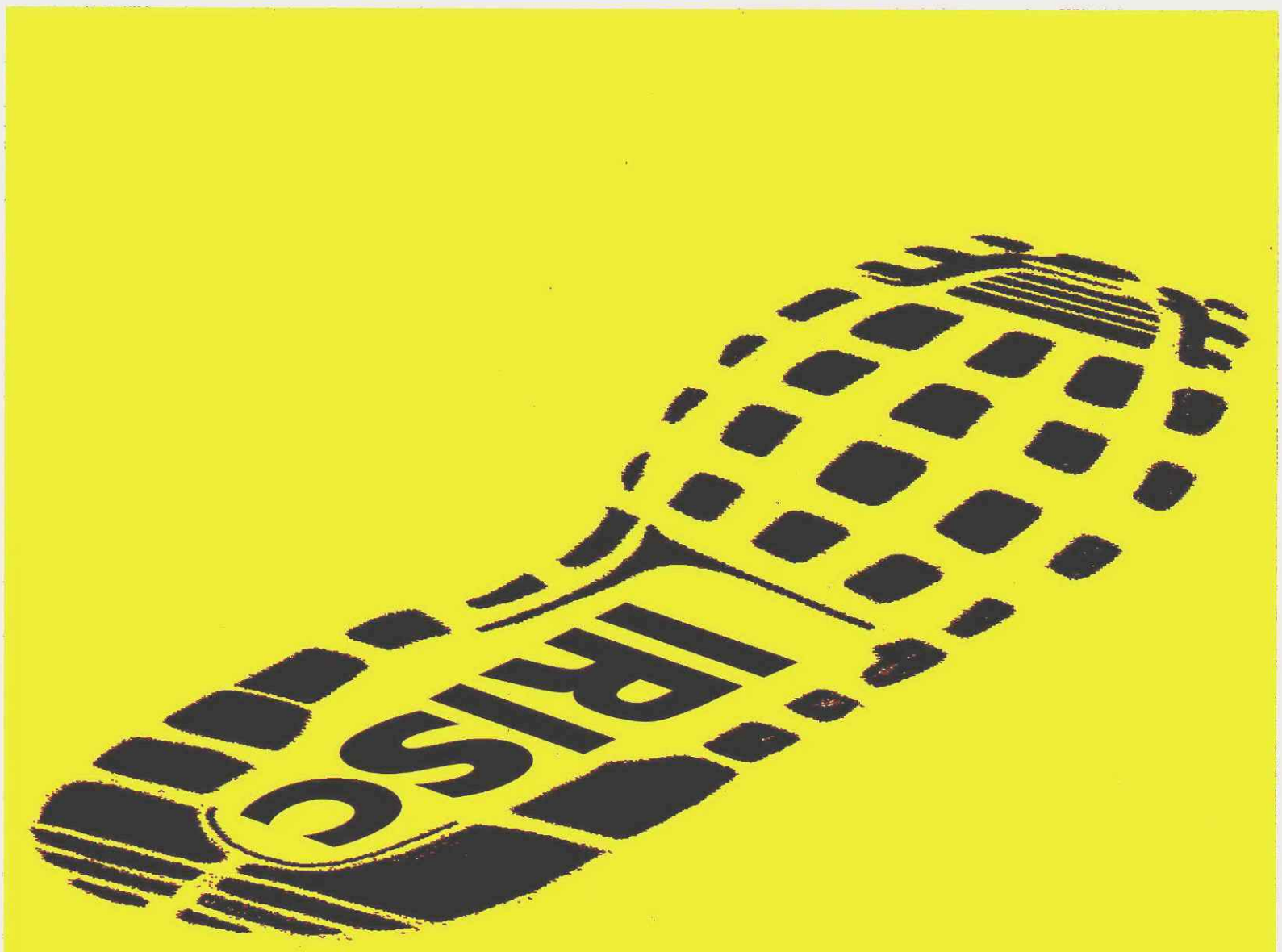
"Product liability is our *raison d'etre*," he said. "We stick to what we do best."

In addition, MEDMARC is licensed as a mutual insurer, which means it will always be policyholder-owned, Mr. White pointed out.

However, Tillinghast's Mr. Kloman feels it's unfortunate that so many mutual insurers "convert themselves from being a pure group captive into a large commercial insurer."

"When a captive starts writing third-party business, it stops being a captive," agreed Mr. White. BI

Joanne Wojcik has served two stints with BI. She was an editorial production assistant in 1980-81 and returned to the staff in 1985 as a copy editor. She was named Los Angeles bureau chief in 1990.



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Looking Back



While the Baltimore Colts were beating the Dallas Cowboys in Super Bowl V, the 1,200-member NFL Players Assn. reached a tentative agreement with team owners to provide **NFL players with a pension at age 55.**

Under the tentative agreement, a player with 10 years in the league would be eligible for a pension of $50 per month for each year played (*BI*, Feb. 1, 1971).

* * *

A large portion of the billion-dollar losses in the **Los Angeles earthquake** probably is uninsured, according to observers.

Municipalities and private citizens bore a large share of the damage in the recent quake, and insurance experts note that neither group is likely to buy earthquake coverage because the policies are so expensive. Many private homes were damaged or destroyed in the hard-hit bedroom communities of Los Angeles, and many cities suffered substantial damage to roads, dams and other structures.

Apparently, though, at least some commercial losses were covered (*BI*, Feb. 15, 1971).

* * *

Pan American World Airways has filed suit against its insurers—underwriters at Lloyd's of London, several U.S. insurers and the U.S. government—seeking $24 million in actual losses, accruing interest and other damages in the loss of the **Boeing 747 blown up by terrorists in Cairo** six months ago. Pan Am has not yet received any payment from its insurers.

The insurers on Pan Am's all-risk policy say the war risk insurers should pay, and war risk insurers say the all-risk policy should pay (*BI*, March 29, 1971).

* * *

Business interests in New York City are lodging a strong protest against a tentative agreement reached last week by the city and the Uniformed Firefighters Assn. that would give **firefighters a full-pay pension** after 40 years of service.

Business interests had lobbied against any pension plan improvements for uniformed city employees, claiming they could lead to "economic disaster" for the city (*BI*, April 12, 1971).

* * *

The intent of the **new Bahamas insurance law** is to force out less-reputable insurance companies that had given the island a bad reputation in the insurance field.

At the time the new law took effect, in June 1970, there were 503 insurance companies listed on the registry of records. Some voluntarily left, some were axed and about 108 remain.

Bahamian authorities say they expect the remaining insurers to meet the requirements of the new law (*BI*, April 12, 1971).

* * *

The Nixon administration may sponsor a **pension reform** bill that would require "50-point" full vesting.

Under the proposal expected to be advanced by the administration, workers would be fully vested in their pensions when their age and years of service total 50 (*BI*, May 24, 1971).

* * *

Corporate insurance buyers are overwhelmingly in favor of Congress adopting national standards for changes in the **auto victim reparations system**, according to a survey by *Business Insurance*.

Those surveyed also would like to see a modified no-fault system, with direct payments to injured parties up to a certain amount, and victims retaining the right to file suits (*BI*, July 5, 1971).

* * *

There are no risk managers among the 15 people named by President Nixon to the **National Commission on State Workmen's Compensation Laws**.

Business Insurance had urged the appointment of a risk manager to the commission to give input about how changes in the law would affect the total risk management picture for employers.

And, the risk managers' professional organization, the American Society of Insurance Management, had earlier nominated a risk manager for the commission (*BI*, July 5, 1971).

* * *

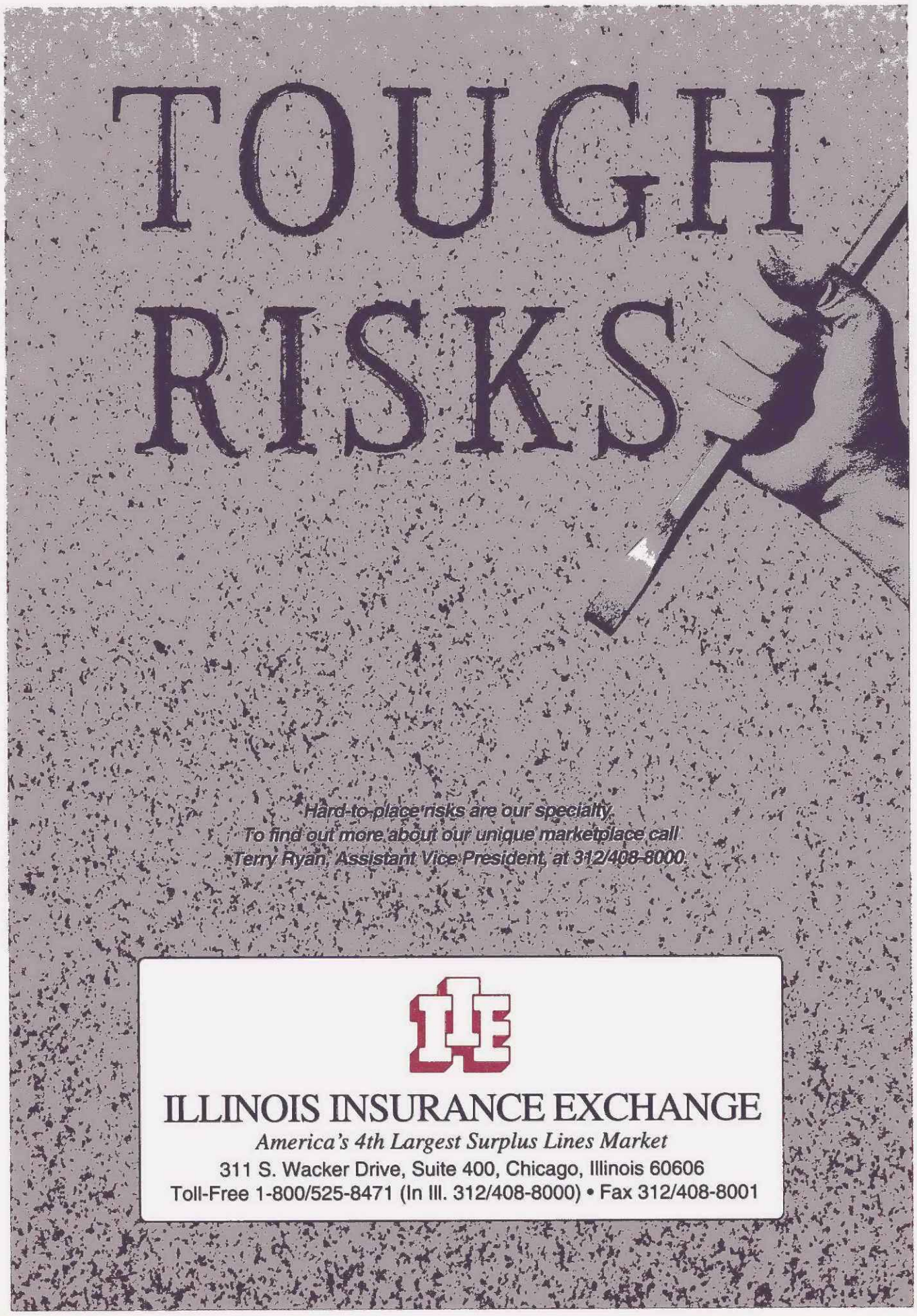
Powerful Republican Sen. Robert A. Taft has joined some of his more liberal colleagues in urging **pension reform**.

Sen. Taft called on Congress to take "affirmative steps to protect the pension rights of America's working men and women." Specifically, he said, Congress should act to assure reasonable vesting and actuarial soundness, control actions of plan trustees and prevent cuts in private pensions in the wake of increases in Social Security benefits (*BI*, July 19, 1971).

* * *

An appellate court has upheld what is believed to be the **largest wrongful death judgment** in the country—a payment of $1.8 million to the parents of a 15-year-old boy who died when a foreign transport plane crashed into the building

Continued on page 48





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Continued from page 46
where he was working.

The boy's 17-year-old brother also died in the June 1969 accident when a Dominicana Airlines DC-4 cargo plane crashed into the auto paint shop owned by the youths' father in Miami. A lawsuit in the older son's death is pending.

Underwriters at Lloyd's of London are the insurers for the airline (*BI*, Aug. 16, 1971).

* * *

Illinois Gov. Richard B. Ogilvie is expected to sign a bill calling for a **fully paid health plan for state workers**.

The plan, which would take effect Jan. 1, 1972, is expected to cost $16 a month for each of the state's 86,000 employees (*BI*, Aug. 16, 1971).

* * *

Employers and their insurers still are looking for answers to their questions about the **wage-price freeze**, nearly two weeks after it was announced by President Nixon.

However, it is clear the edict freezes increases in employee benefits and allows no pension plan increases or new profit-sharing plans to be implemented. And, although premium levels for custom-rated corporate insurance programs can be adjusted based on loss experience, the rating principles applied must be those in effect in July or August of this year (*BI*, Aug. 30, 1971).

* * *

A Labor Department survey shows that 25 million Americans work for private employers that provide **no retirement plans** to supplement Social Security.

Most of these workers, the study notes, are employed by small, non-union firms that pay low wages. In contrast, 30 million workers are covered by private pension plans, and most of them are in unionized companies (*BI*, Aug. 30, 1972).

* * *

There is no directors and officers liability insurance to cover the directors of **Leasco Corp.** who have been held liable for damages to former stockholders of Reliance Insurance Co.

A federal judge ruled the computer leasing company made a material omission on its registration statement with the Securities and Exchange Commission when it offered to acquire Reliance in 1968.

A source close to the company said Leasco had been unable to arrange D&O coverage because the company was young, and young firms either cannot get the coverage or can get it only at prohibitively high rates (*BI*, Sept. 13, 1971).

* * *

The U.S. Justice Department has subpoenaed the financial records of several **U.S. corporations with captive insurers in Bermuda**.

At least eight U.S. companies have been ordered to furnish information about their Bermuda captive operations to a federal grand jury. The Justice Department declined to comment on the reason for the probe, though some sources suggest that the government is attempting to determine whether the increasingly popular offshore companies are violating any regulations (*BI*, Oct. 11, 1971).

* * *

Lloyd's of London underwriters have added another **exclusion to their directors and officers liability policies**, making it clear that directors and officers are not covered against suits for polluting air or water.

The four U.S. insurers that write D&O coverage also are expected to add the exclusion on all new and renewal policies.

Some insurance sources commented that such suits already would have been excluded from D&O coverage because they almost certainly would entail fines and penalties, which are not covered by the policies (*BI*, Oct. 11, 1971).

* * *

Bermuda officials say they are taking the **first official head count of captive insurance companies** on the island.

Captives have never been specifically counted because all foreign companies are registered under one category, regardless of their business. Estimates of the number of captives on the island range from 80 to 150 (*BI*, Oct. 11, 1971).

* * *

Health insurers say they cannot support proposed **federal standards for health insurance regulation**.

The proposal by Health, Education and Welfare Secretary Elliot L. Richardson would set several federal regulatory standards and would set up a compulsory health insurance program paid for by employers and employees and underwritten by private health insurers (*BI*, Oct. 25, 1972).

* * *

The federal Pay Board says it is "fairly final" that the 5.5% **wage increase ceiling** under Phase II economic policy includes benefits.

The board says that, at least so far, it has found no situation to justify changing its position that "everything you get as an employee working for someone comes under that single 5.5% limit" (*BI*, Nov. 22, 1971).

* * *

There appears to be no end in sight to the **skyrocketing excess liability premiums**.

Industry observers say that excess umbrella liability underwriters currently are charging 25% to 35% of general liability premiums and 30% to 40% of commercial automobile premiums, and rates will continue to increase.

Factors cited as contributing to the rate increases, which began about 1968, include losses from Hurricane Betsy; increases in class-action and pollution liability suits; the advent of jumbo jets, huge cargo vessels and massive industrial complexes; and the mergers of some large insurance companies, which cut capacity (*BI*, Dec. 6, 1971).

* * *

Both business and labor appear to support a recent Supreme Court decision that employers are not required by law to bargain with unions on **benefits for retired workers**.

The decision reverses a ruling by the National Labor Relations Board and is hailed by employers as making the negotiation process more workable.

Most union leaders agree (*BI*, Dec. 20, 1971).

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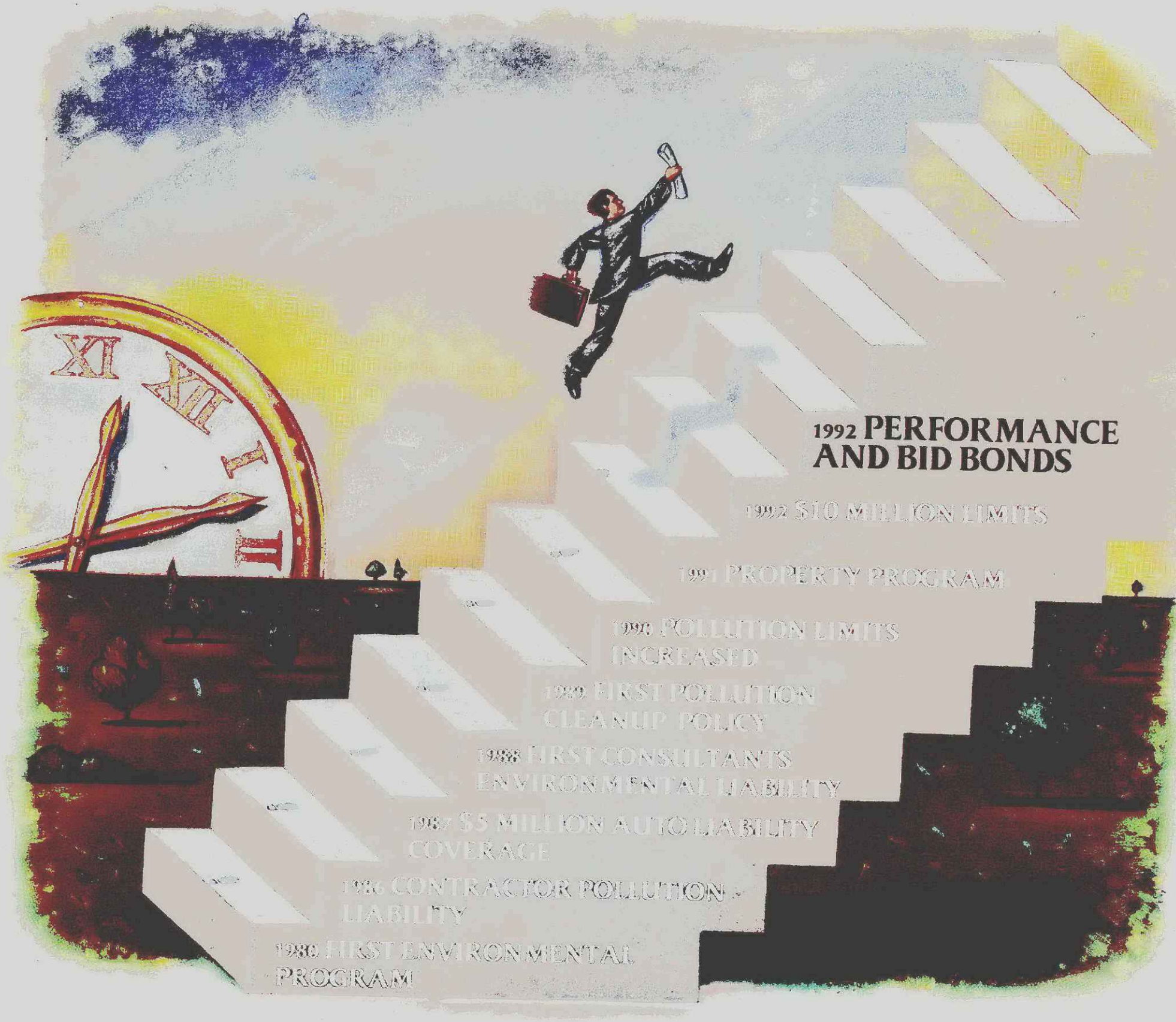
The Nixon administration has proposed a **pension reform** package that includes rules allowing vesting when an employee's age and years of service total 50. The proposal says further study is needed on the subject of funding of pension plans that terminate (*BI*, Dec. 20, 1971).

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A Conversation With:

James V. Davis

James V. Davis, chairman and chief executive officer of Willis Corroon Corp.'s Advanced Risk Management Services division in Nashville, Tenn., is a specialist in risk financing techniques. He began working with captives and other financing alternatives soon after joining the company in 1976.

Before joining the former Corroon & Black Corp., he spent 10 years with Vanderbilt University, including a three-year stint as acting dean of the Owens Graduate School of Management.

Mr. Davis, who received a doctorate from Cornell University's Johnson Graduate School of Management, taught for 11 years at the School of Fundamentals of Risk Financing sponsored by the Risk & Insurance Management Society Inc.

Mr. Davis recently discussed the growth and future of captives and other alternative risk funding mechanisms with Associate Editor Michael Bradford.

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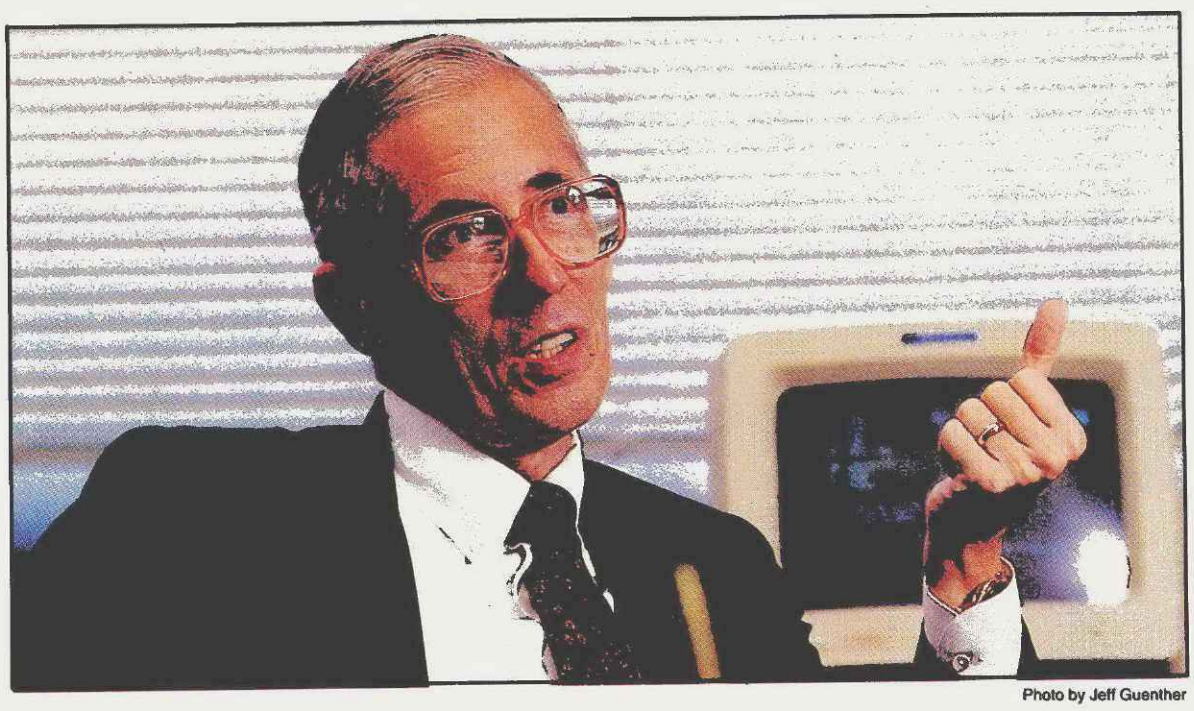


Photo by Jeff Guenther

Has the captive movement grown in ways you did not expect?

I think what has surprised me has been the number of captives that have been formed for non-quantifiable reasons. Some of those you could have expected, but also a fair number of them I would not have expected; firms have put the companies together primarily because they wanted to have a dedicated source of funding to pay losses and where they wanted to use the captive for a cost allocation mechanism across the divisions of a company.

Are risk managers too occupied with the financial performance of captives and not enough with issues like safety and risk control?

Industry has gone overboard in terms of trying to wring the last percentage point of savings out of the 15% to 20% of each premium dollar that represents hard-dollar costs to the underwriter and the intermediary. It really needs to turn its attention to the 75% to 80% of the premium dollar that is represented by loss costs. Now that creates a real problem for some risk managers along a number of dimensions.

One, a number of risk managers really like the loss financing side of the business better than they like the loss prevention and loss control side.

Two, in most large organizations loss control is decentralized to the operating divisions of the company and really doesn't report to the risk manager. I've had a running debate with a number of people in the industry about whether risk managers need to change that. And I believe they do.

One of the things I've noticed over the last 12 to 18 months is that a number of workers compensation programs have been moved from the control of the risk management department to the human resources side of the business. This has been done because it is perceived that human resources has taken a more proactive approach to controlling the cost of employee medical programs and that risk managers have been reactive in terms of controlling the costs in the workers compensation program.

If the workers compensation program goes, since that is the biggest premium producer in many risk management programs, then that's going to cut the influence of the risk manager to be effective on the covers over which he or she still has control.

Is it a good idea to move those programs away from the risk management department?

If the choice is between having an area of the company attack the problem proactively as opposed to reactively, and if that is a fair characterization of what the human resources departments are doing, yes.

What percentage of risk will be financed through alternatives compared with the traditional market five years from now?

If you buy the number that roughly a third of the total of the property/casualty premium that's available is now in the alternative market, in another five years you might see that number up to around 40%.

One of the things that is happening is that insurance is being demystified in the minds of many commercial buyers. And the more it becomes demystified, the more firms will rely on alternative financing vehicles.

Have risk managers become more sophisticated and able to demystify insurance more easily?

There are a lot of quite sophisticated risk managers. The really sophisticated risk managers tend to be concentrated in the larger companies. As a profession, it still is one that suffers a great deal from the unevenness of the people who practice it.

How do you smooth out that unevenness?

One of the ways that RIMS has tried to do it is through the various schools that it offers its members to try to give them backgrounds in financing, accounting, loss control and some of the other areas that they may not have had backgrounds in.

Longer-term though, I think what RIMS is going to have to do is concentrate much more on equipping its members with general management skills. I think it's awfully easy for a risk manager to be stereotyped within an organization as a very narrow staff specialist.

Market conditions influence the formation of captives and alternative risk financing mechanisms. Will there be another severe hard market or will the cycles begin to smooth?

Either one of us could retire if we had the answer to that question. Underwriters have been saying for the last two or three years that they felt politically they could not afford a repeat of the last hard market cycle. But in the same breath, they also say that the deeper the current cycle goes, the more violent correction it will bring.

It's really hard right now to see what it is that would change the market. The industry is significantly over-capitalized. You have insurance companies saying they don't want to write personal lines any more. That, in essence, means they now have free capital to devote to the other facets of the property/casualty business so that commercial property/casualty has even more in the way of capital.

'I think what has surprised me has been the number of captives that have been formed for non-quantifiable reasons.'

During the last hard market, brokers and policyholders formed what have become giant risk-funding vehicles like A.C.E. Ltd. and X.L. Insurance Co. Ltd. Will more of these large-scale facilities be formed?

Marsh & McLennan is working on its proposal for a property equivalent of A.C.E. and X.L. to try to respond to the reduction in property catastrophic coverages (*BI*, Sept. 21; June 22). There have also been proposals circulated to form an earthquake captive, but that one has never seemed to get a whole lot of momentum behind it.

I think what will happen is you will see an A.C.E. and X.L. equivalent formed every time that traditional insurance companies fail to respond to a significant industry problem.

With so many states having passed captive laws, is there any reason for the insurers to be domiciled offshore? Can a small to medium-sized company find all it needs in an onshore captive domicile?

It can indeed. I think the choice among domiciles really tends to be very narrow these days. Certainly you can make an argument, particularly for a large company, that it is still worthwhile domiciling in Bermuda, for example, if you are going to be accessing A.C.E., X.L., Zurich International, Centre Re and taking advantage of the other products that are there. Were the excise tax on reinsurance premiums, however, to go from 1% to 4%, I think that would change dramatically the amount of interest in having an offshore company.

Vermont and Hawaii are both working very aggressively to ensure their domiciles are competitive with anything elsewhere.

Do risk managers prefer forming single-parent captives as opposed to participating in group captives or risk retention groups?

With or without the Risk Retention Act, putting a group captive together is a painstaking process. It's just difficult to get independent firms to go together and pool their losses in any meaningful way in a group organization. There's sort of an immediate reaction of: 'I know my losses are good, but yours happen to be a dog. Why do I want to do business with you?'

But once you get them together, they can really be cost-effective. It's one of the few ways that a small company can get the economies of scale that a large company can get on its own.

Is the single-parent captive still a viable risk management mechanism?

As long as it's fitted to a company's specific needs. It's still easily one of the most flexible loss-financing tools.

Can captives still be used for their tax advantages?

The IRS caught up with captives a long time ago. One of the things that we've always done as insurance brokers is taken the position that if we're going to be an effective consultant for our clients, we have to approach our clients with a greater depth of knowledge than just knowledge of policies and coverage forms. In that context, we've retained tax attorneys to provide us input on the tax and legal ramifications of captives.

In the past 18 months, courts have ruled that corporations in some cases can deduct premiums paid to captives. Rulings indicate that the insurer must write relatively large amounts of unrelated business to gain the deduction.

What does this mean for captive owners?

Probably for the captives of U.S. parents, not all that much. Most U.S. corporations are not going to have their captive insurance company go outside and write a lot of unrelated risk because too many companies got burned doing that in the early and mid '80s.

Now in other parts of the world, it's a lot simpler because taxing authorities still will grant premium deductibility for the payments to a wholly owned captive.

Regulators are threatening to restrict fronting arrangements. How serious is the threat to captives?

It is a serious threat if restrictive fronting regulations actually go into place because a significant portion of the premium volume that goes to captives is for workers compensation and automobile liability insurance. Both of those covers require use of admitted insurance company paper.

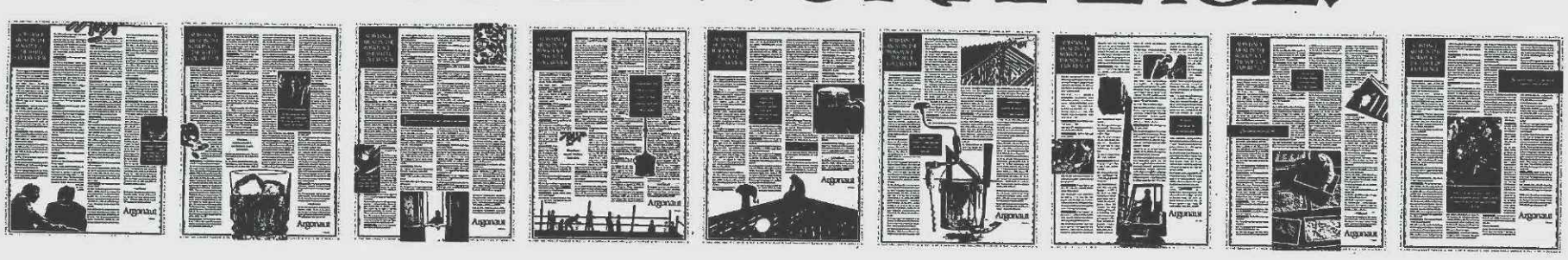
If restrictions are too tight, will they bring about the end for some captives?

I think that's absolutely true. The version of the anti-fronting regulations that the (National Assn. of Insurance Commissioners) was circulating earlier this year would have required capital and surplus that would have been too onerous for many captives. Parents wouldn't want to have that kind of capital tied up in a company. The requirements on claims handling and setting of loss reserves would also have been anathema to some captive owners. BI

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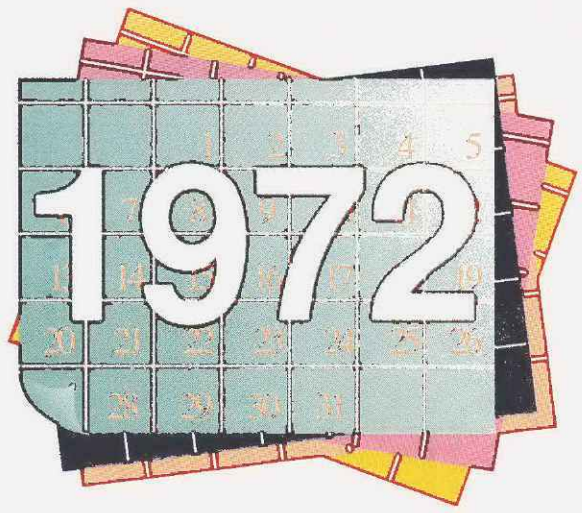
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Looking Back



The **capacity crisis** appears to have been put to rest in 1971, but other problems remain to be dealt with in the new year.

Risk managers responding to a survey by *Business Insurance* generally agreed that the capacity problems of the last few years have eased considerably. But, many said they still are working on renewals, considering setting up captives and worrying about the impact of federal legislation on employee benefits (*BI,* Jan. 3, 1972).

* * *

Levels of **asbestos fibers** in the air previously considered safe can cause serious lung disease, according to a Harvard University study of 195 workers in a New England shipyard (*BI,* Jan. 3, 1972).

* * *

An expert predicts that the number of Americans with **group dental coverage** will grow to between 75 million and 100 million in the next decade from the current 7 million.

Roy L. Lindahl, chairman of the Council on Dental Care Programs, called dental care "one of the major medical problems of the '70s" and added that group dental care should help curtail the more than 100 million work hours lost in 1971 because of dental problems (*BI,* Jan. 3, 1972).

* * *

Los Angeles-based broker **Bayly, Martin & Fay Inc.** has been acquired by The Sperry & Hutchinson Co. for $20 million in cash.

Bayly, Martin & Fay is one of the 10 largest commercial brokers in the United States, with revenues of $10.2 million for the year ending June 30, 1971. Sperry & Hutchinson, primarily known for its S&H Green Stamps, has been diversifying in recent years into business, consumer services and interior furnishings (*BI,* Jan. 17, 1972).

* * *

Rep. Wilbur Mills, D-Ark., chairman of the House Ways and Means Committee, told members of the Assn. for Advanced Life Underwriting that, despite years of discussion and months of formal testimony, it is unlikely that Congress will enact **pension reform legislation** this year (*BI,* Feb. 28, 1972).

* * *

A recent crackdown on **Bahamas-based insurance operations** has eliminated 255 "unsatisfactory" insurers, or 74% of the insurance companies registered on the island before 1970.

Bahamian officials say that the fact that so many companies did not survive under the new law is proof that the law was needed to clean up the insurance industry there (*BI,* Feb. 28, 1972).

* * *

The directors of the American Society of Insurance Management Inc. have voted to retain the group's name and not change it to the **Risk & Insurance Management Society Inc.**

Proponents of the name change said the new name more accurately reflects the makeup and mission of the group and would eliminate the term "American" from the title to reflect the group's Canadian membership.

Opponents said ASIM already had established itself as a recognized name and authority in the field (*BI,* May 8, 1972).

* * *

Major league players are taking the field again after a **13-day baseball strike**, and they are coming back with an 8.5% increase in their pension benefits.

Under the agreement between the players and the owners, $500,000 of the existing surplus in the pension fund will be used to increase benefits to offset the 17% cost-of-living increase since the plan was negotiated three years ago. Players had requested that the whole surplus of more than $1 million be used to increase benefits (*BI,* May 8, 1972).

* * *

Sources at the U.S. Department of Labor say the department is leaning toward a system of self-inspection to assure compliance with the **Occupational Safety and Health Act**.

A self-inspection system to reduce workplace deaths and injuries could be implemented as early as next year, the sources say. Such a plan would please the federal government and business interests because it would be less costly to administer than a system of governmental inspections.

However, union leaders have said that allowing businesses to conduct self-inspections rather than having a system of regular government inspections is unacceptable (*BI,* May 22, 1972).

* * *

A New York-based shipping concern has become the first firm to file to form a **captive insurance company in Colorado**.

Overseas Bulk Ships Co., a subsidiary of Overseas Ships Holding Co., has filed a letter of intent to incorporate a captive subsidiary, to be called OSG Insurance Inc. (*BI,* July 3, 1972).

* * *

The Committee for National Health Insurance, chaired by United Auto Workers President Leonard Woodcock, charges that six major

Continued on next page

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1897 Formation of Willis Faber through merger of Henry Willis & Co. and Faber Brothers.

1905 R A Corroon Co. established in New York

1929 Merger of Willis Faber and Dumas & Wylie to form Willis Faber & Dumas.

1929 Corroon & Reynolds becomes first insurance broker with publicly listed stock.

1966 Establishment of Corroon & Black Corporation following merger of Corroon and Reynolds and C R Black Corporation.

1976 Willis Faber shares listed on London Stock Exchange.

1977 Corroon & Black shares listed on New York Stock Exchange.

1990 Willis Faber and Corroon & Black merge to form Willis Corroon Group.

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Continued from previous page

group health insurers reaped "windfall" profits of $96 million last year as a result of the wage-price freeze and the poor job market. Insurers deny the charge.

The committee says the six insurers, which write about half the health insurance for all U.S. workers, realized the financial gain because the premiums they charged for 1971 and many 1972 contracts anticipated that health care costs would continue to increase. However, those costs were frozen, meaning that the premiums charged by the insurers were inflated, according to the committee (*BI,* July 3, 1972).

* * *

Marsh & McLennan Cos. Inc. is the largest U.S. broker, with 1971 revenues of $151 million.

In its first Agent/Broker Profiles issue, *Business Insurance* reports that M&M also has 6,090 employees, meaning that it has about 40 employees per $1 million in revenues. This ratio of employees to revenues was repeated through most of the other top brokers, including No. 2 Johnson & Higgins, with revenues of $75 million to $100 million; No. 3 Alexander & Alexander Inc., with revenues of $57.8 million; No. 4 Frank B. Hall & Co. Inc., with revenues of $44 million; and No. 5 Fred S. James & Co. Inc., with revenues of $33.3 million (*BI,* July 31, 1972).

* * *

Republicans are scurrying to rework a $20 million liability package to protect the city of Miami Beach during the party's national convention set for later this month.

The city has been unable to get **riot and civil commotion coverage** and apparently is pressuring the Republican Party, which already has liability coverage, to obtain the coverage (*BI,* Aug. 14, 1972).

* * *

A congressional commission has recommended major changes to keep the nation's 37-year-old **railroad retirement system** from going bankrupt.

The commission's recommendations to President Nixon and Congress include an immediate 2% payroll tax on both employers and employees to keep the system solvent. The problem, according to the panel, is that there are not enough active rail employees to support the retirees: About 600,000 active employees currently contribute to the plan, which is paying benefits to more than 1 million retirees (*BI,* Aug. 28, 1972).

* * *

More than 1 million California union workers and their dependents are now covered by **health care plans that are fully employer-funded**.

Some 421 major plans help pay hospital, surgical and other medical costs for 1.1 million workers, which represent 98% of non-farm wage and salaried employees in California who belong to unions (*BI,* Aug. 28, 1972).

* * *

Democratic presidential candidate George McGovern is proposing his own set of pension reforms, including full 10-year vesting.

Sen. McGovern charges that the Nixon administration and the U.S. Chamber of Commerce have teamed with the Senate Finance Committee to "cheat American workers" by undercutting the proposed Williams-Javits pension reform bill. He is calling for a standard requiring that employees be vested in 50% of their pension benefits after five years of service, and vest at a rate of 10% a year for the following five years (*BI,* Oct. 9, 1972).

* * *

Proponents of the concept say **flexible benefits**, which allow employees to choose all or some of their benefits from a list of options, will be worth the effort.

Benefit experts say that flexible plans will not increase employers' benefit costs, and actually may help slow their increase.

In addition, they say flexible benefits will improve the employee/employer relationship and may provide more opportunities for good employee benefits communication (*BI,* Dec. 4, 1972).

* * *

Workers compensation in Pennsylvania soon will cover **occupational diseases** as well as occupational injuries.

Under a new law, employers must cover the insurable liability for occupational diseases, except those related to coal mining, which are covered by the federal government. Employers may get their coverage from private insurers or state insurance funds, or they may self-insure (*BI,* Dec. 18, 1972). BI

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A Conversation With:

Steven M. Gluckstern

[redacted]

One of the biggest commercial insurance stories of the past decade has been the explosive growth of financial reinsurance. And, among those companies writing financial reinsurance, none has grown more visibly than Centre Reinsurance Holdings Ltd. of Bermuda.

Centre Re is headed by President and Chief Executive Officer Steven M. Gluckstern, a former mathematics teacher. Before joining Centre Re, Mr. Gluckstern was general manager of reinsurance operations for Berkshire Hathaway Inc. as well as president of Columbia Insurance Co. and senior vp of National Indemnity Co.

Centre Re, which was founded in September 1988 with $250 million in capital, now has assets of more than $3 billion.

Mr. Gluckstern explained the intricacies of the financial reinsurance marketplace to *BI*'s Bermuda correspondent Roger Scotton.

* * * *

How did financial reinsurance get started?

The roots of financial reinsurance probably go back hundreds of years. The notion that people look for insurance products that help finance their losses in addition to transferring risk goes back to the beginning of when people bought reinsurance. The modern story, though, is that in the 1960s, '70s and '80s, reinsurers were working with clients with high-frequency loss areas they wanted to fund and were interested in finding some way of designing reinsurance that may have financing aspects. What happened was that people began looking for highly financial uses of reinsurance.

But reinsurers have been selling products that have elements of financial reinsurance for some time. The explosive growth came in the early 1980s when loss portfolios really began to take off. In 1985 to '86, which is when the idea for (Centre Re) took shape, people began thinking of financial reinsurance as a class of business on its own, rather than as an adjunct of reinsurance.

Financial reinsurance comes in many forms and has several labels. Will there ever be a time when one name is applied to all financial reinsurance products?

Probably the moniker of financial reinsurance is going to stick, though personally, I don't like it. The reason is that it carries a lot of connotations about products that were sold that really weren't reinsurance. American regulators poke at financial reinsurance because they view it as non-risk bearing, or as financial transactions that have nothing to do with insurance risk.

'Finite risk,' which is the term we like to use, we hope connotes the association of a certain amount of insurance risk. But, to answer your question, my guess is that there'll never be a single term, unless it's financial reinsurance. And so long as it's broad enough to include risk bearing contracts, then we may have to learn to live with it.

Why does financial reinsurance still suffer from somewhat of an image problem?

I don't necessarily agree that it does. But one reason it may have an image problem is because many of the products first sold in the late '70s and early '80s had minimal, if any, risk transfer. When they were eventually dissected, people found they weren't really reinsurance at all but a form of financing. They weren't fraudulent, but they were incorrectly described as reinsurance. So the suspicion was immediately raised that these financial products had, at their root, the minimization of risk. The perception still exists—I think unfairly—that financial reinsurance is minimal risk insurance.

Another factor is the perception that these products are used to cover up companies' economic condition. And there are examples of products being abused and companies being kept afloat by craftily designed reinsurance. There was a time, about seven years ago, when people tended to think that if a company was buying financial reinsurance, then there must be something wrong with (the company).

But we've come a long way since those days. Financial reinsurance helps manage risk profiles and takes the peaks and valleys out of results.

I have to say, though, that if you're writing bad business, and you continue to write bad business, there's no financial reinsurance I know of that will keep you out of bankruptcy.

At the end of the day, financial reinsurance will not prop up weak companies. There's still a perception that it will. I would say this is not a fair general impression, but I would also accept that it is not entirely unwarranted.

What's the best use of financial reinsurance?

People buy this class of products for lots of different reasons. But the central reason is that they are seen as a more efficient way of managing risk in areas where you expect a reasonable amount of activity. I believe it allows buyers to manage risk with the lowest cost. It's illogical to buy huge amounts of potential risk transfer in areas that are highly predictable. If the risk is highly predictable, then you should buy it in a predictable band and pay as little as possible. The more risk that you ask someone to assume, the greater the price they'll charge.

Define the ideal financial reinsurance client and the ideal kind of risk.

Long-tail casualty business that attracts high prices for traditional risk transfer is probably the single most applicable generic area. Within that area, you might take the layer that is known as risk-exposed in the first $1 million of loss. Traditionally an insurer might have bought a layer of $900,000 excess of $100,000. The rates charged to pay for that may have been extraordinarily high. The results over a 10-year period may be highly predictable, though over a one-year period the results are not predictable and may produce a lot of losses or no losses at all.

That kind of client and that kind of risk exposure is most naturally suited to the bread-and butter financial reinsurance products.

What's the profile of a client that would not normally be expected to buy financial reinsurance products?

A highly leveraged reinsurance risk, where people are paying very little premium for very unlikely and unpredictable events for very big limits. That being said, people have been doing funded cat covers for a long time. These try to blend financial reinsurance with high leverage.

Has financial reinsurance altered the way traditional reinsurers do business?

I believe that it has. The line between traditional reinsurance and financial reinsurance is becoming increasingly blurred. It's very hard to know where one ends and the other begins. Many of the traditional reinsurers are now selling financial products of the kind which, five years ago, would have been labeled as financial reinsurance.

I think that high-financial-content reinsurance, or whatever you want to call it, is an important component of what all buyers of reinsurance are buying. So if you're a generalist reinsurer and your business objective is to offer a wide spread of products to your clients, it's not illogical to include financial reinsurance in your product mix.

Will Bermuda remain the domicile of choice for financial reinsurers?

I believe it will. I believe that its proximity to the United States, which is the largest insurance marketplace today; the fact that this is an English-speaking community; and the fact that it is an attractive tax and regulatory environment mean that there are few places that can compete with Bermuda's pack-

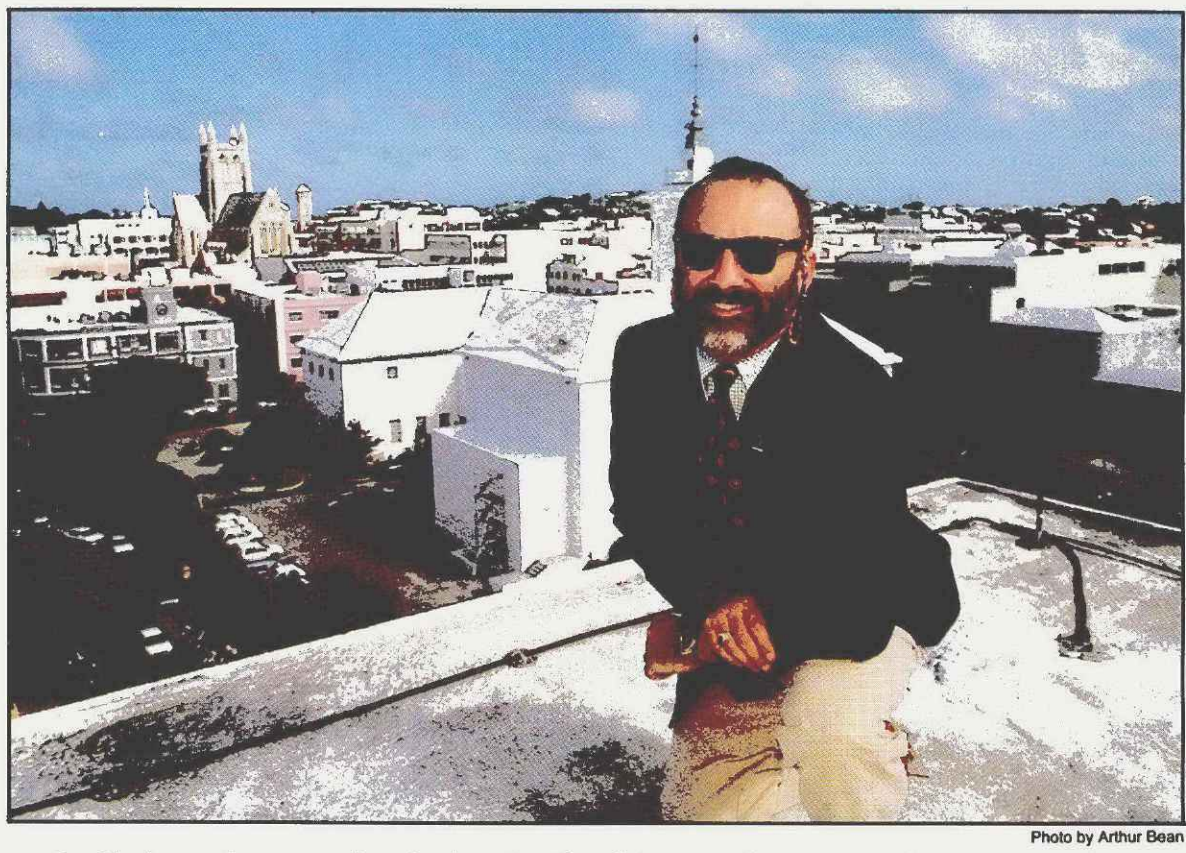


Photo by Arthur Bean

age of resources and talent. (Considering) all these factors. . .if you're a company making a long-term commitment, this is the logical place to do it.

What about current proposals regarding the accounting treatment of financial reinsurance contracts?

This may be simplistic, but my view is that the first test that should be made is whether a reinsurance or insurance product transfers risk. If it doesn't transfer risk, then you don't need any accounting rules, because it's not reinsurance or insurance; it's a deposit and everybody knows how to account for deposits.

If the transaction does transfer risk, either on a prospective or a retrospective basis. . .then it really seems unfair to ask the ceding company to retain that risk on its balance sheet and only to recognize (the transfer) over time. The risk has been transferred to me, so why shouldn't the ceding company be able to take credit for it, irrespective of when it occurred?

Will accounting proposals cripple the financial reinsurance market?

That assumes current accounting proposals are going to be adopted. If they are, the financial reinsurance market will be changed rather than crippled. After all, if we're selling a product that really has a basis to it, that people need and want, then we'll look at what the rules say and we'll design a product to achieve those ends. We'd have an evolutionary transition.

The most extreme changes being suggested today by the Financial Accounting Standards Board, for example, may change retrospective reinsurance by having such strict—and, in my opinion, illogical and bizarre—accounting rules, we may find that deals that have been done historically can't be done in the future.

There are a lot of very creative people in this business. And the needs of the people who buy the products won't go away just because an accounting board says it's going to change a particular accounting treatment. . . .I don't see us being pushed out of existence by any means.

The financial reinsurance business is widely considered 'quantitative and technical.' Does the proverbial 'handshake deal' have any place in the financial reinsurance business?

You live by your word in this business, and the handshake is still a very important part of the way we do conduct our business. That being said, before anyone at Centre Re shakes hands and makes that kind of commitment, I hope we've done a very thorough job of taking a technical and quantitative look at what we're committing ourselves to.

I don't believe financial reinsurance will ever get to the stage where all that's involved is a promise and a handshake. We spend a huge amount of time and effort trying to understand what the numbers and the results tell us. I don't believe that you can make good financial judgments unless you take a look at history and at least explain what it says to you. That doesn't mean that the answer's there.

In the end, our underwriting has a lot of gut to it. In the end you ask, 'Do I like the people? Do I think they know what they're doing?'

Centre Re makes a lot of multiyear commitments and the numbers are not going to tell you what's going to happen in 1996. But we do try to model, on a computer, every financial transaction we enter into. We try to understand what's the best we can do, what's the worst we can do and what's going to happen in between them. There's no guarantee you're going to get it right, but you're more likely to get right having

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done all this than not having done it.

What took the reinsurance industry so long to recognize the importance of financial reinsurance, the time value of money and the dangers inherent in the way the industry has tended to do business historically?

That's a good question, and I'm not sure I know what the answer is. You have to realize that this is an industry that has generally not been quick to adapt to a lot of change. It's been a traditional type of industry. My guess is that a lot of the business was probably done on a handshake, and that when things went wrong because someone didn't look at the numbers, people generally brought them back into line because their friend was sitting across the table.

As we entered the second half of the 20th century, the dollar amounts on the table got enormously large and people began to question the wisdom of a handshake when they were committing to $25 million of coverage. They began to wonder what would happen if the other guy got hit by a truck!

So there was a transition in the flow of dollars through the pipeline of insurance. It's been a natural transition, a natural evolution. It's not so much that people were late in recognizing financial reinsurance, but business was done in certain ways. And it's not just limited to insurance. Look at Wall Street, where there have been incredible changes over the last 20 years.

Technology has also played a role. You could not run the business that Centre Re runs today without very sophisticated personal computers. But these PCs didn't exist 20 years ago. In those days you couldn't have asked an underwriter what would happen if your investment opportunities were only 6%. He wouldn't have known how to answer the question, and you couldn't have expected him to.

What's the biggest threat to the continued growth of the financial reinsurance industry?

I don't believe there are a lot of reasonable threats out there. Irrational treatment by accounting or regulatory authorities could impinge on it, though I don't think that is too likely.

One of the elements in any financial reinsurance is that it has a limitation on liability. Whether the cap is 150% of premium or 200% or 500%, there's always a limitation. A regulatory authority taking a position that this form of limitation on liability transfer would not be classified as insurance would cause very substantial disruption in our marketplace.

The fundamental element of the business is that we can predict what our worst case is going to be. But if someone said, 'We're not going to allow you to have a worst case; you must take unlimited, unbridled risk each time,' there would be real disruption of the business.

What are the prospects and opportunities for further growth in the financial reinsurance industry?

I think that the greatest opportunity for us now lies in adapting many of our products to the insurance marketplace. The use by corporations of financial risk management techniques is a vast market that will become very exciting over the next 10 years.

What will financial reinsurance look like 25 years from now?

I think it will look a lot the same. But I believe people will be buying two kinds of reinsurance 25 years from now. One is highly leveraged reinsurance, where people are paying very small rates on line for very unlikely events, like earthquakes and major typhoons. They'll have to buy that.

But the only other form of products they'll be buying will be financial products—risk management reinsurance designed without the notion that somehow you've managed to outsmart the reinsurer and are transferring the risk to him. Risk management reinsurance would view the reinsurer as a financial partner who can provide a balance sheet to use when the results are worse than predicted and a facility to manage those times when your business is going through extremes, either at its bottom or top.

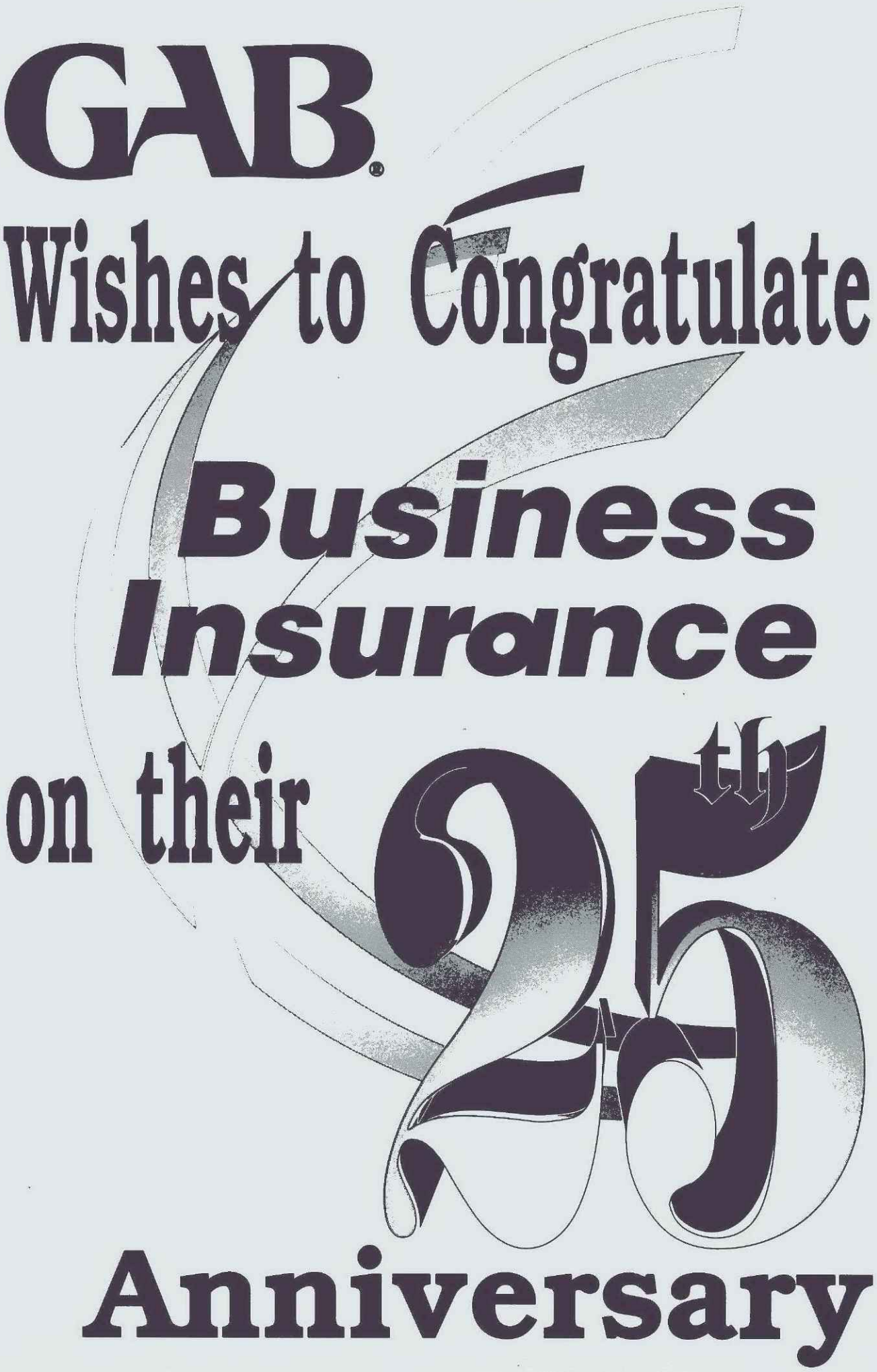
I think that a lot of what you would call traditional reinsurance will have vanished from the marketplace in 25 years. I think you'll really see a bifurcation. And I think that a lot of the risk management techniques that we're using for reinsurance will have flowed into the insurance market. I think we'll see many, many corporations around the world managing risk in similar ways.

Why isn't Steven Gluckstern still teaching mathematics?

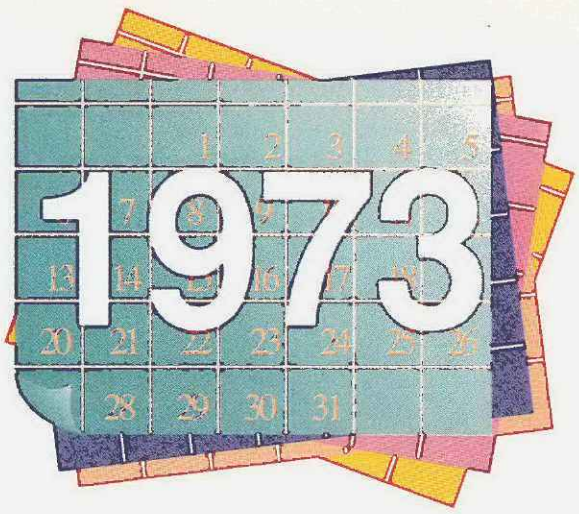
I love teaching, I love children and one day I'll go back to teaching. But the glib answer is that it's difficult to make a living teaching math. There are also many intellectual challenges in business that I wasn't being exposed to as a teacher, and there are still more intellectual challenges facing me.

I am now more concerned with the running of the business. We have a lot of talented people in this company, and I am spending less time on capital commitment of risk and more time on actually running the operation.

But, in the long run, I would like to teach again someday. In my opinion, teaching is probably the single most important component of the continuity of our civilization. BI



Looking Back



Risk managers say that changes in the **comprehensive general liability policy** that take effect today will have a greater impact on small and medium-size companies than on large corporations. Large corporations, because of their size, usually can negotiate manuscripted or very flexible policies.

However, risk managers cautioned that all insurance buyers should study the differences between the 1966 CGL form and the revised one. And, they are reserving judgment on the new form until they see how it works in actual practice (*BI,* Jan. 1, 1973).

* * *

A St. Louis County Circuit Court has ruled that Monsanto Co.'s **self-insured medical plan** is illegal because it contains "all the elements of insurance," and Monsanto is not a licensed insurer (*BI,* Jan. 15, 1973).

* * *

International Business Machines Corp. has added an **adoption assistance plan** to its employee benefits program.

The groundbreaking plan, which will pay 80% of eligible expenses up to a total of $800 for each adoption, was implemented because "it seemed like a good, equitable thing to do," according to IBM (*BI,* Feb. 12, 1973).

* * *

Lloyd's of London underwriters are the insurers for the bulk of the **largest personal injury award in U.S. history**: $4.025 million awarded to a 13-year-old boy who was paralyzed from the neck down in a schoolyard injury in July 1970.

Although there are several defendants and insurers involved in the case, Lloyd's will be liable for $3.9 million as the insurer of Mount Zion Hospital in San Rafael, Calif.

A Superior Court jury in San Francisco handed down the award for Kelley Niles, who was injured in a fistfight during a supervised summer recreation program sponsored by the city of San Rafael and the San Rafael school district. Both the city and the school district will pay $25,000 (*BI,* Feb. 12, 1973).

* * *

The **war risk coverage** on a Libyan Arab Airlines Boeing 727 that was shot down by Israeli fighter planes last month had been allowed to lapse just days before the incident, in which 106 people died.

Aviation sources said the coverage had lapsed five days before the plane was shot down because the Libyans felt the coverage was expensive. Apparently, Libya's nationalized insurance industry will have to pay for the aircraft, which is valued at about $7 million. Israel said it will compensate the families of those killed (*BI,* March 12, 1973).

* * *

Mattel Inc. has sued 23 insurance companies, charging the companies failed to pay $8 million of $10 million in **business interruption losses**.

The suit charges the insurers have withheld payment because Mattel has refused to comply with appraisal of damage provisions of the policies involved in the claim, which results from a 1970 fire that destroyed a Mexican warehouse. Mattel claims the appraisal clause is intended to apply to the fire insurance losses, not the business interruption losses (*BI,* March 26, 1973).

* * *

Product liability lawsuits have increased 400% in five years—to an estimated 500,000 in 1972. Reasons for the increase include the spread in judicial application of the doctrine of strict liability, which is now recognized in more than half the states (*BI,* April 23, 1973).

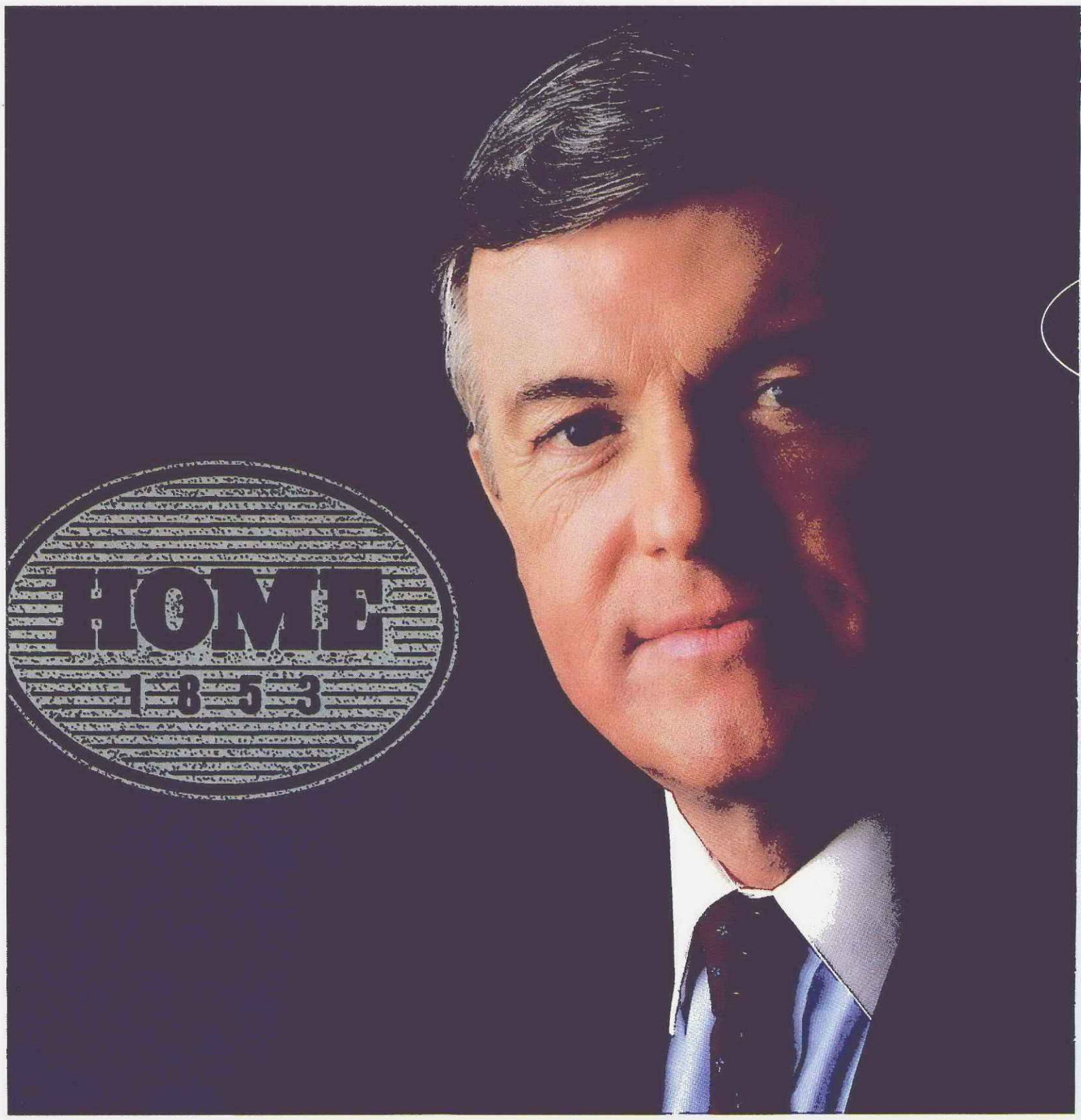
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The ultraconservative **John Birch Society** says the Occupational Health and Safety Act is a step toward fascism.

According to a John Birch Society pamphlet: "OSHA has been carefully designed to create a climate of terror—terror which can be used selectively for political purposes—to turn businessmen into criminals, to cast them as ogres who have no interest in safety, to deny their civil rights and eventually those of everybody. . .The real purpose of OSHA—as of so many federal

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THE HOM



OLD PROS ON

Continued from previous page
schemes—is to impose a totalitarian discipline on the American people, of the type found in Nazi Germany and Communist Russia" (*BI*, June 4, 1973).

* * *

The National Assn. of Insurance Commissioners has given final approval to a $500,000 study of **examination techniques used by state insurance departments** to assure company solvency.

The study will be financed by the insurance industry, and the NAIC says it already has firm pledges of financial support totaling more than the $500,000 projected cost. The results of the study are expected by April 15, 1974. The NAIC hopes the study will reveal how to update examination techniques so it will be easier to detect potential insolvencies (*BI*, June 18, 1973).

* * *

The Treasury Department has called "a big mistake" what had been thought to be a Nixon administration proposal that **employer contributions** to sickness, accident and disability insurance be considered taxable income to employees.

The Treasury says the proposal was included by mistake in printed tax suggestions presented to the House Ways and Means Committee by Treasury Secretary George P. Schultz.

A Treasury official says the proposal was one of many that had been "kicked around in discussion, but it never should have made it into the form presented on the Hill" (*BI*, June 18, 1973).

* * *

There apparently is no property or liability coverage on losses from a **fire at a nightclub in New Orleans' French Quarter** that killed 38 people. Although the contents of the Upstairs nightclub were insured on a surplus lines basis in overseas markets, there was no property coverage on the second-floor club and no liability coverage (*BI*, July 2, 1973).

* * *

The Senate and the House both have approved amendments to the Taft-Hartley Act to allow **prepaid group legal services** as a negotiable, jointly administered employee benefit. A joint conference committee will have to meet later this month to reconcile differences in the Senate and House versions of the bill (*BI*, July 2, 1973).

* * *

Consolidated Mutual Insurance Co. reportedly is the insurer for the largest hotel robbery in New York City history, the theft of $203,000 belonging to the British rock group **Led Zeppelin** (*BI*, Aug. 13, 1973).

* * *

Hearings are expected to begin this fall before a Senate committee on a bill to make it easier for employers to comply with the **Occupational Safety and Health Act**.

Employers and their lobbying groups have expressed great dissatisfaction with OSHA, saying it is very burdensome for them to meet all the requirements of the current law. In response to their requests, a group of senators introduced the Occupational Safety and Health Act Amendments of 1973. The bill is pending before the Senate Labor and Public Welfare Committee, which is expected to begin hearings after the current congressional recess ends in early September (*BI*, Aug. 27, 1973).

* * *

The Nixon administration is studying a proposal that would require employers with more than 25 employees to offer them membership in a **health maintenance organization** as an option to traditional medical coverage.

The proposal is included in a national health insurance "action memorandum" issued recently within the Department of Health, Education and Welfare and leaked to the press by Sen. Edward M. Kennedy, D-Mass. The memo says there has been no "formal decision" on the HMO requirement (*BI*, Sept. 10, 1973).

* * *

The United Auto Workers union is demanding some form of auto industry-financed **pension termination insurance**.

The UAW hopes to include the pension protection provision in its negotiations on new contracts for 700,000 autoworkers at the nation's three largest car makers (*BI*, Sept. 10, 1973).

* * *

The new contract between the United Auto Workers and Chrysler Corp. includes dental coverage and a **"30-and-out" retirement plan**, under which a worker can retire after 30 years of service, regardless of age.

The pact also includes an agreement that Chrysler will pay any taxes levied on workers if a national health insurance program is enacted (*BI*, Sept. 24, 1973).

* * *

Britain's Labor Party says that it will press for **nationalization of the British insurance industry**, except Lloyd's of London, if it regains control of Parliament in 1975.

Labor Party leaders say that nationalization of the non-Lloyd's section of the insurance industry would result in more efficiency and lower prices. Lloyd's is excluded from the plan because it underwrites relatively little domestic life and auto insurance, which are major targets of the nationalization.

The Labor Party's plan is sure to meet stiff opposition from the Conservative Party, which currently controls Parliament, and from the insurance community in Britain (*BI*, Sept. 24, 1973).

* * *

A bill that would limit private expenditures for medical care in the case of **catastrophic illness** has been introduced in the Senate.

The bill, introduced by Sens. Abraham Ribicoff, D-Conn., and Russell Long, D-La., would limit individuals' expenses to $2,000 and the first 60 days of hospitalization. It also would make available a "certified private insurance policy at a reasonable cost" to cover those expenses. And, low-income people would have all health expenses paid by a federal program (*BI*, Oct. 8, 1973). BI

E TODAY



A NEW TEAM

What Comes Down Must Go Up?

Once upon a time, the property/casualty cycle turned like clockwork; that's no longer the case

By Judy Greenwald

Like a chameleon that changes color to reflect its surroundings, the property/casualty insurance cycle reacts to its environment, yet retains its essential identity.

Over the past 25 years, the property/casualty market has hardened, then softened, then hardened yet again—but each cycle is unique and reflects different circumstances.

"Cycles are entirely natural for economic life and are likely to continue," said consultant H. Felix Kloman, a principal with Tillinghast in Stamford, Conn.

"There is a natural cyclicality to almost everything we do, and the insurance industry is not immune to that cyclicality, so we should not be surprised to see it," he said.

Recently, though, the fundamental rhythm of that cycle may have changed. This last soft market has already lasted for several years, perhaps indicating a trend toward only relatively short hard markets followed by long soft markets.

The market used to change "like clockwork," said Salvatore Zaffino, chairman and chief executive officer of intermediary Crump Re in Hartford, Conn. "It doesn't happen anymore."

Until the 1970s, it could be said there was a six-year cycle, "three up and three down," said Sean Mooney, vp and economist at the Insurance Information Institute in New York. Since the 1970s, however, there have been only two cycles, "both quite different in character."

The soft market of the early 1970s was followed by the hard market of 1977 and 1978, which in turn was followed by a soft market that lasted from 1979 until 1984. The market then suddenly—and dramatically—hardened. But after only a relatively brief but intense hard market, prices started to decline in 1987 through today, though the price cuts have not been as big as in the early 1980s.

Meanwhile, overlapping factors including too much capacity, the growth of alternative risk financing methods, the sour economy and fear of regulatory action have all acted to prolong the current soft market beyond almost anyone's expectations.

Because different factors have been the catalyst for previous market turns, even industry veterans and outside analysts have trouble foreseeing the next catalyst.

Hurricane Andrew, the costliest disaster ever, is one likely candidate. "This may be the push over the edge," said Tom Gallagher, senior vp at Prudential Reinsurance Corp. in Newark, N.J.

Others are certain only that it will take a crisis of some sort to turn the market.

"It's always been a crisis-driven situation," said Michael Lewis, first vp with Dean Witter Reynolds in New York. Cycles are always driven by need, not desire, he said.

Take the hard market of the 1970s, for instance.

It is generally blamed at least in part on a crisis in automobile insurance rates, which led to GEICO Corp.'s near bankruptcy and overheated the market.

Another contributing factor was the 1974-75 stock market crash, pointed out Gloria Vogel, first vp with Lehman Bros. in New York. Insurance companies then had invested heavily in common stock, which is reported at market value, and the crash took away significant amounts of capital. The St. Paul Cos. Inc., for instance, at one point lost half its surplus.

Or, consider the abrupt market hardening of the mid-1980s, which is attributed to the "liability crisis" and the contraction of the reinsurance market.

Spurred by a gradual loosening of price regulation, insurers in the early 1980s used primary rates "very aggressively" as a marketing tool, said Mr. Mooney.

For the first time, insurers could lure customers away from their competitors by cutting prices, he said. Pushing the trend was cash-flow underwriting. High interest rates meant insurers could cut rates to bring in more business and make up the difference with their investment income.

Insurers counted on having a certain number of years to earn interest to pay claims, but they did not actually know what the amount of these claims would be. Judgments on claims costs were "uncertain and difficult," Mr. Mooney said, which led to a tendency to "low-ball" on reserves.

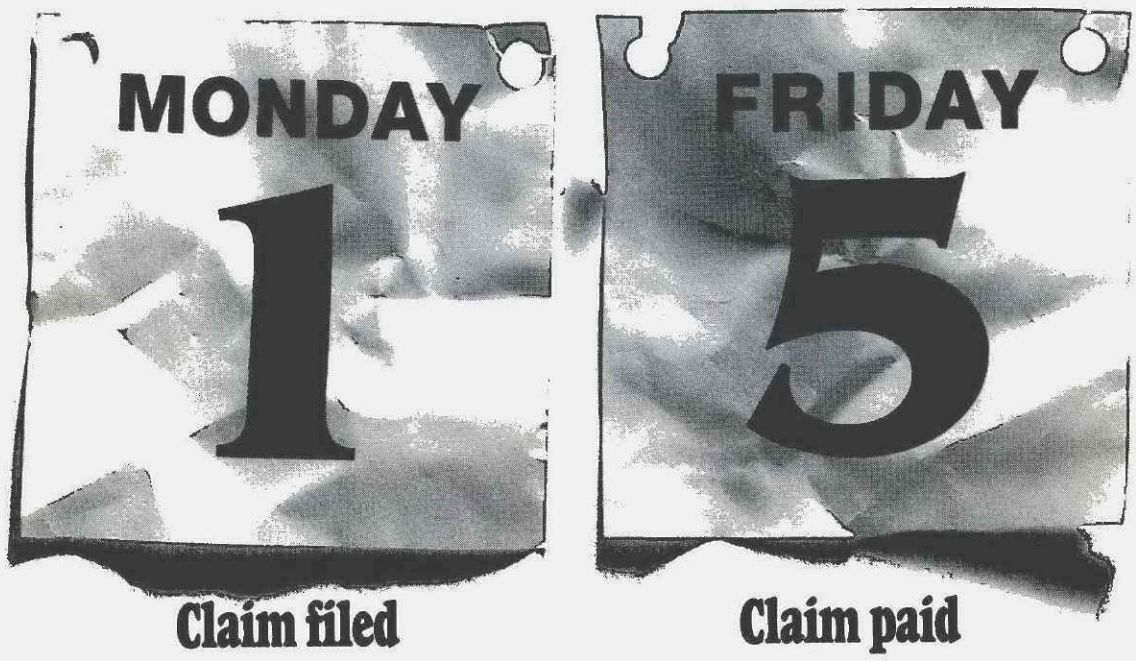
This left insurance companies short when liability costs rose and courts began to assess liability much more broadly.

Adding to the forces that turned the market was a rapid contraction in the reinsurance market, noted Barbara Stewart of Stewart Economics in Atlanta.

Today, the insurance industry "faces a very, very complex environment," said William H. Boornazzain, senior vp of national com-

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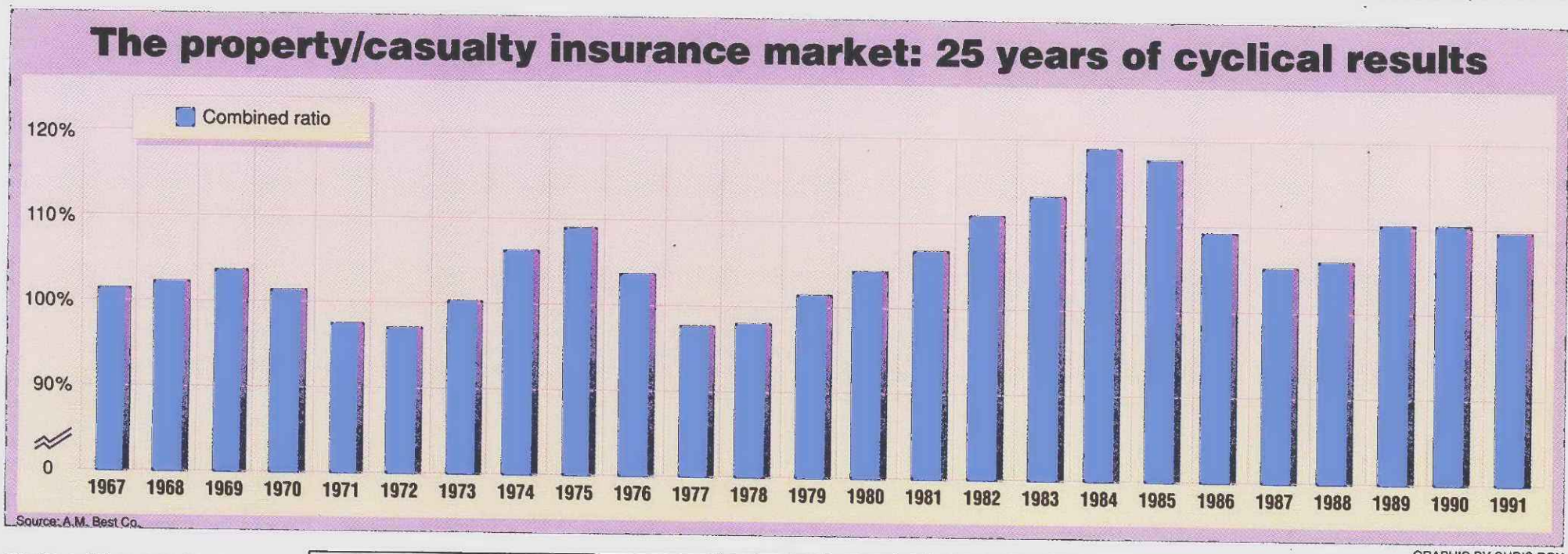
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GRAPHIC BY CHRIS ROY

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mercial accounts for Aetna Casualty & Surety Co. in Hartford, Conn. Revenue growth is down, the economy has been poor the past four years, investment income is declining, rates are competitive and insurers are withdrawing from writing business in certain areas. Exacerbating all this has been two back-to-back hurricanes.

Among other factors that have shaped the market cycle is alternative risk financing. The outflow of premium dollars from commercial insurers has delayed commercial insurance rate hikes.

If insurers raise rates, policyholders have the "incentive and experience to go elsewhere in the alternative market," Mr. Mooney said.

"Those premium dollars don't return," which means insurers writing traditional business are left to compete harder to get the remaining business, said Kieran P. Burke, president of wholesale brokerage Tri-City Insurance Brokers Inc. in New York.

Overcapitalization also continues to play a major role. Even with the two major hurricane losses, "we still didn't lose as much money as we did when the stock market crashed," noted Joanne Morrissey, a principal with Firemark Research in Parsippany, N.J.

"There's clearly been a fundamental change" in the cycle brought about by the extra surplus, said Robert M. Steinberg, chairman and CEO of Reliance Insurance Co. in Philadelphia.

Until the excess capital works itself out of the industry, there will continue to be lengthy soft markets distinguished by the "very long, slow degradation of results," Mr. Steinberg said. Companies will struggle to bring their return on equity back to acceptable levels.

Excess capital will disappear, he said, as poor companies either go out of business or are taken over by better companies.

Reported industry surplus has grown to $160 billion to $165 billion today from just $65 billion in the mid-1980s. Combined with the alternative market's success in attracting about one-third of the traditional market, a "lot of supply and reduced demand" has prolonged the soft market, said Michael White, deputy chairman of Alexander & Alexander Services Inc. in New York.

What's more, insurer withdrawals from certain lines have freed up even more capital, said Mr. White.

The greater involvement of foreign insurers in the business also has added to the available capacity, said Steven Newman, chairman, president and CEO of Un-

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The cycle

Continued from previous page

derwriters Reinsurance Co. in Woodland Hills, Calif. "The deeper the pockets, the longer it takes normally for an industry to blow the whistle."

Having all this surplus without the opportunity to write premium makes insurance companies more like banks and helps prolong the cycle, said Richard J. Roth, senior vp in charge of underwriting for Arkwright Insurance Co. of Waltham, Mass.

If insurers, in fact, got out of the insurance business completely and lived off their investment income, "a lot of these companies would be a lot further along," he said, tongue-in-cheek.

Another factor prolonging the current soft market has been the strong stock and bond markets, which have bolstered results and prevented insurers from reaching that "crisis level" that is needed for a change, said Mr. Lewis.

"The companies haven't been hurting that badly overall. . .so they feel free to compete freely," said James J. Meenaghan, president and CEO of The Home Insurance Co. in New York.

He also noted this prolonged competitive atmosphere has occurred even without high interest rates and the "loads and loads of cheap reinsurance" that characterized the last soft market.

Lloyd's of London has also played a role in the prolonged soft market. Syndicates now write less U.S. business than before, which means more business for new U.S. and European reinsurers and higher retentions in the domestic market.

If Lloyd's had continued to dominate the reinsurance market, it may have responded to the current environment by pulling back and causing a turn in the cycle. Now, its smaller market share would be insufficient to cause a turn even if it did pull back, Mr. Mooney said.

Another factor that could be causing a delay in a market turn is that insurers are now acting on the assumption that there won't be a turn, said Mr. Lewis.

Insurers are running their business as though the market turn will never happen: monitoring expenses, cutting excess costs and, as they become more focused on how and where they operate, ceasing to write business in areas that do not produce satisfactory results.

The economy is doing its part to inhibit a turn by keeping loss costs down, said Ralph J. Palmieri, president of First State Management Group, an ITT/Hartford Group Inc. unit in Boston.

It is still not clear what will change this market.

"Each hard market recovery has its own unique characteristics. This one will certainly have its own," said John H. Snyder, vp at A.M. Best Co. in Oldwick, N.J.

The market will turn when the psychology of CEOs and their boards moves from the urge to protect market share to the belief that "if I can't make money, I can't stay," said Mr. Newman.

"People only stop writing when they they're scared," said Michael Goldberg, vp at Berkshire Hathaway Group in Omaha, Neb., who said that might take a $30 billion to $40 billion catastrophe.

When it does come, there will not be the dramatic hikes seen in the last turn, many say.

Rate hikes of 300% to 400% are unlikely because the economy will not allow it, because regulators would prevent it, and because it would jeopardize customer relationships and "companies wouldn't do it again," said Ms. Vogel.

The sagging economy may be particularly important in holding down rates.

"Insurers could not raise rates realistically at the time the companies were already struggling with the recession," said Cheri Hawkins, director of insurance at Weyerhaeuser Corp. in Tacoma, Wash. "People are having trouble just keeping companies afloat."

The turn, when it comes, will be perceptible but not dramatic, said A&A's Mr. White.

"Neither the consumers nor the regulators would allow us to have that, and probably shouldn't," agreed Tom Case, president of Employers Reinsurance Corp. in Overland Park, Kan.

Perhaps, though, there is no longer one cycle to change. Some observers believe that a number of different "mini-cycles," not necessarily acting in concert, will soften the curves in the cycle.

"It will never go back to what it was," said Firemark's Ms. Morrissey, who foresees mini-cycles in workers compensation, property, health and other lines.

"They're not all going to be together as one big price-competition cycle. It's going to be mini-cycles within the subset of the insurance industry," she said.

But Charles Ruoff, senior vp at Sedgwick James Inc. in New York, disagreed. "I think the only clear distinguishing factor is personal and commercial lines," he said. When the psychology of the market changes, "that psychology runs through the marketplace, and it's not restricted to a single line."

Most observers believe there eventually will be an upward trend in prices, however mild.

"Ultimately, I still believe it's a cyclical industry," said Mr. Lewis. "There will be price firming and softening trends going forward," although it may not be as volatile because legislators and regulators will not permit it.

But the days of "clockwork" changes in the cycle are probably gone.

So much has changed that "I don't see that it would go back to a normal cyclical cycle, if you will," said Judith Tornese, vp-risk management at Transamerica Corp. in San Francisco. "I think the status quo is going to continue." BI

Associate Editor Judy Greenwald, who joined BI in 1984, covers the property/casualty insurance industry.

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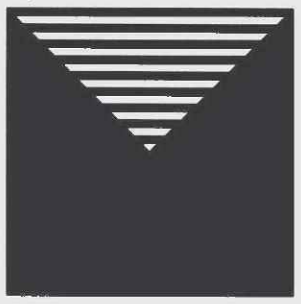
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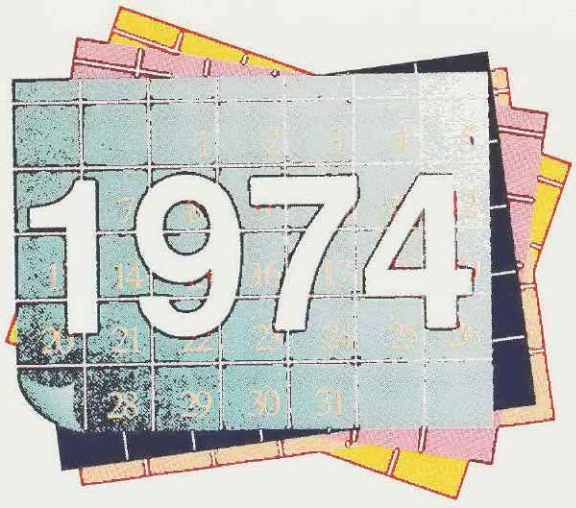
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Looking Back



President Nixon is expected to propose in his State of the Union address a **two-tiered national health insurance program**.

The program, which would cost an estimated $37.5 billion by 1975, would consist of a government plan to provide coverage to low-income people and those who have trouble obtaining health insurance, and a private plan that would require employers to provide a certain level of health insurance coverage.

Employers would have to pay 75% of the costs after a start-up period (*BI*, Jan. 21, 1974).

* * *

More and more employers nationwide are adopting flexible work hours, as companies see **"flex-time"** as a cost-free employee benefit.

Flex-time, which includes a core period in the day during which all employees work and two bands of flexible time each day, costs employers nothing but is a benefit employees appreciate, its proponents say (*BI*, March 4, 1974).

* * *

Despite the Internal Revenue Service decision to disallow **tax deductions for premiums paid to single-parent captives,** U.S. corporations remain interested in captives.

Despite the IRS decision on captive tax deductions, many corporations find that captives offer other financial advantages, such as improved cash flow (*BI*, March 4, 1974).

* * *

The crash of a Turkish Airlines DC-10 that killed 345 people is sending ripples through the airline insurance community.

Lloyd's of London and the London market have the majority of the coverage for the aircraft hull, insured for $20 million. Passenger liability claims are expected to add an additional $10 million to $20 million in losses in the Paris crash, **the worst crash in aviation history.**

In addition, the possibility exists of liability suits against the plane's manufacturer, McDonnell-Douglas Corp., because the crash occurred when the plane lost its cargo door (*BI*, March 18, 1974).

* * *

The growing importance of the risk management function in U.S. companies may bring the **disclosure of insurance and risk management data in annual reports**.

Walter Woodward, president of the American Society of Insurance Management, said that the impact of insurance—and the importance of the risk management department—has increased significantly in recent years (*BI*, April 15, 1974).

* * *

High inflation and the growing sophistication of risk managers are building interest in **cash-flow insurance plans**.

The main advantage of cash-flow insurance plans is that they keep a corporation's money in its own coffers for a longer period of time, allowing the funds to earn interest for the company or letting the company avoid having to pay high interest rates on money borrowed to pay premiums (*BI*, April 29, 1974).

* * *

A U.S. District Court judge has ruled that General Electric Co. is guilty of sex discrimination because it **denied disability benefits to its pregnant workers**.

General Electric is expected to appeal the decision, which, if it stands, could cost the company millions of dollars in back pay for pregnant workers (*BI*, April 29, 1974).

* * *

Although they were formed to insure the risks of their parent companies, more **captives are writing outside books of business**.

Bermuda-based captives in particular are actively seeking outside commercial business, according to experts in the captive field. Captive owners, finding success in insuring their own risks, are expanding into the general insurance business (*BI*, May 13, 1974).

* * *

Competition is forcing premiums down and limits up on **directors and officers liability coverage**, observers say.

More insurance companies have entered the field of D&O coverage, increasing competition and forcing rates to drop somewhat, even among the Old Guard. Even those insurers that are not dropping rates are being forced to increase limits on the coverage, industry sources agree (*BI*, May 13, 1974).

* * *

The House Ways and Means Committee is launching an assault on one of the major **tax breaks for captive insurance companies**.

The committee, which has been studying treatment of foreign income, has tentatively agreed to eliminate "subpart F" tax exemptions, which affect the tax treatment of captive income from insuring U.S. risks.

Rep. Wilbur Mills, D-Ark., even suggested setting a minimum tax on the foreign income of U.S.-controlled overseas subsidiaries, including captives, but that suggestion was dropped in the wake of a strong lobbying effort by U.S. multinational corporations (*BI*, June 10, 1974).

* * *

Major U.S. corporations are reporting **significant rate increases** for their property/casualty insurance coverages.

The rate hikes, caused by continuing inflation and the growing frequency of claims, appear to be averaging about 10%. The steepest rate hikes are for workers compensation, product liability, boiler and machinery insurance, and certain fire coverages.

Rates are not rising across the board. Buyers report that directors and officers liability premiums are remaining the same or, in some cases, even dropping slightly (*BI*, June 10, 1974).

* * *

The additional work and expense created by the implementation of **cafeteria benefit plans** are keeping many companies from taking the plunge, even when they agree with the concept.

Most benefit experts agree that employees would like the plans, which allow workers to choose from a variety of benefit options. But, employers are concerned about the additional expense and administrative problems involved in the plans (*BI*, July 8, 1974).

* * *

By his resignation, **President Nixon** preserved his employee benefits, which include an annual $60,000 pension for life.

Mr. Nixon probably would have lost his benefits if he had been impeached and removed from office.

He still could lose the benefits if he is indicted and prosecuted for his role in the Watergate cover-up (*BI*, Aug. 19, 1974).

* * *

President Ford is expected to choose Labor Day to sign into law the **Employee Retirement Income Security Act of 1974.**

This massive pension reform measure finally will become law more than 12 years after President Kennedy established a Cabinet-level task force to investigate the private pension system (*BI*, Sept. 2, 1974).

* * *

A.H. Robins Co. Inc. has insurance for at least part of the liabilities and damages that will arise from lawsuits over the company's **Dalkon Shield** intrauterine contraceptive device.

Sources say that Aetna Casualty & Surety Co. underwrites the coverage that will respond to product liability suits regarding the device, which Robins has manufactured and distributed since 1970. Robins currently faces lawsuits seeking more than $500,000 in damages filed by two Kansas women who became pregnant while using the Dalkon Shield.

In addition, a class-action suit has been filed against the company in New Jersey by a group of obstetricians and gynecologists who charge Robins with "deliberate misstatements and calculated failure to disclose information about the Dalkon Shield" (*BI*, Sept. 16, 1974).

* * *

The new **Pension Benefit Guaranty Corp.** created by the Employee Retirement Income Security Act of 1974 is still waiting for the appointment of its first boss.

And, while the search for a leader continues, the PBGC already has a backlog of claims for pension benefits from almost 200 terminated pension plans.

The final decision on a director will be made by the secretaries of labor, treasury and commerce, who make up the PBGC's board of directors (*BI*, Oct. 14, 1974).

* * *

The average total cost for a **directors and officers liability claim** is $566,500, according to a recent survey.

The second annual D&O survey conducted by The Wyatt Co. reveals that the average award in a D&O claim is $385,000, and defense costs average $181,500, based on responses from 1,321 U.S. corporations.

The survey also shows that the most common types of D&O claims involved antitrust violations, conflict-of-interest charges, irregularities in securities issue and misleading representations made in conjunction with corporate acquisitions (*BI*, Oct. 14, 1974).

* * *

The market for **medical malpractice insurance** is drying up and may blow away, according to an executive for one of the few companies that still write the coverage.

Waverly G. Smith, president of St. Paul Fire & Marine Insurance Co., said that the market has reached a crisis stage. He noted that St. Paul recently stopped underwriting the coverage in Maryland when it could not obtain approval for a rate increase (*BI*, Nov. 25, 1974).

* * *

The American Society of Insurance Management will change its name to the **Risk & Insurance Management Society Inc.**, effective Jan. 1, 1975.

Members voted for the name change to more accurately reflect the purpose and scope of the organization and to remove the term "American," with its implied geographic limitations.

The society had been called the American Society of Insurance Management since 1955, and before that it was called the National Insurance Buyers Assn. (*BI*, Dec. 9, 1974).

* * *

Major U.S. corporations say that their **employee benefit costs** have increased an average of 10% to 15% in 1974, though some cite hikes as high as 40%, according to a *Business Insurance* survey.

The country's double-digit inflation rate appears to be the main culprit, as employers say that the most common causes of their higher benefit costs in 1974 were cost-of-living supplements to retirees, increased limits for hospitalization coverage and rate hikes for their group health plans (*BI*, Dec. 9, 1974). BI

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A Conversation With:

Rolf F. Hueppi

[redacted]

Rolf F. Hueppi, president and chief executive officer of Zurich Insurance Group, is a truly global insurance executive, having worked in England, India, the United States and, of course, Switzerland for nearly 30 years.

Mr. Hueppi began his career as an apprentice for the Lloyd's of London representative in Switzerland. He was then transferred to London for one year to work with brokers and in an underwriting box at Lloyd's.

On returning to Switzerland, he worked for Zurich on a voluntary basis. He passed up a chance to go to college in Paris when Zurich in 1964 offered him a job as assistant to the president of its operations in India. In 1966, while in his early 20s, he was appointed general manager for India.

After a stint in Switzerland, he was transferred to the United States in 1972, where he eventually was appointed Pittsburgh branch manager.

He filled various posts in Switzerland and in the United States until he was named the group's deputy chief operating officer based in Zurich in 1987. He was promoted to chief operating officer in 1988 and chief executive in January 1991.

Mr. Hueppi spoke last month in Zurich to Associate Editor Gavin Souter.

* * * *

How has the insurance industry changed over the past 25 years?

The most important development is that customer expectations have become a lot more differentiated. This means that the insurance industry has had to adapt a traditional product-oriented approach—which says 'this is the product we have and you can buy it if you want'—to an attitude of looking at customer needs and finding ways of responding to those needs. That is the single most important element in the evolution of the industry.

Why did insurers have to change to meet the needs of the customer? Was it customer-driven?

I think primarily yes, particularly in the larger commercial risks. Risk management awareness has grown tremendously in that segment. This has placed significantly different demands on the insurance industry.

What about the risks themselves. Have they changed?

Underlying forces in the socio-economic systems have changed risk dramatically. Among these are the propensity for litigation and growing affluence, which brings with it the willingness to buy protection and the desire to demand rights and compensation for events that 25 years ago were considered acts of God and were not covered by insurance.

Then in industrial risks, in particular, you have the agglomeration of risk. We have much more pronounced complexities of risk due to technology and the accumulation of risk because of the concentration of values in small areas that were unheard of 25 years ago.

Also, the unpredictability of major catastrophes has increased significantly. And this has led to greater demands on insurance management from the point of view of allocating capital to various areas of risk in terms of geography and the type of risk you can absorb, then balancing that in a total insurance portfolio.

What will change the insurance industry in the next 25 years?

The underlying needs of our customers will be even more specific than they are today. That has to do again with the sophistication of industry. But you also have to go back to the personal lines customer, because the personal lines customers are now more affluent, and managing their security and safety needs is becoming much more of an individual issue than it used to be.

The future customer is one that wants to have a response to his needs and really is not particularly concerned whether that comes out of the liability or the property sector. So customer orientation that started with the commercial accounts will be brought over to the personal lines account.

What other changes will there be in the commercial and industrial insurance market?

Insurers will target market segments both in terms of risk management, in things like hazard analysis and loss prevention, as well as in the traditional financial risk solutions.

For the more sophisticated customer, this will not just be risk transfer but will include risk financing mechanisms that make the risks of our customers manageable all of the time.

So we move away from traditional insurance to an integrated approach in partnership with the customer.

This will include risks that are not necessarily insurable, things like pollution, environmental impairment, asbestosis, pharmaceutical issues. The insurance industry with its capital looks for solutions that will help the customer overcome the problems.

We are talking about a future financial and risk servicing package that the insurer and customer will design together. That will be done for most corporations on a global basis.

There will be very few players. There are not many players who will be capable of providing the underlying services and the global management of those services.

From what you are saying, there will obviously be a closer relationship between the insurer and the policyholder. Where do brokers fit in, or are they no longer needed?

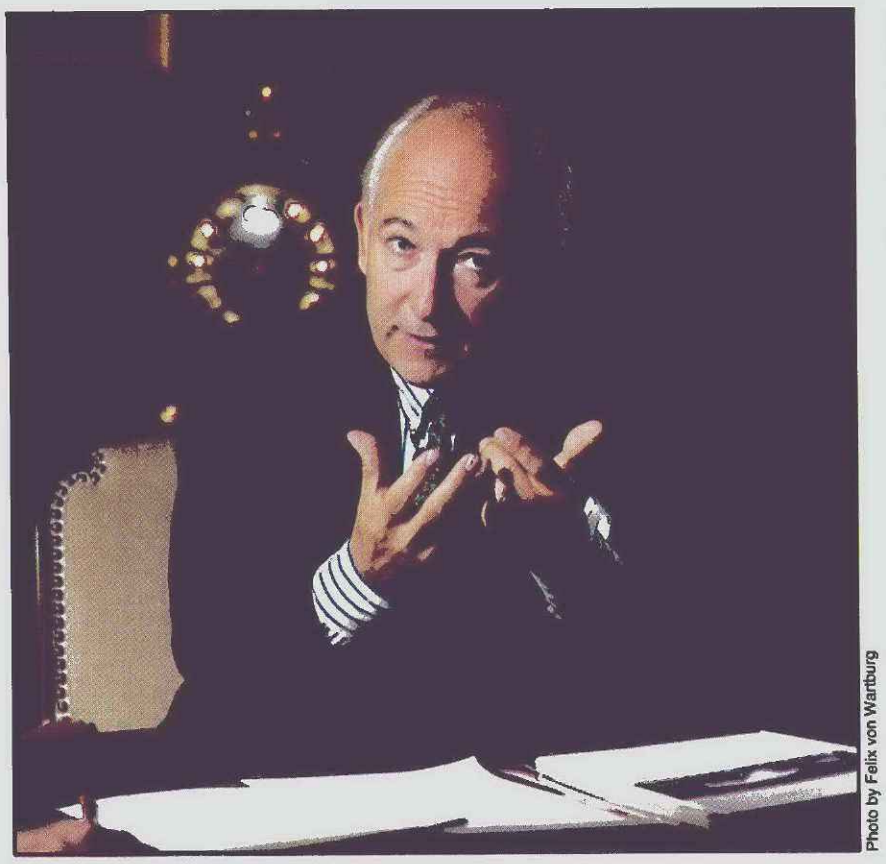


Photo by Felix von Wartburg

The industry 'has not communicated what it does for the economy, or for the social environment.'

No. The brokers are a very important part of this.

In the future, sophisticated insurance solutions will demand a triangular relationship where the brokers, insurers and customers look for solutions together.

Brokers play a very important role in the total market and give customers access to alternatives, and this gives us the opportunity to judge ourselves against the demands of brokers.

But there must be a very good understanding as to who provides which services. For instance, we are very happy when a customer performs certain functions himself because he has very good risk management capabilities, very good risk analysis capabilities, very good administrative capabilities. He can be more efficient in some of these areas than we can be.

How will the structure of insurers change?

There will be a lot more specialization. You will find that a large number of companies, particularly in Europe, will have some difficulty in making the transition to an open market. Therefore, managing a marketplace and positioning yourself in it will be very different.

And I don't think that all of industry members will make it. I think there will be a significant realignment.

There will be large and small insurance companies because there will be specialists, there will be regional companies that will perform very well, there will be large companies that have focused themselves very well. But the undifferentiated company that is still prevalent in Europe today will disappear.

Does this apply to the majority of companies in Europe at the moment?

If the question is, 'Will there be less than 50% of the companies operating in 25 years from now,' I think that will probably be close.

Will that be the same in the United States? Will there be 50% fewer companies?

We are all going in the same direction, but I do not feel that it will be as strong in the United States as it is in Europe. U.S. realignment has already gone further.

On the personal lines front we are seeing more and more insurers and banks coming together. Will that continue?

I almost presume that in what I say. We talk about managing risk and the financial needs of our customers, and that includes managing things that are related not just to the security of physical assets, but managing financial security and taking care of savings and investment management. The insurance industry will move in that direction.

The customer will consult with a sophisticated insurer on how he should protect his assets, much more so than he has today. So there will be a closer liaison with some of the services that banks currently provide and the insurance industry provides.

Will there be many other changes happening soon?

The important thing in our industry is to be a step ahead of what the industry can do, but you don't need to be miles ahead. To create artificial needs way ahead of what the customers want is a very expensive process. It might be fun, it might be interesting and it might be innovative, but economically it is usually not very successful.

What do you think has been the insurance industry's biggest mistake?

That has never changed. It has been very consistent for many years. The insurance industry has done a very, very poor job in making itself be seen as part of the value creation economic community.

The image isn't there. For much too long it's been seen as a necessary evil as opposed to something that creates value for the customer. It has not communicated what it does for the economy, or for the social environment.

On the positive side, what do you think the insurance industry has achieved?

Despite all I have said about what it hasn't done, I think it has contributed a lot to society. It has contributed a lot to the economic evolution of industry. It's done a lot to help people enjoy their relative affluence. It's provided a very predictable safety net for customers.

Also, it's paid its losses and it has provided the leveling of risk for industry and individuals.

And many insurance companies have done very well for their shareholders and have employed a lot of people.

How could it better service clients? What sort of services and facilities will it offer?

The most important value which we will bring to a customer in the future is the knowledge that we have of risk from our perspective. Historically, that has not been done.

Every day I have thousands of claims from around the world, and I get a great deal of information from those claims. I must manage that information well and make it available to my customers and help them use that knowledge to reduce their costs.

Each claim comes about for very specific reasons. If you analyze that, you have the value added which a future insurer will have to bring.

My unique advantage is that I know what happened in all of these claims, and I can use that knowledge and information to manage risks.

The whole management of risk from analysis to reduction to elimination has to be seen in a much broader perspective than has been the case with traditional loss control and surveying.

That's the core value added. It is as important as risk transfer. BI

Looking Back



Insurers are warning corporate buyers that 1975 will be **a year of tight capacity** for commercial insurance.

After suffering enormous underwriting losses, skyrocketing inflation and the loss of surpluses to the bear market in 1974, the insurance industry says buyers can expect significant rate hikes for coverages "across the board," and less capacity and stricter conditions in many lines (*BI*, Jan. 13, 1975).

* * *

International Telephone & Telegraph Corp. plans to transfer more than $127 million to **boost the surplus of its Hartford Insurance Group** unit.

ITT executives explained that the transfer of funds was made to bolster Hartford's surplus, which has been depleted because of the severe decline in the securities market. Insurers generally maintain a 4-1 premium-to-surplus ratio, but before the ITT contribution, Hartford had been writing at a ratio of 6-to-1 (*BI*, Jan. 13, 1975).

* * *

Congress is investigating possible federal solutions to the **medical malpractice insurance crisis**, which has been characterized by extremely tight capacity and high rates.

One bill, introduced by Sens. Edward Kennedy, D-Mass., and Daniel Inouye, D-Hawaii, would establish a voluntary federal malpractice insurance program along modified no-fault lines.

The other bill, sponsored by Sen. Gaylord Nelson, D-Wis., would establish a voluntary federal malpractice reinsurance fund that would initially pay liability claims of more than $25,000 (*BI*, Jan. 27, 1975).

* * *

The Ford administration is opposed to any **national health insurance plan** this year.

President Ford is "almost certain" to use his veto power if Congress enacts a national health insurance plan. The White House says the decision was based on the state of the economy and on President Ford's intention to place a one-year moratorium on new federal spending (*BI*, Jan. 27, 1975).

* * *

St. Paul Fire & Marine Insurance Co., which insures about 48,000 doctors, will begin writing **medical malpractice insurance on a claims-made basis** and stop issuing occurrence-based policies (*BI*, Feb. 10, 1975).

* * *

U.S. employers **spend 32.7 cents of every payroll dollar on employee benefits**, according to a study by the Conference Board. This is up from 25.6 cents 10 years ago.

The study says the increase is due in large part to the fact that many employers are liberalizing their benefit plans. For example, more employers are paying the full cost of benefits for their workers, and more are supplying the same benefit package to blue-collar and white-collar workers (*BI*, Feb. 24, 1975).

* * *

More companies are using **self-insured employee benefit programs**, according to a Fortune Market Research study of the top 1,000 U.S. industrial corporations.

In addition, the study says, about half the companies that insure their benefits have changed their insurer within the last five years (*BI*, March 10, 1975).

* * *

Premiums are set to take off for **aircraft hull and liability and aircraft product liability coverages** in the wake of disastrous hull losses in 1974 and concerns about the outcome of liability claims.

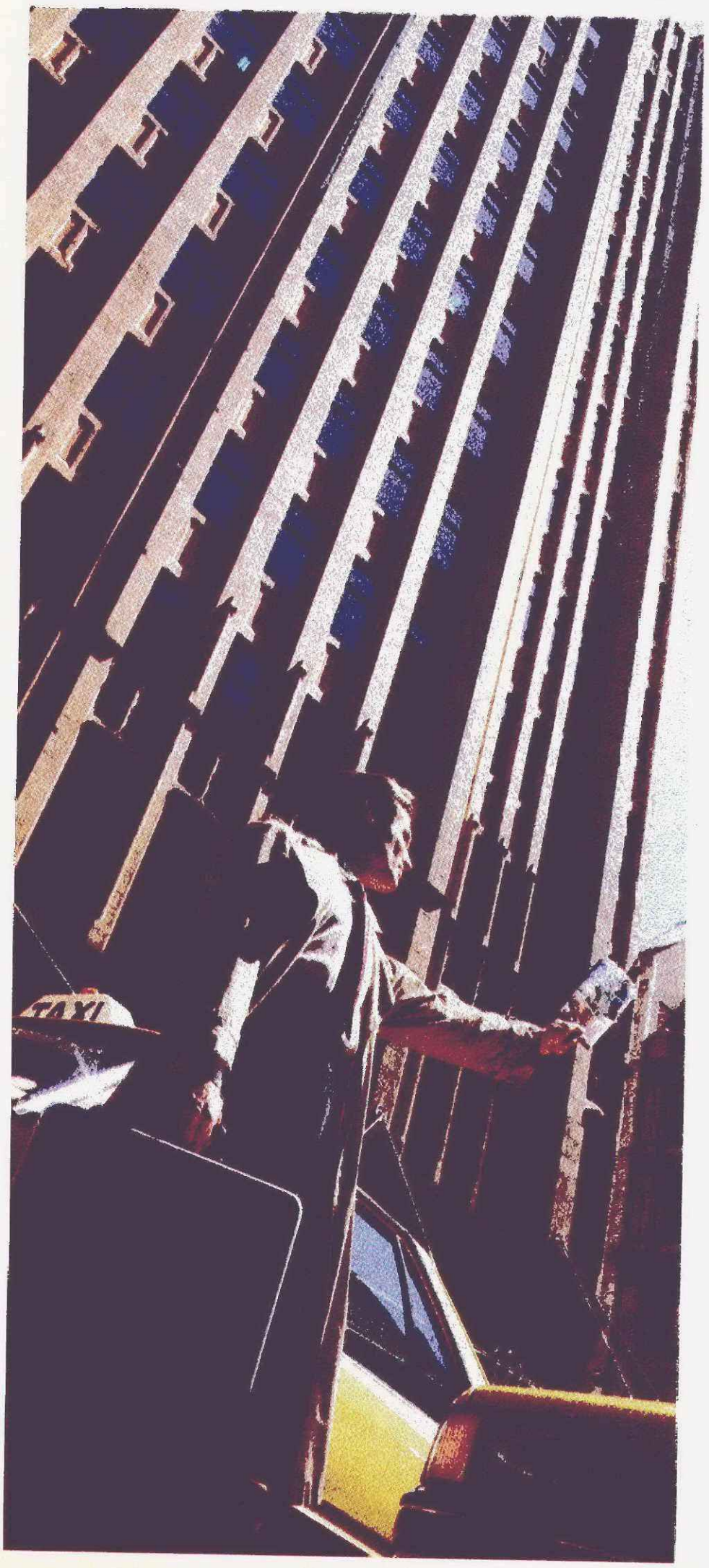
Insurers say hull insurance rates will rise 5% to 10%, but liability rates are likely to jump 15% to 25%. And aircraft product liability rates will soar—and in some cases double—even after 1974 rate hikes of as much as 30% to 50% (*BI*, March 10, 1975).

* * *

The House Ways and Means Committee may vote to levy a special 1% tax on all group health insurance premiums to finance **health care coverage for millions of laid-off workers**.

The committee also may act to

Continued on next page



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Continued from previous page
force employers to extend coverage to laid-off employees for at least 90 days after a layoff. These actions would raise employers' group health insurance premiums by 7% to 8% (*BI*, March 24, 1975).

* * *

The Financial Accounting Standards Board has issued final rules, effective July 1, that make it more difficult for corporations to list as expenses the amounts charged to "accrued reserves" for **future self-insured losses** (*BI*, April 21, 1975).

* * *

Physicians in Missouri, Maryland and Michigan are setting up **mutual insurers to provide medical malpractice coverage** to members of the state medical societies, many of whom have had trouble finding coverage.

In addition, several states are studying the possibility of setting up joint underwriting associations to deal with the rapidly disappearing medical malpractice insurance market (*BI*, June 2, 1975).

* * *

The **Pension Benefit Guaranty Corp.** has proposed regulations on what basic retirement benefits the PBGC will cover, a move that is critical to determining whether a pension plan has sufficient assets.

The PBGC has proposed covering normal-age retirement benefits, certain early retirement benefits, disability retirement benefits and pensions for survivors of deceased plan participants (*BI*, June 30, 1975).

* * *

There is a bipartisan effort under way to amend the **Health Maintenance Organization Act** of 1973.

Identical bills have been introduced in the Senate and the House to change the act to reduce the burdens it places on employers and to cut the cost of the benefit programs HMOs must offer (*BI*, June 30, 1975).

* * *

Blue Cross/Blue Shield officials warn that **group health insurance premiums** in the Washington, D.C., metropolitan area could double by 1980 if hospital costs continue to increase at their current rate.

BC/BS says that daily hospital charges increased 18.5% between 1974 and 1975, spurred by an oversupply of available hospital beds (*BI*, Sept. 22, 1975).

* * *

The recent **insolvencies of Signal Insurance Co. and Imperial Insurance Co.** has sent shock waves through the insurance community.

The California insurance commissioner earlier this month ordered the companies to stop writing new or renewal business effective Sept. 10, saying the insurers were insolvent under California law. The commissioner said Imperial was insolvent because it had inadequate reserves, and that since Imperial is the primary asset of parent Signal, it, too, is insolvent (*BI*, Sept. 22, 1975).

* * *

A defense attorney specializing in **product liability cases** predicts that insurers will switch to claims-made coverage for such risks.

John T. Coleman of the law firm Baker & McKenzie in Chicago said insurers are concerned about how to establish rates for damages in the future and how to deal with disputes about which coverage applies in product liability suits (*BI*, Oct. 6, 1975).

* * *

Havir manufacturing Co., a small Minnesota machine tool builder, is being liquidated because it can't afford product liability coverage and cannot afford to defend itself against a rash of product liability lawsuits.

Havir is though to be the first company to go out of business because of **unmanageable product liability expenses** (*BI*, Oct. 20, 1975)

* * *

General Motors called a special meeting of all its executives who hold public-service positions in the health care field to urge them to help find ways to hold the line on **rising health care costs**.

GM took the unusual move after it was hit with an increase of about 21% in the cost of its employee health insurance. GM, the nation's largest industrial employer, will pay about $800 million for health insurance in 1975 (*BI*, Nov. 3, 1975).

* * *

Five lawsuits against Mattel Inc. have been settled out of court for $30 million, by far the **largest directors and officers settlement in history**. The settlements involve class-action lawsuits filed in 1973 and 1974 charging securities law violations.

Three groups of underwriters of D&O coverage for Mattel—Lloyd's of London and the London market, International Surplus Lines Insurance Co. and Uniguard Insurance Group—will pay a total $13.8 million of the settlement (*BI*, Nov. 17, 1975).

* * *

A U.S. Tax Court ruling in a petition filed by Ford Motor Co. is expected to have a major impact on the future of **captive insurance companies**.

The case, generally considered a landmark for captives, involved a petition filed by Ford as the result of a $6.6 million assessment by the Internal Revenue Service on premiums paid by Ford's foreign subsidiaries into its Bermuda-based captive, Transcom Insurance Co. Ltd.

The IRS claims that "payments from foreign subsidiaries (to captives) are receipts of dividends to the domestic corporation advanced to the offshore company," because by insuring risk in a wholly owned captive, the economic loss remains in the corporate family (*BI*, Dec. 1, 1975).

* * *

In five years, **property/casualty self-insurance will increase by 50%** due to corporate economizing, predicts Time Inc. Employee benefits self-insurance is likely "to double" in this period, Time's marketing department found in a survey of more than 500 corporations (*BI*, Dec. 1, 1975).

* * *

Inflation and government regulations, especially the Employee Retirement Income Security Act, appear to have put employer interest in **cafeteria benefit plans** on the back burner.

ERISA put a freeze until 1977 on the establishment of new cash or deferred profit-sharing plans, critical to the cafeteria plans. Other problems with the plans, which allow employees to choose from among a variety of benefit options, include increased administrative and benefit costs, which are especially unpopular with employers in these highly inflationary days (*BI*, Dec. 15, 1975).

* * *

The recent growth in medical malpractice lawsuits and awards has added significantly to the **cost of insurance for physicians and hospitals** this year, and will add to health care costs for everyone, according to the Health Insurance Assn. of America.

The HIAA says the phenomenal increase in malpractice claims and awards has "resulted in malpractice insurance costs to physicians and hospitals in 1975 of $1.5 billion, a 25-fold increase from $60 million in 1960" (*BI*, Dec. 29, 1975). BI

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Benefit Managers' Balancing Act

Employers sweeten benefits to satisfy workers, but are increasingly strained by the cost burden

Growth has been the buzzword in employee benefits.

The level of benefits that employers offer their workers has grown tremendously over the past 25 years.

So has the amount of money that employers spend on benefits.

And, the concept of employee benefits has grown from what some once considered a giveaway to an integral portion of employees' compensation.

"We're giving employees choices that simply didn't exist in the 1960s," said William Spievak, director of compensation and benefits program development at Ball Corp. in Muncie, Ind. "Twenty-five years ago, it was enough to offer health, life and retirement plans."

But, the evolution of employee benefits has presented benefits managers with an unenviable challenge: satisfying employees' increasing demands while keeping costs under control.

"It is a delicate balancing act. We are trying to balance the needs of employees with our ability to pay," said Dick Spitznass, vp of compensation and benefits at Georgia-Pacific Corp. in Atlanta.

Fred Hamacher, vp of compensation and benefits at Dayton-Hudson Corp., recalls that the Minneapolis-based retailer's health care costs 20 to 25 years ago were about $85 a year for individual coverage. Today, $85 would buy two to three weeks of individual coverage.

In 1990, the last year for which figures are available, employers spent an average of $12,402 per employee on benefits, up 621% from $1,719 in 1967, according to figures compiled annually by the U.S. Chamber of Commerce in Washington.

The Consumer Price Index climbed by about 300% during the same period.

Not surprisingly, health care costs have risen the most. In 1990, health and disability benefit costs averaged $3,197 per employee, up 1,430% from $209 in 1967, the Chamber reports.

"Health care costs were just a token item," Mr. Spitznass said.

But other benefit costs have soared, too. Pension costs in 1990 averaged $1,778 per employee, up 581% from $261 in 1967.

The rising costs, of course, have captured employers' attention.

"Benefits were once virtually given away. You can't do that anymore," said John Mueller, director of human resources at New York-based Prudential Securities Inc.

But, rather than reducing a rapidly rising expense, most employers recognized that they would have to expand—not cut—their benefit programs to stay competitive.

"We make a substantial investment in our employees through training. That investment is lost if the employee walks down the street," said Mike Snipes, director of compensation and benefits at Allstate Insurance Co. in Northbrook, Ill.

"We invest a lot in training. We don't want to go through that all over again," said Kathy Dupree, director of employee benefits at MetroVision Inc. in Atlanta.

In some cases, benefit programs became symbols of corporate culture.

When Apple Computer Inc. launched a flexible benefits plan in the mid-1980s, it wasn't trying to control costs like many other companies adopting flex plans.

"Cost containment was not a focus at all. We were heavily into recruiting and we found offering an innovative program would offer the kind of employees we wanted. Those employees like choice. Offering flex was a leading edge thing to do," recalled Sally Gottlieb, benefit manager for Apple in Cupertino, Calif.

The types of benefits employers offered became a way for employers to communicate the type of company they were or wanted to be considered.

The message expressed by providing work and family benefits is that "we are a caring and thoughtful employer," said Iris Goldfein, a partner at Coopers & Lybrand in Chicago.

Different benefit plans give different messages.

For example, unlike defined benefit pension plans, which typically are company-paid, most 401(k) plans are designed so employees have to contribute something. The message of the plans is clear: The company will contribute to your retirement, but you, the employee, will have to do your part, too.

"We care about our employees. We want employees to have savings for retirement. That is why we have a 401(k) plan. But we also believe employees have to save for their retirement. We strongly believe in individual control over their own destiny," said John Schroeder, senior corporate counsel and assistant secretary at Advanced Micro Devices in Sunnyvale, Calif.

As benefit plans expanded and became more expensive, what were once commonly known as "fringe" benefits lost that qualifier.

That meant, among other things, that executive officers no longer were remote figures to benefit departments.

The impetus for a pioneering managed care program at Allied-Signal Inc. came from then-Chief Executive Officer Edward Hennessy, who made clear that the company could not afford continued double-digit health care inflation, recalled Joseph W. Duva, former director of employee benefits at Allied-Signal and now a partner at Ernst & Young in New York.

Benefits themselves became a big business. No one flinches today when a benefit manager says that his or her budget exceeds $100 million a year.

All of that money served as a catalyst for even more change.

Fewer than 10% of all employers self-insured their health care benefits in 1967, said Fred Hunt, president of the Society of Professional Benefit Administrators in Chevy Chase, Md.



Illustration by Tony Griff

By Jerry Geisel

Now, more than half of all employers self-fund their health plans.

The third-party claims administration business, in turn, has grown, perhaps by 1,000%, Mr. Hunt said.

Benefit consulting, too, has become a multibillion-dollar business.

The huge increase in regulations governing benefits had much to do with the growth. Specialized talent was needed to help employers comply with the maze of rules laid down by the government.

"There was a piling up of one complicated law after another," said John Feldtmose, president of A. Foster Higgins & Co. Inc. in New York.

Certainly, it would be much simpler and perhaps cheaper for employers to give employees more cash and let them purchase benefits on their own. But that idea is as inconceivable today to employers as it was 25 years ago.

"Benefits still attract workers, which is why companies offer them," said Carson Beadle, a managing director with William M. Mercer Inc. in New York.

As a practical matter, many employers could not give up benefits because their unions would not allow them to. Indeed, some benefits, like prescription drugs and dental programs, grew as a result of union pressure.

The shifting demographics of the workforce—a huge change that has unfolded over the past 25 years—is the catalyst behind perhaps the fastest-growing benefit today: programs that help employees balance work and family responsibilities.

"Twenty years ago, we painted everyone with the same brush. Today, we recognize diversity in the workforce and the individual needs of employees," said Allstate's Mr. Snipes.

As recently as 1978, just 110 employers had some type of work and family benefits program, according to the Conference Board in New York. But, by 1984, 2,000 employers offered such programs, and 5,500 employers offered such benefits by 1991.

Indeed, a decade ago, the concept of work and family benefits "was not on anyone's radar screen," said William Setterstrom, senior vp at Northern Trust Corp., a large Chicago-based bank.

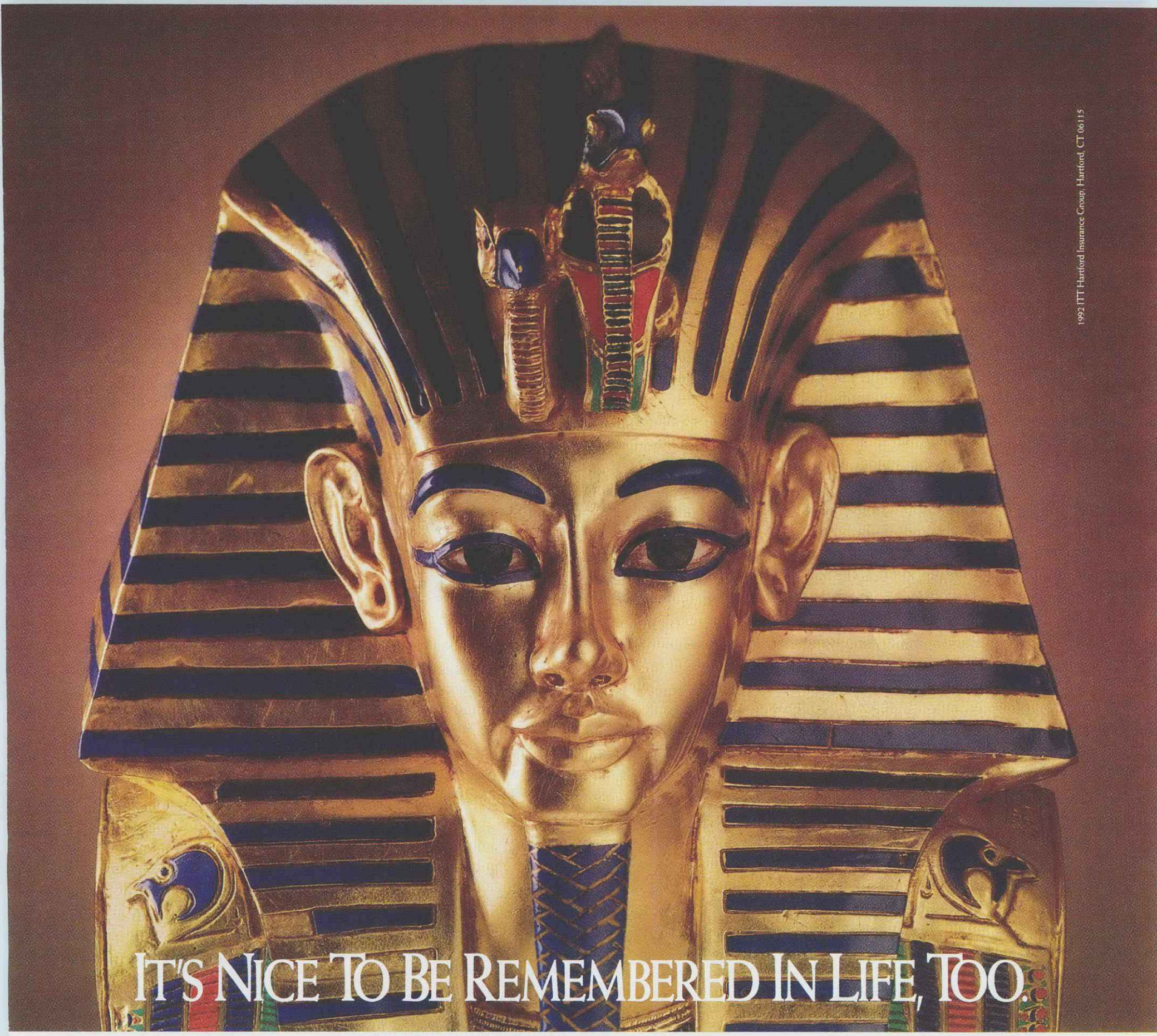
And, 25 years ago, women with children still were a minor part of the workforce.

The percentage of working women with young children has almost doubled over the span of three decades. In 1960, just 18.6% of working women with children under age 6 were working. The percentage soared to 30.3% in 1970 and jumped to an estimated 58.4% in 1989.

The traditional nuclear family—a husband, non-working spouse and two children—has become an anomaly among employees at many corporations.

For example, at Barnett Banks Inc. in Jacksonville, Fla., just 13% of employees fit the nuclear family model, pointed out Cathy Wooster, benefits planning manager.

Continued on page 68



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Benefit plans

Continued from page 66

"You just don't have that many Jack and Jill average families anymore," said David Rahill, a principal with Foster Higgins.

The increasing number of women in the workforce, especially those with children, has presented employers as well as employees with a basic problem: how to juggle a job with family responsibilities.

An Allstate survey of its employees several years ago found that 25% had to take time off from work because of a family problem.

"Employees felt they were between a rock and a hard place. Some employees felt if they had to choose between their work and their family, they would leave," Mr. Snipes recalled.

But many employers became more accommodating largely for practical business reasons.

"We make a considerable investment in employees through training. We think it makes a lot more sense to help employees with short periods of family-related problems than lose them entirely," Mr. Snipes said.

Allstate provides, among other things, up to six months of job-protected leave with medical benefits for employees who need time off because of a family situation.

"Today, employers realize the demographic changes are permanent. They realize that family situations can cause employees' considerable stress. If an employee stresses out, absenteeism goes up and productivity goes down," said Carolyn Sladek, a consultant with Hewitt Associates in Lincolnshire, Ill.

But, work and family benefits are not entirely employer-driven.

"Women are becoming bolder. Women are demanding more, and companies are responding to retain employees," Ms. Sladek said.

"Women have been rising through the ranks and can better express their needs," agreed Ms. Goldfein.

The growth of work and family benefits also marks a new phase in the development of employee benefit programs.

In earlier phases, a company's standard package of employee benefits—health, life and pensions—were offered to provide financial security, like protection from huge medical bills and income from an annuity at retirement.

But work and family benefits take a different theme. "They are not cash benefits as much as lifestyle-related benefits," said Foster Higgins' Mr. Feldtmose.

"These are benefits which improve people's lives and free them from other kinds of anxieties. Ultimately, there may be more employee retention power in work and family benefits than in other benefit programs," said Tom Paine, a retired Hewitt Associates consultant.

Like work and family benefits, flexible benefit plans also are booming.

In 1983, only 88 employers offered comprehensive flexible benefit plans. But, 378 employers offered the plans 1986, and 970 employers were offering them at the start of 1992, according to Hewitt Associates.

Flex plans, like work and family benefits, are driven by changing demographics. Today's more heterogeneous workforce has different benefit needs and interests than the more homogeneous workforce of the 1960s.

"With employee diversity, you needed choice," said Apple's Ms. Gottlieb.

"You have so many employee profiles. Flex became a way to meet those profiles," said Gail Bentevegna, director of administration systems at Playboy Enterprises Inc. in Chicago.

For example, the increase in working women has prompted greater employee interest in a tax-effective way to fund child care expenses. And, employees covered under a working spouse's health care plan often do not need the same health coverage as an unmarried employee.

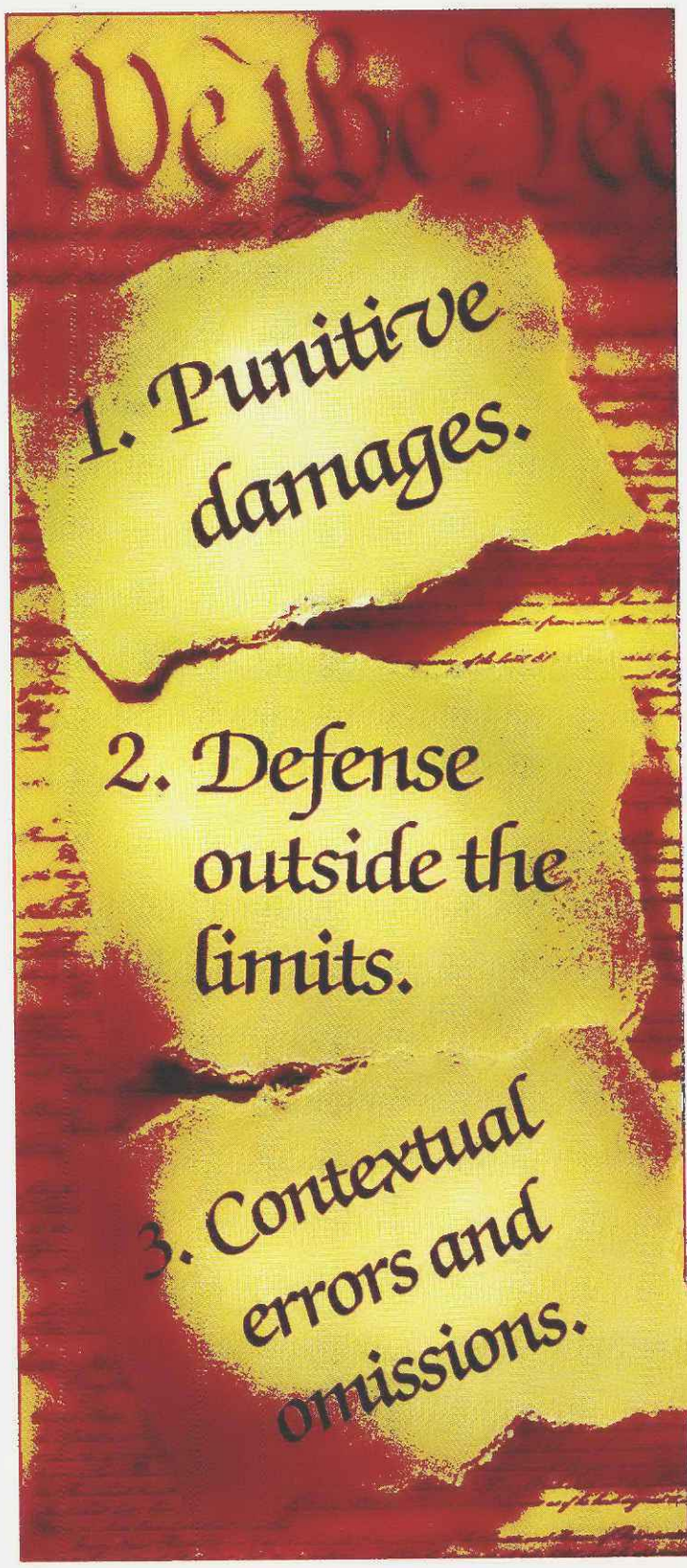
"With the workforce so varied and becoming more so all the time, the benefit choices had to be more varied," said Mr. Rahill.

Employers say that in addition to fulfilling workers' needs, flex plans also have helped them recruit and retain employees.

"The reaction was very positive among employees. They say our flexible benefit plan is one of the very best things about working for us," said Keld Alstrup, vp-human

Continued on page 70

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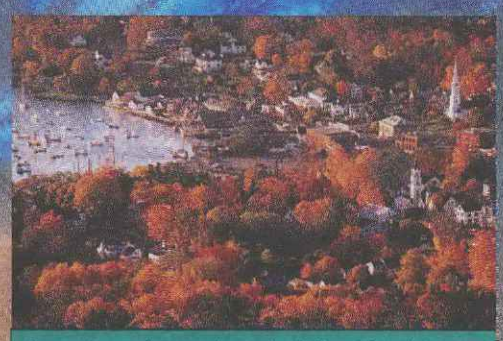
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Benefit plans

Continued from page 68

resources at Volvo Cars of North America in Rockleigh, N.J. "Our plan makes us a more attractive employer."

"To keep the best employees, it is critical to design a benefit plan to meet employees' needs," said Ms. Wooster of Barnett Banks.

At the same time, the need to control health care costs also fueled the growth of flexible benefit plans.

"Initially, flex was a way of recognizing diversity. But in the 1980s, a new philosophy emerged. More employers used flexible benefit plans as a way of limiting costs," said Hewitt's Mr. Paine.

That change in philosophy was simple: By providing a fixed number of dollars or credits and "pricing" the different benefit options available, employers could limit their own costs to a set amount.

"Before flex, we essentially wrote a blank check for benefits. With flex, a company can decide each year what it will spend on benefits," Ms. Wooster said.

Improvements in technology for administering such programs also speeded the growth of flex plans.

For example, Playboy Enterprises, with about 600 workers, earlier this year installed and now internally administers a flex plan using a personal computer.

"Today, you can do things internally that were not possible five years ago or would have cost tens of thousands of dollars in consulting fees. We can be cost-effective while offering cutting-edge benefits," Ms. Bentevegna said.

Rising costs and changing demographics also have changed employer attitudes about retiree health care benefits.

Twenty-five years ago, retiree medical benefits were a virtual giveaway. Medical costs were so low that few employers even separated the cost of retiree benefits from those of active employees. Given that attitude, it is not surprising that little thought went into plan design.

"The design was not very rational," said Herbert Kosloff, a vp with Towers Perrin in New York.

For example, under many plans, an employee who retired at age 55 after 10 years of service received the same health care benefits as a 30-year company veteran.

"Frankly, employers promised more than they could deliver," said Ball Corp.'s Mr. Spievak.

But rising costs—triggered by cutbacks in Medicare, soaring health care inflation and, for many companies, a growing pool of retirees—has and continues to trigger changes in retiree health plans.

"Employers began to question the fundamental relationships of benefits. Would an employer put in a pension plan that promised benefit increases with inflation? I think the unqualified answer would be no. Yet, this is the way we designed retiree health plans," said Mr. Mueller of Prudential Securities.

In addition, a new accounting rule by the Financial Accounting Standards Board, FAS 106, has forced companies to be more cognizant of the true cost of promised retiree welfare benefits.

In the pension arena, MTC Imaging Inc. and Advanced Micro Devices symbolize the sweeping changes that have occurred in the last two decades.

At first blush, the two firms have little in common. MTC is a small New York-based health care services provider with about 40 employees. Advanced Micro Devices is a Silicon Valley microprocessor producer, with 11,000 employees.

But they have two things in common: Both offer a 401(k) plan, and neither has a defined benefit plan.

Both cite similar reasons for not offering a defined benefit plan.

"The cost always outweighs its effectiveness," said Charles Scott, MTC's vp-operations.

"With a defined benefit plan, the cost is fixed. We need a plan where costs and contributions are flexible depending on how well we do," said Mr. Schroeder of Advanced Micro Devices.

The two companies cite similar reasons for adopting a 401(k) plan.

"We needed a plan that would be economical, allow employees a choice of investment options and one in which employees would play a role in saving for retirement," Mr. Scott said.

"We believe strongly that employees should help contribute toward their retirement," Mr. Schroeder said.

MTC and Advanced Micro Devices are hardly unique in their preference for defined contribution plans over defined benefit plans.

In 1975, 208,000—or 67%—of the nation's 311,000 private pension plans were defined contribution programs. By 1988, there were 584,000 defined contribution plans, comprising 80% of the roughly 730,000 private pension plans, according to the Employee Benefit Research Institute.

Even more striking is the growth in the number of participants in defined contribution plans.

In 1975, 33 million people were covered by defined benefit plans—nearly three times the 12 million participants in defined contribution plans. By 1988, the number of defined benefit plan participants had risen 24% to 41 million, while the number of participants in defined contribution plans soared more than 200% to 37 million.

Years of constant legislative and regulatory changes played a role in the decline of defined benefit plans.

"There have been so many changes and so much complexity in the defined benefit arena. The government has almost been saying to employers, 'Get out of the defined benefit plan system,' " said Kim McCarrel, a consultant with The Wyatt Co. in Portland, Ore.

While government has been a factor in the decline of defined benefit plans, some fundamental shifts in employer attitudes also have spurred interest in defined contribution plans.

With much more competition domestically and abroad, many employers have been looking to shift more of the huge cost of retirement plans to workers by moving from defined benefit plans, in which a company typically pays all of the cost, to 401(k) plans, in which employees fund most of the benefits.

"In a tougher economic environment and more world competition, employers are trying to shift retirement costs to employees," said Gary Blank, a Wyatt consultant.

But employees shifted their attitudes, too.

401(k) contributions swelled at least in part because workers have become more concerned that perhaps their employers and Social Security may not be around to pay benefits when they retire.

"Baby boomers recognize they have to provide more for themselves," said Charles Clinton, assistant vp with ITT/Hartford Group Inc. in Simsbury, Conn.

But not all employers are giving up on defined benefit plans. A trend among employers that started in the late 1980s and is accelerating today is adopting defined benefit plans with a cash balance feature. About 200 employers, including many of large companies, now have cash balance plans.

The concept of a cash balance plan is simple. The benefit provided is expressed as an account balance. As a result, the employee instantly knows the value of his or her benefit. But a cash balance plan is funded by the employer like a defined benefit plan.

Growing employer frustration and plan costs have fueled the growth of cash balance plans.

"Employers were often spending the equivalent of 5% or 6% of payroll of their defined benefit plans. But the benefits certainly were not appreciated. Employers were looking for the same appreciation and visibility that they were getting from their 401(k) plans," said Pat Rotello, a partner with Kwasha Lipton in Fort Lee, N.J.

"It is an easy-to-understand benefit," said Mr. Mueller of Prudential Securities, which recently adopted a cash balance plan.

Not all benefits are so easy to

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understand. In fact, as benefit programs have changed and become more complex, employers increasingly have turned to outside experts for assistance.

New federal regulations and laws, in particular, have increased the ranks of benefit service providers.

For example, as employers struggled to cope with the Consolidated Omnibus Budget Reconciliation Act of 1985, a news item comprising just a few paragraphs appeared in the Sept. 15, 1986, issue of *Business Insurance*: A Houston firm announced it was selling a PC-based program that would administer health care claims under COBRA.

The short item generated 600 phone calls in two weeks, recalled Alan H. Williams, president of Travis Software Corp. Ultimately, Travis sold 3,000 copies of its COBRA administration package.

Twenty five years ago, laws like COBRA did not exist, and government involvement in employee benefits was virtually non-existent.

But starting with the enactment of the Employee Retirement Income Security Act of 1974, an almost annual parade of benefit laws and rules has come out of Washington.

One result of Washington's impact is obvious: Service providers, like Travis, and the benefit consulting industry have mushroomed.

"ERISA was a real turning point. It drove the consulting business. There was an influx of legal and administrative needs," said A.M. D'Alessandro, chairman and CEO of Alexander Consulting Group Inc. in Lyndhurst, N.J.

"ERISA was an immense piece of legislation, and employers, quite naturally, didn't have the staff to comply," agreed Foster Higgins' Mr. Feldtmose.

But ERISA and the wave of benefits legislation and regulation did more than drive up business for benefit consulting firms. Federal rules forced companies to put more time and effort into communicating their benefits.

"To get lower-paid employees to participate in programs like 401(k) plans, which have non-discrimination rules, employers had to do a better job of explaining benefit plans to employees," said Al Schlachtmeyer, a Hewitt Associates consultant in Lincolnshire.

There is another positive side to Washington's heavy hand in the benefits arena: The hugely popular flexible benefit plans and 401(k) plans would not have been possible without congressional intervention.

But, benefit managers say just trying to keep tabs on all the changes has made it difficult to plan for the future and think about long-term issues, like benefit plan design.

"Sometimes, it was hard just to try to catch your breath," said Ball's Mr. Spievak.

Crystal-ball gazing always is a risky business and the benefits field is no exception. Few could have predicted in 1967 how benefit programs would change over the next 25 years. But some trends seem likely for the next 25 years.

The aging of the population will boost employee demand for long-term care insurance.

Already, long-term care coverage "is one of our fastest growing lines of business," said Nancy Bern, a vp with John Hancock Mutual Life Insurance Co. in Boston.

At the same time, just as companies are retooling benefit programs to meet individual needs by offering more work and family programs, employers will demand more individual responsibility. That will mean more health care plans under which employees receive incentives or are penalized depending on their health status and their personal habits. For instance, smokers can expect to pay more for coverage.

"There is a growing company philosophy that those who are responsible for increased health care costs should pay more," said Sonia Muchnick-Baku, manager of special projects at the Washington Business Group on Health.

Benefit managers also envision a continuation of technological improvements so, among other things, employees will better understand their benefit programs.

"Employees will sit down at their PCs and will be able to use modeling techniques to know—with inflation figured in—how much their benefits will really be worth at retirement," predicted Mr. Spievak. BI

Jerry Geisel is editor-at-large of Business Insurance. He has reported extensively on employee benefit trends and issues from his base in Washington since joining BI in 1977.

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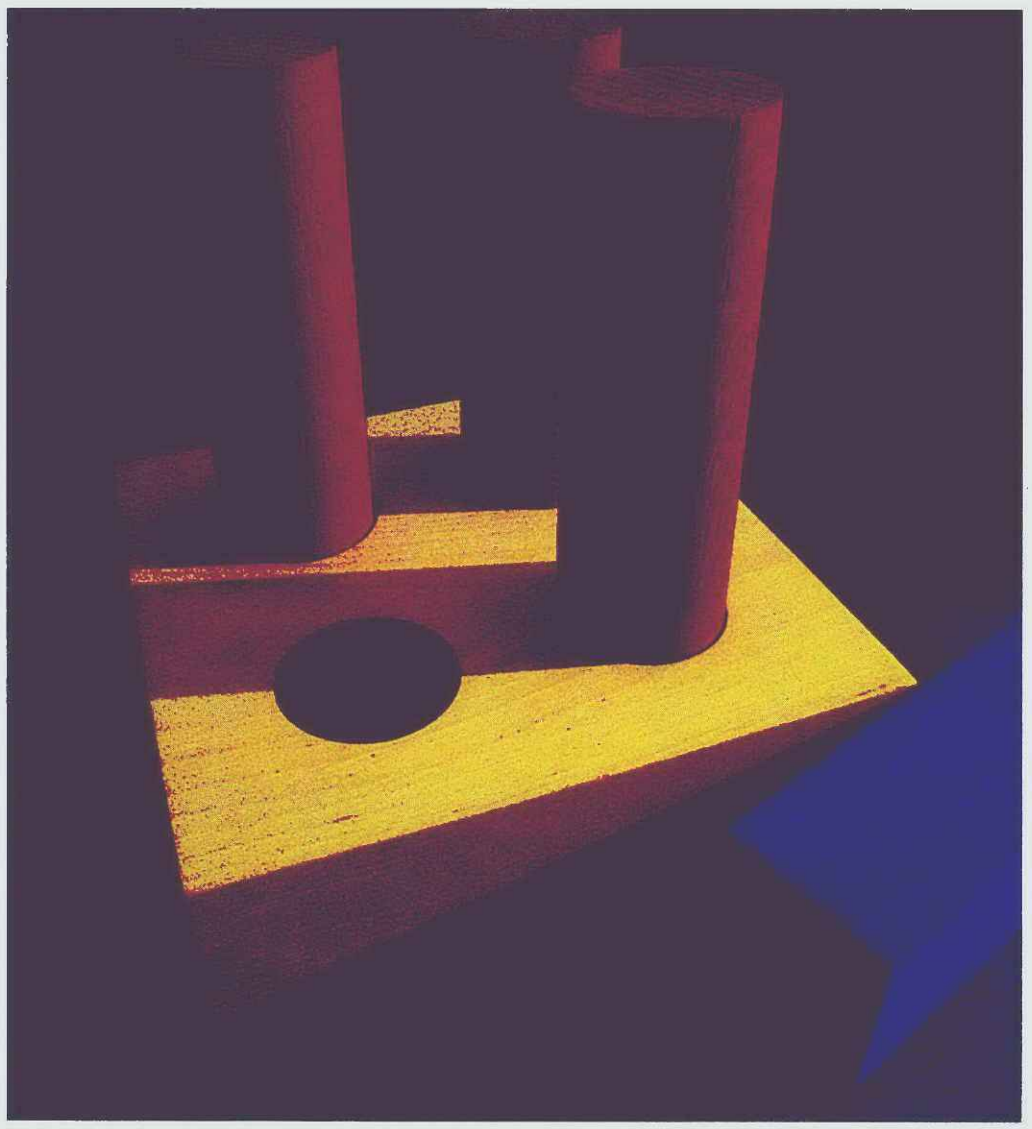
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The Lesson of Section 89

Congress taught that benefit plans are not tax loopholes

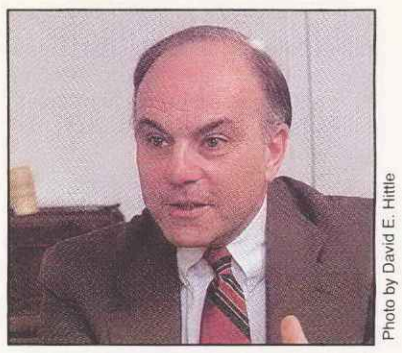


Photo by David E. Hittle

Mark Ugoretz

By Jerry Geisel

There may have been a silver lining in perhaps the biggest congressional benefit legislative fiasco in the last 25 years.

Section 89, a part of the Tax Reform Act of 1986, was repealed just three years after it was enacted and before it ever went into effect. Employers mounted an unprecedented lobbying effort on Capitol Hill to convince legislators that the non-discrimination rules for health plans laid down in the law were hopelessly complex.

Through that lobbying effort, many members of Congress learned they have to do a better job of understanding benefit programs before imposing new rules, said Mark Ugoretz, president of the Washington-based ERISA Industry Committee, which represents about 125 large companies.

"Members of Congress learned one lesson: They learned that they need to understand how benefit plans work. They learned that benefit plans are more complicated than they anticipated," Mr. Ugoretz recalled.

In fact, what Mr. Ugoretz describes as the "shame" of several tax laws enacted in the early and mid-1980s was that "Congress bought into the perception that employee benefit plans were tax loopholes."

Much progress has been made in convincing members of Congress that employer-sponsored plans are not tax-avoidance schemes and are, in fact, a vital mechanism in providing health and retirement benefits, he says.

Despite earlier lobbying successes by business, benefit programs will come under renewed scrutiny next year from a Congress filled with many new members looking for ways to increase revenues to fund new programs, Mr. Ugoretz pointed out.

"There will be targets. Those targets will be where the money is. The perception is there is not enough money in the Treasury. There is a disinclination to raise taxes. So, they are looking for a pool of money. The trouble with pension plans is that they appear to be a big pot. They will be a target in the 103rd Congress."

Congress, Mr. Ugoretz adds, wants to expand health care coverage but lacks the revenue to do so.

"Congress has maneuvered itself into a position by making promises that it can't keep. If you want to add 36 million people to the access rolls, it has to be paid for. Someone has to pay for it. Yet members of Congress say they can pay for it with restrictions on fraud and abuse or by changing the health care forms. That is not true. The money is going to have to come from someplace," he said.

Today, only a handful of benefit organizations in Washington exclusively lobby on behalf of employers. Without those groups to explain how benefit plans work, "There would be a tremendous impulse toward European-type, government-run, large, heavy-leaden bureaucracies that the Europeans themselves are trying to get from out under," Mr. Ugoretz says.

While the popular image of lobbying is probably somewhat sinister—deals being cut behind closed doors—the reality is quite different, he says.

Lobbying is advocacy, Mr. Ugoretz says. "We are asked by our members to advocate their positions on Capitol Hill and, in doing so, to work with members of Congress and their staff, as well as with other lobbying organizations.

"We are asked to educate people on the way our members' benefit programs work. In short, we try to educate people on the way the world of employee benefits really works and what the impact a piece of legislation will have on how benefits will be delivered and the likelihood they will be continued."

The difference between good and bad lobbying is one of credibility, says Mr. Ugoretz, a former congressional staffer who joined the ERISA Industry Committee in late 1983 as the group's first executive director.

"A good lobbyist is a good advocate. He is someone who will say: 'You have a point on how it really works. But is there a better way to do it?' Bad lobbying is disingenuousness, imprecision and—you don't see it too often—out and out misstating of facts."

A key part of Mr. Ugoretz's job is to give members of Congress and their staffs an honest explanation of the impact of a proposal on benefit programs.

"We will give them a precise explanation of the impact of what their proposal will be. We want members of Congress and regulators to understand how the benefits system works.

"The absolute sine qua non of what we do is that we must be credible. We cannot, nor can anyone in this field, walk in and misstate what the impact of a bill will be. Nor can you attack the way someone else operates.

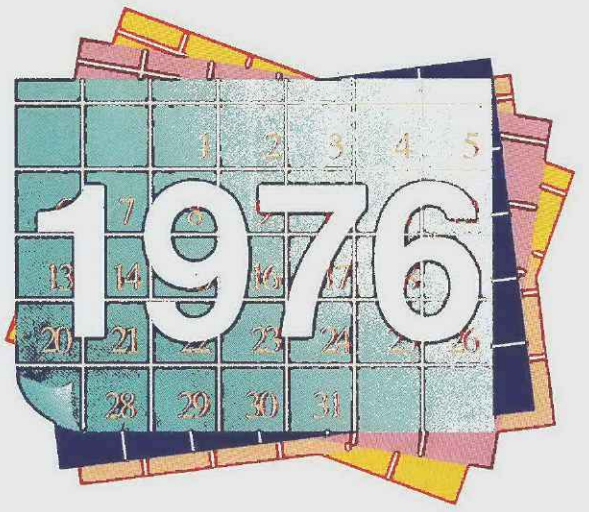
"It is pointless to attack congressional benefit programs to secure our position. It doesn't work because Congress is a different kind of institution." BI



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Looking Back



Corporate risk managers are reporting **increases in premiums as high as 400%** during recent months for various lines of coverage.

In a survey by *Business Insurance* of the 59 risk managers on its new Editorial Advisory Panel, 85% said their companies had experienced premium increases in recent months. The average increase among those companies was 73.7%. But hikes were as high as 400%, which was the increase in excess liability rates reported by a computer company that spends $4 million annually on insurance (*BI*, Jan. 12, 1976).

* * *

A group of about 30 small manufacturers have formed a lobbying group for **changes in the tort law system**.

The new group, called RETORT, or Reason & Equity in Tort, was formed by the manufacturers after they experienced difficulty getting adequate product liability insurance (*BI*, Jan. 26, 1976).

* * *

The **surplus of 10 property/casualty insurers dropped** to less than $2 billion at the end of September 1974 from $4.9 billion at year-end 1972, according to a study by Blyth Eastman Dillon & Co. Inc.

The study also reveals that the ratio of premiums to surplus was 1.6-to-1 for the 10 insurers at year-end 1972 but increased to 3.8-to-1 by the end of September (*BI*, Feb. 9, 1976).

* * *

Group health plans could save millions of dollars by requiring a **second surgical opinion**, according to a House subcommittee investigating unnecessary surgery.

Based on the study of a New York union's second-opinion program in which 17% of the operations recommended by the first physician were discouraged by the consulting doctor, the committee estimated that 2.4 million of the 14 million elective surgeries performed annually in U.S. hospitals are unnecessary (*BI*, Feb. 9, 1976).

* * *

The United Auto Workers' demand for **increased health care benefits** appears to be the major obstacle in upcoming contract talks between the UAW and the major automakers.

The UAW already has announced that its benefit demands in the July negotiations will include prepaid vision care, coverage of visits to doctors' offices, improved dental coverage and the extension of prepaid dental coverage to retirees (*BI*, May 3, 1976).

* * *

The U.S. Commerce Department recommends a 15-month, comprehensive federal study of the **product liability insurance crisis**.

The department says that although there is an obvious problem for companies trying to get adequate product liability coverage at reasonable rates, there is little hard data on the causes of, and possible solutions to, this problem (*BI*, May 3, 1976).

* * *

After 14 years as a corporate entity, the well-known **Merrett Syndicate at Lloyd's of London** wants to become a family affair again.

Stephen Merrett, the 36-year-old son of the syndicate's founder, is arranging a $6 million deal to regain control of the syndicate from the Italian consortium that now owns it through a U.K. subsidiary. With 1,400 members, the syndicate is one of the largest at Lloyd's (*BI*, May 3, 1976).

* * *

Acting **Federal Insurance Administrator J. Robert Hunter** has warned the insurance industry to clean up its own act quickly or face federal action.

Mr. Hunter told the Independent Insurance Agents of Wisconsin that although insurers' financial situation is improving, he fears they may be implementing excessive rate increases.

He said that if the insurance industry does not correct its faults, the federal government might be forced to act to assure fair and adequate coverage (*BI*, May 31, 1976).

* * *

A top Justice Department official is calling for **reform of the McCarran-Ferguson Act**, which for more than 30 years has exempted the insurance industry from antitrust laws.

Jonathan C. Rose, deputy assistant general in the antitrust division, said that changes in the McCarran-Ferguson Act would bring about the benefits of greater competition and less regulation for both insurers and consumers (*BI*, June 14, 1976).

* * *

Some large hospitals in Indiana, after receiving huge increases in their **medical malpractice coverage**, may be paying more in premiums than the value of their policies.

Following a rate hike of 344.6% announced by the Insurance Services Office, Indiana hospitals with more than 444 beds buying a policy

Continued on page 76

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Continued from page 73

with an aggregate limit of $300,000 will be paying more than that in annual premium. In response, the Indiana Hospital Assn. is studying the feasibility of setting up a captive (*BI*, July 26, 1976).

* * *

A majority of U.S. employers offer **dental benefit plans**, according to the first-ever *Business Insurance* Employee Benefit Board survey.

The survey of 90 benefit managers shows that more than 60% have dental plans, covering a total of 1.5 million workers, and other companies intend to implement the plans soon (*BI*, Sept. 6, 1976).

* * *

At least 150 cities in California received notices of **non-renewal of their municipal liability insurance** after two major insurers withdrew from the market.

During the last fiscal year, municipal liability insurance premiums in the state rose an average of 63% (*BI*, Sept. 20, 1976).

* * *

Private employers' benefit costs rose 23% between 1973 and 1975, according to a survey by the U.S. Chamber of Commerce.

The Chamber says that employers paid an average of almost $3,984 for employee benefits in 1975, and benefits average a whopping 35.4% of payroll (*BI*, Oct. 18, 1976).

* * *

A broad national effort has developed to push **product liability reform** through Congress and state legislatures.

The effort involves both the insurance industry and manufacturers and has resulted in the creation of two national ad hoc groups, the Multiple Assn. Action Committee and the National Product Liability Council (*BI*, Nov. 1, 1976).

* * *

The problems of rapidly rising rates and shrinking capacity that risk managers have been facing in recent years in the primary insurance market are now showing up in the **excess and surplus lines market**. And, inflation is adding more problems for risk managers in their latest battle.

Surplus lines experts report that pricing is extremely volatile and big rate increases are the norm, as many of the problems of the primary market spill over into excess/surplus lines (*BI*, Nov. 15, 1976).

* * *

A **national health insurance program** would raise total annual health care spending by $10 billion to $25 billion by 1980, according to an actuarial projection.

According to a study, which was prepared for the Department of Health, Education and Welfare, the actual increase would depend on which of six separate national health insurance plans were enacted (*BI*, Nov. 15, 1976).

* * *

After the Supreme Court decided that **excluding pregnancy from disability coverage** is not a violation of laws barring sex discrimination, some congressmen are mobilizing to change those laws.

Legislation already is being prepared to include pregnancy in the sex-discrimination laws after the Supreme Court ruled that General Electric Co. did not discriminate when it denied disability pay for some pregnant workers (*BI*, Dec. 13, 1976).

* * *

Even as they struggle under **huge premium increases for group health insurance** during 1976, employee benefit managers say they expect more of the same next year.

As a result, the benefit managers on *Business Insurance's* Employee Benefit Board say they are giving very serious consideration to internal funding programs for employee benefits, either through tax-sheltered trusts or through other types of self-insurance (*BI*, Dec. 13, 1976).

* * *

A 25% increase in the membership of Lloyd's of London assures **greater capacity for Lloyd's** during 1977.

More than 2,400 new names will be joining Lloyd's syndicates during the next year, bringing the total number of names to more than 10,000 and providing additional capacity.

However, many at Lloyd's note that much of the added capacity will be eaten up by inflation. Because of inflation, experts estimate that the actual gain in capacity at Lloyd's from the 25% increase in membership will be only 12% to 15% (*BI*, Dec. 13, 1976).

* * *

The Interagency Task Force on Product Liability in its report to the White House's Economic Policy Board has concluded there is **no nationwide product liability crisis**.

Reporting on the results of its three-month study, the task force said there is no "nationwide multi-industry product liability crisis," and it made no major legislative or policy recommendations.

The task force did acknowledge that product liability insurance rates are high and that some businesses, especially small ones, are having trouble finding the coverage at all.

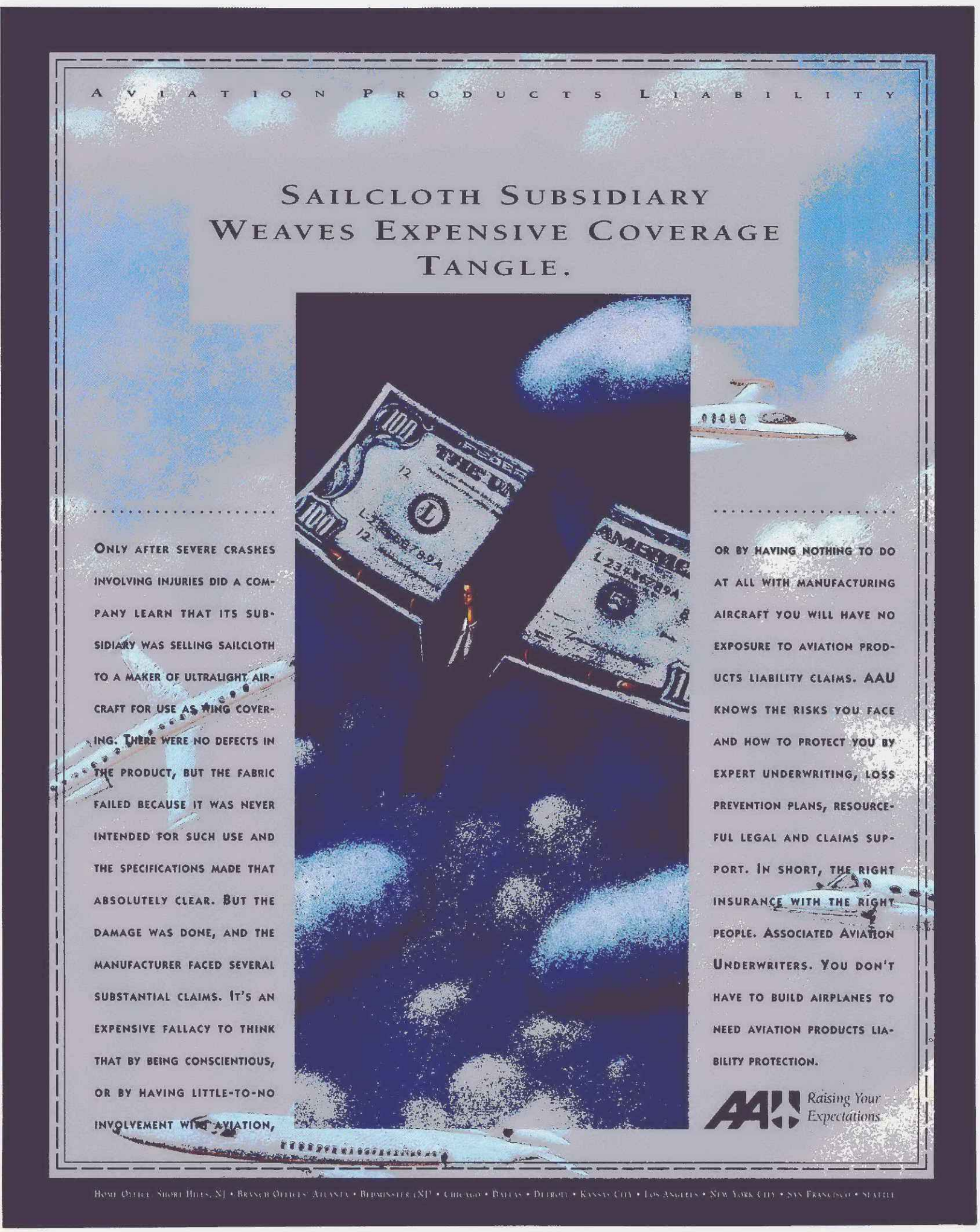
However, it estimated that "less than 0.1% of American businesses have a serious affordability-availability problem" (*BI*, Dec. 27, 1976).

* * *

Carnation Co. is challenging a ruling by the Internal Revenue Service on the **deductibility of premiums paid to the company's captive**, and the outcome of the case is expected to have a profound effect on the captive industry.

The IRS notified Carnation in March that it was disallowing tax deductions for nearly $1.76 million in premiums Carnation paid to its captive in 1972. Carnation filed for a redetermination, and the case is expected to come to trial.

Captive experts say the case will make clear the IRS position, and that will have an obvious impact on the future of the captive industry (*BI*, Dec. 27, 1976). BI





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A Conversation With:

Harry Conaway



Photo by Bob Knudsen

Nine years ago, when Harry Conaway left the Washington law firm of Miller & Chevalier to become an attorney/adviser on employee benefit issues at the Treasury Department, his friends wondered if he might be bored.

Congress had just enacted the Tax Equity and Fiscal Responsibility Act, better known as TEFRA, and his friends figured Mr. Conaway would be stuck in a backwater—Treasury's Office of Legislative Counsel—writing regulations.

"Boy, were they wrong," Mr. Conaway recalled.

He played only an ancillary role in the next tax law—the Deficit Reduction Act of 1984. But Mr. Conaway soon found himself in the thick of things, helping draft many of the benefit provisions, including Section 89, in the Tax Reform Act of 1986. He also represented his boss—the assistant secretary of treasury for tax policy—in negotiations with Congress on the bill's treatment of benefits.

Legislation was not his only concern. Mr. Conaway also directed the drafting of many benefit regulations, including a series of pension non-discrimination rules.

Mr. Conaway left the Treasury Department in late 1988 to become a principal in the Washington office of William M. Mercer Inc.

During an interview with *BI* Editor-at-Large Jerry Geisel, Mr. Conaway offered his insights, as a former government benefit policymaker, into why benefit regulations take so long to develop and why they are so complicated.

* * * *

Twenty-five years ago, we had simpler rules in the employee benefits arena. Are we better off with today's complicated rules?

I don't think the rules have to be as complicated as they are to achieve the objectives that they are intended to achieve. However, many of the objectives, particularly from the government's perspective, are worthwhile.

But why do rules end up so complicated?

Too often there are a lot of people involved in the legislative and regulatory process. Too often bills and regulations are developed by a committee where one person got his rule and another person got her rule. There are so many players, particularly in the legislative process, that it is difficult, if not impossible, for legislation to reflect a short list of objectives.

At the same time, you have a lot of people at the IRS and Treasury with different perspectives. You try to accommodate as many views as possible. That contributed to complexity.

Any other reasons?

The employee benefits area is inherently complex. Because benefit plans are so complex, you need complex rules. Much of the complexity actually is simplification. It is designed to simplify administration or compliance with the rules.

For attorneys/advisers, consultants—it is a nightmare because you have to work through all the rules and scenarios. But for a particular company, in many situations, they don't have to know all the rules. They just have to know how their plan is affected and if there is one rule that accommodates their plan, they don't have to go any further.

Can you give an example?

In the 401(a)(4) pension non-discrimination rules, there are safe harbors, a general test and exceptions to the general test. Much of this was developed to accommodate different plans to permit different approaches to proving non-discrimination. The effect is more complexity, but at the practical end, particular employers may be able to comply more easily.

Benefit managers are baffled why it takes government so long to write rules. Deadlines aren't missed by a month or two months, but sometimes by years. Why does that happen?

One problem is that deadlines, at least when I was in government, are set too optimistically.

But the issues also are complex. It takes a fair amount of time to develop a consistent set of rules. At the same time, at the Treasury you don't have people with as much experience with private sector plans as would be

'It wasn't necessary. . . to impose the administrative burden that went along with Section 89 to achieve policy objectives.'

desirable. That slows things down. There is a steep learning curve for many of the people.

Also, there always is turnover and new people and that slows things. I don't know if there is a name for it, but the slowest person working on a regulation sort of sets the pace of the regulation.

Is the private sector often cut out of the rule-making process? That is, are the views of employers considered?

I'm sure many employers feel that way. From the government's perspective, I didn't feel that way. I would speak to a lot of people on the phone. There would be a lot of formal and informal meetings in which ideas would be tested on lawyers, employers and consultants. I tried to get as much pre-reaction to a rule as I could.

There is nothing, though, that can replace the reaction you can get from the publication of a proposed regulation.

Employers perceive some arrogance at the IRS. An example would be the pension non-discrimination rules. It took years to develop them. Then the IRS gave employers only about six weeks to comply. Was that arrogance or was it something else?

There is a kind of unspoken internal pressure in the culture not to appear to accommodate the private sector too quickly.

Why?

No one ever got held back by saying no. There always was a fear or anxiety of being too easy or too soft.

It is not something that someone said. It just was in the culture.

How could that culture be changed?

I think things have changed. When I was there, there was so much annual legislation. Things were much more adversarial at the time of tax reform legislation in 1986.

Frankly, I got to a point where I felt many in the private sector were complaining about so much I couldn't tell what was a bona fide complaint.

Did some cry wolf?

You couldn't tell, at least I couldn't tell.

They criticized everything?

That's right.

Can you give an example of where employers were so negative that they could have had a much greater impact if they had taken a different approach?

There were a series of meetings with some of the associations during the development of the 1986 tax legislation. The feeling I developed was that their submissions were laundry lists of every complaint the associations had. There was no attempt at the trade association level to weed out the serious from the less serious.

If they had been able to do that more effectively, there would have been more trust and mutual reliance when rules were developed.

There also was a belief held by some in the private sector: Never help the government because it always will turn on you. The cost of that is that you lose credibility with the government.

On the other hand, the government loses the ability to market-test particular ideas.

One of the great surprises in the Treasury Department's first major tax reform proposal in late 1984 was the elimination of 401(k) plans. What was the reasoning behind that?

When people look at the tax reform proposals, they forget the context in which the rules were proposed.

The objective of the Reagan administration was to lower marginal tax rates in a revenue-neutral way. If you are going to lower tax rates in a revenue-neutral way, the feeling was you have to broaden the tax base.

When we got to 401(k) plans, their relatively loose non-discrimination rules, as well as the flexibility about contributing or not contributing, made them the least effective in achieving our objective: getting meaningful benefits to low and middle-income employees.

In that case, why wasn't the reasoning, 'Let's tighten the non-discrimination rules' rather than eliminate the plans?

In Treasury II (the Reagan administration's second major tax reform proposal released in May 1985), there was a proposed tightening of the non-discrimination rules and not eliminating the plans. At that point, the private sector made the argument that with tighter non-discrimination rules, 401(k) plans could be effective plans.

The private sector arguments carried some weight?

Certainly.

Later, then-Secretary of Treasury James Baker again proposed to eliminate 401(k) plans. What changed?

That was not an employee benefits decision. It was a macro-level decision. There were changes in non-benefit areas as well because the entire package had to be revenue-neutral.

Ultimately, 401(k) plans survived.

The private sector made the same arguments on Capitol Hill that they made to us.

Did the administration ever consider eliminating non-discrimination rules in exchange for a lower pretax limit for 401(k) plans?

That had been rejected. Our feeling was there is a kind of spectrum. The idea is that IRAs allow individuals to contribute $2,000 a year without non-discrimination rules. The regular limits (for defined contribution plans) permitted $30,000 a year with relatively tough non-discrimination rules.

The feeling was to apply an intermediate cap on 401(k) plans with an intermediate level of non-discrimination rules. It wasn't appropriate to remove the non-discrimination rules unless the cap was moved down to $2,000. In short, we created a spectrum: the higher the cap, the more difficult the non-discrimination rules would be.

What was the reasoning behind the provision in the first tax reform proposal to cap the amount of tax-free health benefits insurance employers could provide employees?

There was a feeling that the tax-free subsidy for health care benefits was excessive. In the context of making tax reform revenue-neutral, it was appropriate to try to pick up some revenue in the heavily tax-subsidized areas. Many Americans had first-dollar coverage, which was contributing to increasing health care costs. The feeling was a tax cap would encourage employers and employees to accept higher deductibles and copayments, which would slow cost increases.

But the tax cap later was withdrawn. What happened?

There was a lot of private sector opposition to taxing benefits. There were a lot of technical difficulties as well. I don't know if the technical difficulties alone

Continued on next page

Continued from previous page
would have been enough to kill the proposal, but certainly the strong employer and union opposition was.

Looking back, should health care benefits have been taxed? Would a tax cap have avoided a lot of inflation?

I imagine we still would have a lot of inflation even without the favorable tax treatment. The tax treatment, though, has added to it and has added to the federal deficit situation.

Of all the benefit provisions in the 1986 tax law, none caused more controversy than Section 89. What was the original rationale for Section 89?

The context was to achieve lower tax rates in a revenue-neutral way. Since we couldn't cap tax-free health care benefits, at least those tax-favored benefits should be conditioned on the satisfaction of non-discrimination rules.

Was there any evidence that there was discrimination in the delivery of health care benefits?

There was not a study. But there was a recognition in government and in the private sector that employers did, in fact, provide executive-only plans. To some extent, there was discrimination.

But something obviously went wrong.

What went wrong was for a whole series of reasons we ended up building a monster machine to deal with a relatively simple problem—the executive-only plans. It wasn't necessary, in hindsight, to impose the administrative burden that went along with Section 89 to achieve policy objectives.

How did that monster machine develop?

This was one of these nightmare cases in terms of the legislative process. But it was done by the book. Rules were in the president's bill. They were in the Ways and Means Committee bill. They were in the Senate bill. They were in the conference bill. The rules changed based on private sector input at each and every stage. They were modified and made more flexible. But when things were modified and made more flexible, they were made much more complex for everybody.

It was different than the pension situation. There were not safe harbors. It became necessary for every employer to test and run through a set of three rules. It was much more than was necessary to achieve the objective.

Are you saying there was overkill on the part of government?

That's right.

Could Section 89 ever come back?

Not in that form. The policy objectives can be achieved in much simpler ways.

Has your perspective on benefit rules changed since becoming a consultant?

My views haven't changed. I didn't believe that when I was at Treasury that the Treasury view always was the right view. My job was to represent the Treasury view. There were many views and the political process was one where you try to accommodate the different views.

My job now is to represent employers and to express to government why, for example, a particular proposal goes too far. And limitations employers have in collecting data. What it costs to collect data and why those dollars are better spent in terms of providing benefits than running numerical tests.

What do you miss about no longer working for government?

I suppose this is part ego, but I miss not being in the middle, not being in the middle of the debate and the middle of decision-making. I'm not in the room when different views are reconciled or when one view is accepted and another is rejected. I'm not making those decisions. Certainly, those were heady times. BI

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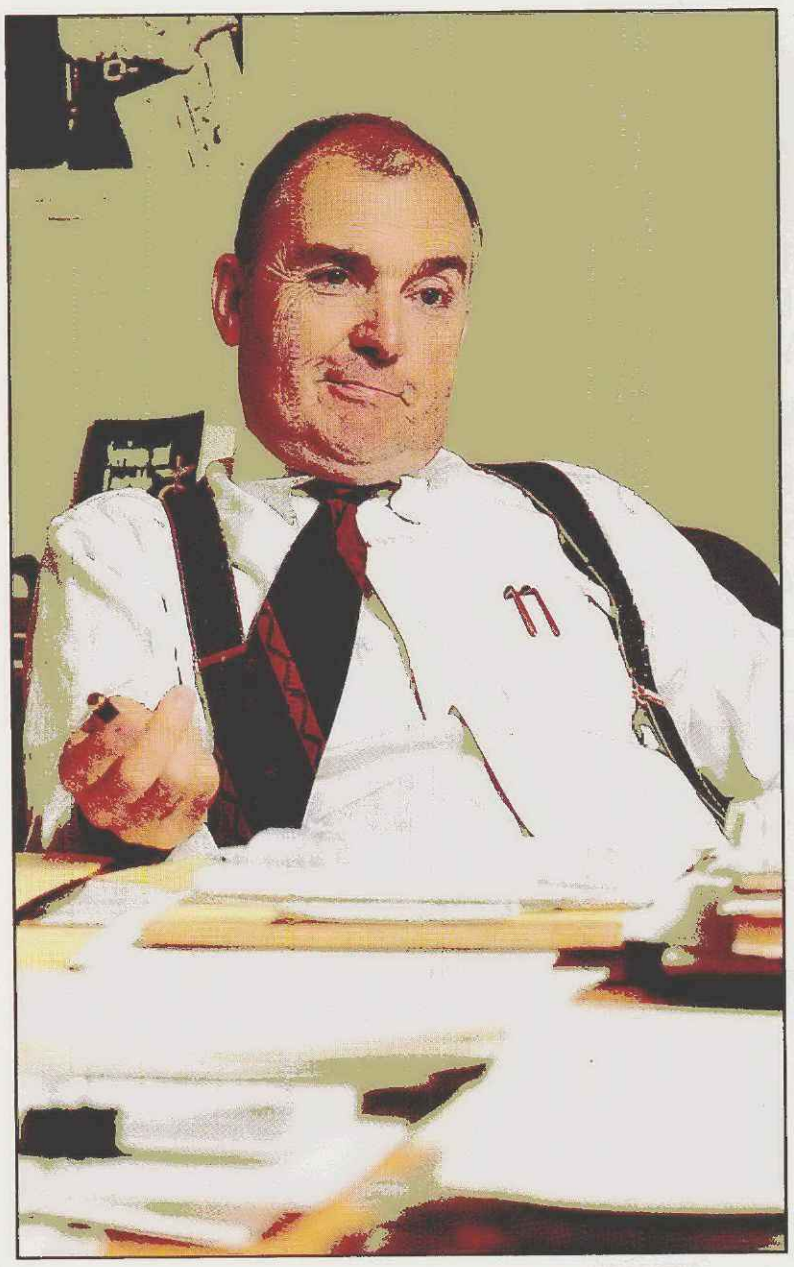
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A Conversation With:

Fred Hamacher

[redacted]

Fred Hamacher, vp of compensation and benefits at Dayton Hudson Corp., sits at his desk behind a paper blizzard any battle-worn benefits professional would recognize—and commiserate with.

Mr. Hamacher's career with the Minneapolis-based retail giant began in 1970, when he was hired as a benefits analyst. In the following years, he worked as benefits manager and director of compensation and benefits. Mr. Hamacher assumed his current position as vp in 1984.

Mr. Hamacher's credentials include a business degree from Indiana University. He is a founding member of the Midwest Pension Conference and chairman of the Benefits Committee of the National Retail Merchants Assn. He also serves as chairman of the Business Health Care Action Group, a coalition of 14 employers that directly contract with health care providers in the Twin Cities area.

Associate Editor Christine Woolsey visited Mr. Hamacher recently to ask him his thoughts about how employee benefits have changed during his tenure at Dayton Hudson and his predictions for the future.

* * * *

How has your role as benefit professional changed in 25 years?

It used to be simpler. I didn't used to spend a lot of time on health care in those days, because costs were fine. My title is vp of compensation and benefits. But some years ago I started looking at my job as vp of compensation, benefits and health care.

How has your view of health care benefits changed over the years?

I'm looking at health care as a non-benefit at this point. I pulled health care out from underneath that benefit umbrella. It doesn't fit under there anymore.

Why not?

It's the only plan where you are getting into life and death situations. My worst case scenario, and it's happening more frequently, is a young woman, 32 or 33, with two young children, who has breast cancer.

There are a lot of new technological changes going on, some of which have absolutely no proof of success at all. How do you as an employer or as an insurance company say you are not going to pay for something like that? Who is paid enough money to make that decision?

Was health care such an emotional and contentious issue 25 years ago?

I can't remember that health care was that big of an issue back then. People were not unhappy. They didn't have to pay much.

But in those days, we didn't have the miraculous treatments and technologies that exist today. We somehow got off the track on how to manage that part of it. Back in those days if you had a one-pound baby, it wasn't going to make it.

Our company recently had three in one month. Three one-pound, one-ounce babies. Two survived.

Who is to blame for the health care crisis?

I spent a lot of time looking at who culprits are in health care—and it's everybody: the consumer, the employer, providers and the government. We're all guilty to a certain extent.

Will employers ever be able to control health benefits costs?

Continued on next page

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Continued from previous page

Right now, I'm not optimistic, and I'm becoming more pessimistic all the time.

As an employer, I've used all the tools—the new ones and old ones. We've taken some of the tools and been fairly rigid. When we manage health care, we do it pretty tightly. But even then the costs still go up double digits. There's something wrong when you are happy with a 15% increase in your costs. That shouldn't be acceptable.

Would employers be better off with national health care?

I have my days—and I talk to more and more benefits people who have more and more of those days—when I want to chuck the whole mess and go to a national health system. Those are the days where you got a bad case, a bad situation, frustration.

On the other hand, there is a basic mistrust of letting the government handle it.

Should employers be required to offer their employees health insurance?

I don't know what the statistics are, but we've got thousands of people who are eligible for our medical plan who don't take it. Granted, a lot of them are probably covered by a spouse or a family member, but I guarantee you there are a number who don't take it because they've opted to buy a six-pack of beer a week. That's their priority.

You feel that's a bad decision?

Well, maybe it's not a bad decision. In our society, if they get injured or hurt, their bills are going to get paid for, and the cost will be shifted to somebody else, pure and simple.

So from their standpoint, 'What the hell, why take it? Somebody is going to pick up my tab.'

What kind of health system reform plan would you support?

Every time I look at a proposal or solution, I look at whether there are winners and losers. If there are winners and losers, it's probably a bad idea.

If everybody's ox gets gored, then it's probably got some merit, because everybody's got to pay a price to fix the health care system.

You are chairman of a local employer coalition, the Business Health Care Action Group in the Twin Cities, which just completed a direct contracting project with local providers (*BI*, July 13). What are the advantages of eliminating the middlemen—insurers, managed care vendors and others—when setting up a provider network?

You have access to all the information you need. You know the costs because you sit there and negotiate them yourself. And, there is no inefficient, additional cost of administration.

You know what you are buying. One of the problems with intermediaries is there are a lot of unknowns. What is in the black box? In our Twin Cities project, it's all opened up. We know the details. Ten cents might go for supplies. We know how much goes for profits. We know how much goes for research.

You do that when you make other kinds of purchases. It's not unreasonable to do that with health care.

Can something like that be done in other communities?

The answer is yes, but I tell you the ingredients are here. The Minneapolis-St. Paul area has a large number of large, national corporations. We are a bunch of Norwegians, Swedes and Germans who like each other and trust each other, which is one ingredient for change.

Secondly, you've got a provider community around here that is a little more progressive and forward-thinking than most. They are willing to try different things. And, both the employers and the providers agree that the system we have today cannot continue this way.

Even with those ingredients, it's been hard. It's very difficult to think in different ways and not bring up your old hang-ups. I've got 25 years worth of hang-ups that I have to get rid of. And, I've got some things that, on a given day, I would not agree to.

Most of the employers that belong to the coalition self-insure their health care plans. Do the advantages of self-insurance still outweigh those of commercially insured arrangements?

Yes, overwhelmingly. Other than small employers I don't know anyone that doesn't self-insure these days.

There are some large employers that still insure their health care plans, though.

I know—and I think that is unconscionable. It's a firing offense. I just don't understand it. It's a wimpy, non-creative, status quo way of thinking.

How have employer attitudes about offering benefits changed?

In the early stages, we were in an add-and-improve way of thinking. Back in the early 1970s, most companies were guilty of doing the infamous annual benefits survey to find out what their competitors were doing.

I got off that track pretty early. I basically quit looking at surveys. I didn't want to follow them, because I didn't like where they were going.

Now, employers are in a 'hold your own' way of thinking. There is not enough money to improve any other benefits, because you are spending it all on health care.

What is the most important employee benefit from the employer's point of view?

For an employer management tool, I'd have to say retirement benefits. I remember a company that we bought back in the '70s that had no type of retirement plan. The company's head of personnel was 82 years old. The company had a lot of older workers. They could not retire.

A retirement program is a way to rejuvenate your workforce without throwing people out on the street.

But today a lot of employers have been trying to cut or get out of their retiree benefit obligations—particularly retiree medical.

That's going to keep going on, there is no question. Those were promises that were made, and they were not based on any long-term thinking.

I learned early on that when you put a benefit plan in, it's for the duration, so you better think it through. You have to operate on the assumption that it will be there forever, so you better do a lot of homework before you make that recommendation.

Despite all of the talk about the aging population, employers to date haven't been much interested in offering long-term care plans. Why not?

An employer would be crazy to get involved in long-term care when their health care costs are crazy. Who needs another unknown? And it is an unknown.

Is long-term care an insurable risk? I don't know if it is. It's very remote. The cost of long-term care is probably overpriced because there is not enough experience to understand the risk.

I think long-term care insurance belongs somewhere under Medicare. I don't think it belongs in the employer's area.

How will benefits at Dayton Hudson change in the future?

I see us paring back more benefits. I see us paying only for health services that are medically necessary. You will get beat up a little bit by employees, but you have to look them in the eye and say, "That's the plan."

Should employees be required to pay more for benefits if they have unhealthy lifestyles?

Our smokers pay 15% more for medical benefits than non-smokers. Bungee-cord jumpers are next on my list.

Would you make a bungee jumper pay more for health benefits?

I would say maybe you don't even cover them. Maybe that's taking it to extremes, but we've had discussion on this.

Ask yourself the question, 'What is my responsibility as an employer—and as an employee who pays part of the medical plan costs—to pay for the injuries of someone who is out bungee jumping?' There is no good answer for that.

But you would pay for someone who gets cancer?

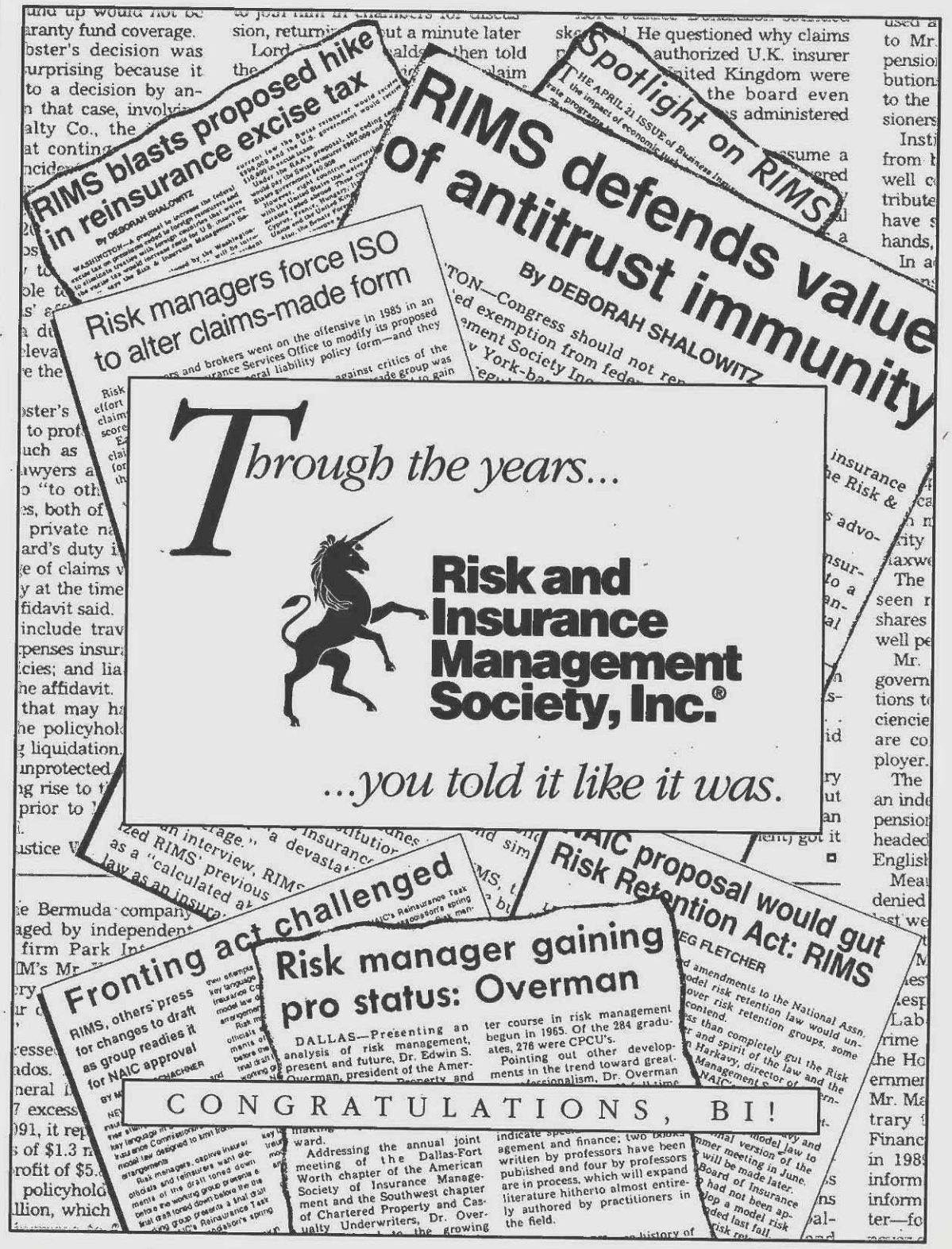
Yes, because they didn't put themselves at risk, by any means.

The American Civil Liberties Union would argue that employers have no business regulating their workers off-duty behavior.

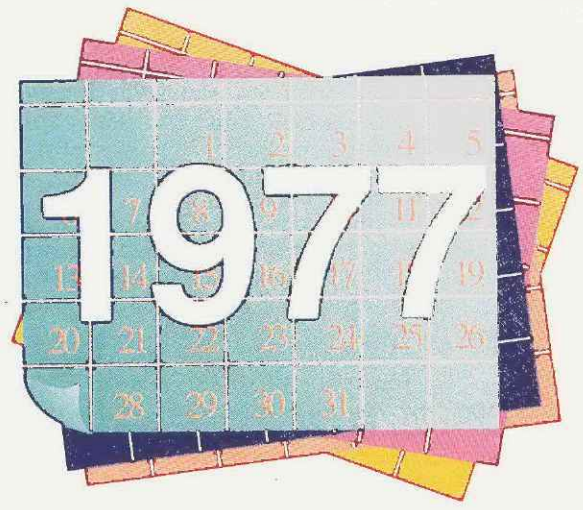
But it's my business when I have to pay for it. They can do anything they want to as long as they don't ask me to pick up the tab.

But, you see, health care is what I call OPM: Other People's Money. When you use other people's money, you have more responsibilities, I think. If you're using your own money, I don't care what you do. BI

I'm looking at health care as a non-benefit at this point. I pulled health care out from underneath that benefit umbrella. It doesn't fit under there anymore.



Looking Back



Pension consultants say there is no large-scale movement among big corporations to **replace their defined benefit pension plans with defined contribution plans** as a result of the Employee Retirement Income Security Act of 1974.

Peter A. Bleyer of Alexander & Alexander Services Inc. in Chicago said only one client out of 7,500 had terminated a defined benefit plan and that was because the company went out of business (*BI*, Jan. 10, 1977).

* * *

A *BI* survey finds that few **second opinion programs** for elective surgery have been established since a House subcommittee concluded last year that the programs would save millions of dollars in benefit costs.

Only 586 Blue Cross & Blue Shield members in New York have obtained second surgical consultations since August, said a spokesman for the national BC/BS Assn. There are more than 5 million members enrolled in Blue Cross & Blue Shield of Greater New York (*BI*, Jan. 10, 1977).

* * *

The owners of a wrecked oil tanker have both hull and liability insurance for the **worst oil pollution spill ever**, but a legal battle is evolving over the shipper's liability. The ship, the Argo Merchant, ran aground off Nantucket Island, releasing 7.5 million gallons of industrial oil. The ship's Liberian owner, Thebes Shipping Co., has both hull and liability coverage.

Thebes has been sued by local fishermen for damages totaling $60 million but is attempting to negate any liability by invoking a 125-year-old maritime law that makes shipowners responsible only for amounts equal to the value of the remains of the wrecked ship (*BI*, Jan. 10, 1977).

* * *

Three **national health insurance bills** have been introduced in Congress, despite the Carter administration's warnings that it will not support such legislation this year.

The administration supports the concept of a gradually phased-in national health plan. But it is expected the president will be concentrating on government reorganization and economic problems in his first year in office (*BI*, Jan. 24, 1977).

* * *

State insurance officials are alarmed by the **rapid growth of employee benefit trusts** operating under the Employee Retirement Income Security Act of 1974.

Their fears have been intensified by the recent bankruptcy of a large self-funded trust based in California, the National Multiple Employers Foundation. And, they are afraid that more trusts will become insolvent, leaving thousands of employees with unpaid claims (*BI*, Feb. 21, 1977).

* * *

The Carter administration has proposed a strict **federal limit on how much hospitals can charge** patients in an effort to slash skyrocketing medical costs by billions of dollars.

The administration said it would ask Congress for authority to establish a ceiling on hospital charges. A spokesman for the Department of Health, Education and Welfare estimated the annual savings for health care payers at $2 billion (*BI*, March 7, 1977).

* * *

The **largest aviation loss in history** is expected to result from the March 27 collision of two Boeing 747 jumbo jets on a runway in the Canary Islands. Almost 600 people died in the crash.

Both airlines, KLM Royal Dutch Airways and Pan American World Airways, had hull insurance totaling $63 million on the planes. It will be the largest hull loss insurers ever have had to pay for a single crash.

That amount is likely to pale in comparison with liability claims, which observers predict could exceed $400 million (*BI*, April 4, 1977).

* * *

The first round of what promises to be a long legal battle has gone in favor of 16 drug companies that marketed **DES**, a drug once prescribed to pregnant women to prevent miscarriages that now is being blamed for the health problems of the women's daughters.

The suit was brought in Wayne County, Mich., by 144 daughters of women who had taken diethylstilbestrol during pregnancy. Since the majority of the daughters could not identify the manufacturers of the drug their mothers took, they sued the 16 firms they claim had dominated the market.

A county court rejected the theory of industrywide liability, ruling that the specific manufacturer must be identified to be sued (*BI*, May 30, 1977).

* * *

Two $21 million damage suits already have been filed on behalf of people killed and injured in the huge **Beverly Hills Supper Club fire** near Cincinnati, and lawyers warn that these suits are only the beginning.

Continued on next page



It's hard to find the responsiveness you need with some case management services.

Continued from previous page

At least 161 people died in the blaze at the club, which apparently was caused by a short circuit. The insurance held by the owners of the supper club appears to be inadequate to cover suits seeking damages that may reach hundreds of millions of dollars (*BI*, June 13, 1977).

The United Auto Workers is setting up a group legal plan for unionized hourly employees of Chrysler Corp.

The plan, which will serve the personal legal needs of 150,000 families of active and retired Chrysler workers around the country, is the **first nationwide group legal plan** (*BI*, July 25, 1977).

* * *

Oregon has become the third state to pass a tort reform measure this year, advancing the drive to ease the crisis in product liability insurance. Utah and Colorado also have enacted tort reform legislation.

Proponents of tort reform are buoyed by the recent success in Oregon and say that state legislators and the public finally are beginning to accept that the court system must be reformed to restore balance. However, opposition forces, especially trial lawyers, have stepped up the battle to defeat tort reform efforts (*BI*, Aug. 8, 1977).

* * *

The Insurance Services Office Inc. is filing nationwide for **exclusion of punitive damages in all liability coverages.**

Although the majority of ISO members on five committees voted in favor of the exclusion, slated to take effect Nov. 1, some insurers will continue to offer the coverage.

For example, Hartford Insurance Group is not planning to exclude punitive damages. Other insurers say they will generally support the exclusion with some exceptions.

ISO also acknowledges that some state insurance departments may balk at the exclusion (*BI*, Sept. 5, 1977).

* * *

The national Blue Cross Assn. is **forcing local Blue Cross plans to intensify their health care cost control efforts.**

In order to remain members of the national association, local plans will have to implement cost control measures such as programs to find fraud, screen claims to avoid unnecessary surgery and improve coordination of benefits (*BI*, Sept. 5, 1977).

* * *

The **cost of employee benefits has increased twice as fast as wages.**

The Council on Wage and Price Stability found that the cost of employee benefits rose 133.9% between 1966 and 1974, while wages rose only 73.7%.

Although final figures for 1975 and 1976 are not available yet, the council said "more up-to-date figures would show an even higher proportion of total compensation accounted for by benefits" (*BI*, Sept. 19, 1977).

* * *

The Internal Revenue Service has formally ruled that U.S. companies **cannot deduct premiums paid to a wholly owned captive.**

The IRS has held this position for some time, but the issuance of this formal ruling appears to close the door to such tax deductions (*BI*, Sept. 19, 1977).

* * *

There would be little cost impact on employee benefit plans if the **mandatory age for retirement** is raised or eliminated.

Congress is likely to pass a measure that would raise the mandatory retirement age for private employees to 70 from 65, and would eliminate mandatory retirement for federal workers.

Benefit experts say that, although life insurance and disability coverage costs would rise if there were more older workers, pension costs would be lower because the benefit would be paid for a shorter period of time. And health insurance costs would remain for the most part unchanged, because Medicare is the principal source of coverage for people over age 65 (*BI*, Oct. 3, 1977).

* * *

A federal appeals court has ruled that states have the right to require employers or unions to provide certain benefits, if those benefits are financed by purchasing insurance. But unions or employers that **self-fund their benefits are exempt from state regulation** by the Employee Retirement Income Security Act of 1974.

The appellate court upheld a New Hampshire law that required group insurance contracts to include mental illness coverage (*BI*, Oct. 3, 1977).

* * *

The Carter administration's new tax reform proposal would **cut in half the tax-free portion of employer-paid life insurance.** Under the proposal, employees would be taxed on employer-paid premiums for life insurance coverage above $25,000; the current limit is $50,000.

The tax proposal also would reduce the ceiling on pension benefits for which highly paid employees would be eligible and make employer-paid group legal services a taxable benefit (*BI*, Oct. 17, 1977).

* * *

The Pension Benefit Guaranty Corp. has officially asked Congress to **raise the annual termination insurance premium** to $2.25 per plan participant from $1.

The hike is needed because pension plans have been terminating at a much higher rate than had been expected, and the PBGC's deficit has already hit $61 million, said Matthew M. Lind, acting executive director (*BI*, Oct. 17, 1977).

* * *

Some recent **insurance company ads are powerful, but less than truthful.**

In one ad, an insurer cites the case of a man who picked up his lawn mower to trim his hedge, was injured and successfully sued the the lawn mower manufacturer. But, the insurer is unable to prove that there ever was such a case.

The other ad says that 1 million product liability suits are filed each year. Even the insurer involved says that is an exaggeration and is changing its ad (*BI*, Oct. 31, 1977).

* * *

The federal Interagency Task Force on Product Liability recommends **tort reform, federal chartering of captives and tax deductions for self-insured reserves** as ways of dealing with the product liability insurance problem.

The tort reforms suggested by the task force included a modified 10-year statute of limitations, compliance with government safety standards as a defense and reducing damage awards by the extent to which the plaintiff contributed to the injury (*BI*, Oct. 31, 1977).

* * *

Workers compensation costs continue to climb, and some employers are beginning to weigh their **workers compensation options.**

Major benefit improvements have driven up the cost of workers comp programs twice as fast as the cost of living: In 1975, the last year for which figures are available, employers spent $8.9 billion to insure or self-insure workers comp programs, a jump of 12% from 1974. In the face of such sharp increases, more employers are considering self-insuring (*BI*, Dec. 12, 1977). BI



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Illustration by Tony Griff

Handshake Agreements No More

Policyholders, insurers settle coverage disputes in courtroom rather than boardroom

Because no battle is ever won, he said. They are not even fought. The field only reveals to man his own folly and despair, and victory is an illusion of philosophers and fools.

—"The Sound and the Fury"

William Faulkner certainly was not thinking of legal battles in 1929. But his words eloquently summarize the war that has been raging between policyholders and their insurers over exactly what is covered by the comprehensive general liability policy.

After more than a decade of litigation, neither corporations nor their insurers have emerged victorious. The only winners to date have been the lawyers.

The past 25 years have seen enormous changes in the way policyholders and insurers resolve coverage disputes.

Gone are the days of handshake agreements, the days when policyholders and their insurers amicably negotiated all coverage disputes, the days when it was virtually unthinkable for a policyholder to sue its insurer.

Today, policyholders and their insurers frequently sue one another over the scope and terms of insurance contracts. And, more often than not, major disagreements over coverage are settled in the courtroom rather than the boardroom.

The lone exception to this trend toward litigation is the Center For Claims Resolution and its predecessor, the Asbestos Claims Facility, the products of the celebrated Wellington Agreement of 1985. Remarkably, these organizations enabled policyholders and insurers to settle thousands of asbestos coverage disputes worth millions of dollars.

"Twenty years ago," recalled Robert Esenberg, risk management administrator for the city of Virginia Beach, Va., "you would never even consider suing your insurer. We used to be able to sit down with our underwriters and negotiate solutions. There was an attempt to forge partnerships."

Policyholder attorney Tom Freeman of Brobeck, Phleger & Harrison in San Francisco agreed: "Years ago, when you talked to an insured about bringing a coverage lawsuit, there was a great hesitance. The feeling was, 'My God, we can't sue our insurers. We have to have an ongoing relationship.' Today, it is not so unthinkable."

For nearly a century, Weyerhaeuser Co. of Tacoma, Wash., was able to negotiate solutions to coverage disputes with its insurers, explained Cheri Hawkins, assistant treasurer and director of insurance. Not until this year did the forest products concern, which was formed in 1900, sue its liability insurers (*BI*, March 16).

"It used to be you would all amicably get together—the broker, the claim adjuster, the underwriter—and you would sit down and talk," explained Ms. Hawkins, who, like Mr. Esenberg, is a former president of the Risk & Insurance Management Society Inc.

"Today you can't even have a discussion without the attorneys being involved. Today litigation is the name of the game."

Policyholder attorney Eugene Anderson of Anderson, Kill, Olick & Oshinsky added: "Years ago risk managers were content to eat a loss in order not to alienate a market. But today the corporate insurance buyer's attitude is, 'If we paid for it, we deserve coverage.' "

What forced policyholders and insurers out of the boardroom and into the courtroom? Most risk managers and attorneys attribute the change to the onslaught of asbestos claims in the 1970s and environmental claims in 1980s.

"You have got to feel you have a lot at stake before you feel pushed to the wall and feel forced to litigate," said Ted Surdam, manager of corporate insurance for Polaroid Corp. in Cambridge, Mass.

By their sheer size and complexity, asbestos and pollution liabilities forced policyholders and insurers into litigation.

"The development of complex, multiparty coverage disputes has made it much more difficult to resolve disputes through settlement," said Lawrence Fitzpatrick, president of the Center for Claims Resolution.

Another contributing factor was the Superfund law, which created huge new liabilities that forced Corporate America to seek out every possible revenue source.

The Comprehensive Environmental Response, Compensation & Liability Act, enacted in 1980, authorizes the government to clean up hazardous waste sites and charge the costs to "responsible parties." Alternatively, the government can sue to force a company to clean up a site.

Under Superfund, responsible parties are strictly liable for cleanup costs if they generated, transported or exercised control over the hazardous waste at a site. It does not matter whether they actually polluted the site. Responsible parties also are jointly and severally liable for cleanup costs, meaning that one company can be forced to pay for the entire cleanup even if many other companies contributed to the pollution.

"The tremendous exposure and the impact of these claims on both policyholders and risk managers have closed a lot of doors as far as being able to sit down and discuss claims" with insurers, said Mr. Esenberg.

"These are 'Bet the Company' kinds of claims," agreed insurer attorney Tom Chrisham of Hinshaw & Culbertson in Chicago. "And that is what has caused policyholders to seek coverage with a vengeance."

Economic incentives were also at work for insurance companies. Massive numbers of asbestos claims in the 1970s and environmental claims in the 1980s made it "more financially feasible for insurers to litigate in expensive coverage litigation rather than pay out on massive numbers of claims," said policyholder attorney Kirk Pasich of Hill, Wynne, Troop & Meisinger in Los Angeles.

"Insurance coverage litigation is a cost-effective way of demoralizing and debilitating policyholders," said Mr. Anderson.

Developments in the area of bad faith may also have played a role in the expansion of coverage litigation.

Bad faith was first recognized as a tort by the California Supreme Court in 1973. Before that, policyholders could only sue insurers for an amount equal to the policy limits. The creation of the bad faith lawsuit enabled policyholders to sue for additional compensatory and punitive damages.

"This gives the policyholder more of an incentive to litigate," explained insurer attorney William Shernoff of Shernoff, Bidart & Darras in Claremont, Calif. "This is one part of the equation in some states."

There are many ways to measure the enormous changes asbestos litigation and pollution litigation have wrought on the risk management and insurance industries.

Perhaps one of the most telling changes can be seen in the relationship between the risk management department and the legal department.

Not only have risk managers been forced to learn the legal language and work closely with the legal department, risk management departments at some corporations now report to legal, rather than financial, executives.

This new prominence of lawyers in the insurance arena has not come without problems.

"Attorneys have different aims than risk managers," said Ms. Hawkins of Weyerhaeuser. "Attorneys are interested in the short-term litigation, but risk managers are interested in the long-term availability of coverage."

In many instances, these differing viewpoints mean that coverage litigation is driven by the lawyers and not by the risk managers, she said.

"A lot of what used to be in our control is no longer in our control," said Ms. Hawkins. "Attorneys are very much in charge now."

Insurer attorney Richard Seabolt of Hancock, Rothert & Bunshoft in San Francisco agreed. He said sometimes risk managers may not even believe there is coverage, but if the lawyers feel they have a potential case, a suit is filed.

This, he said, was the case in celebrated litigation brought by La Jolla, Calif.-based Aerojet-General Corp. against its liability insurers.

"In *Aerojet*, the risk manager, Ed Riordan, testified that he waited eight months before giving notice to his insurers because he thought that environmental claims were not covered. It was the lawyers who convinced him to give notice and later to file a massive lawsuit," said Mr. Seabolt.

A California jury eventually found that Aerojet was not entitled to coverage for a toxic waste cleanup that could cost as much $500 million because the company "expected or intended" the damage.

Another way to measure the change in the landscape is to

Continued on page 86

By Stacy Gordon



IN AN INCREASINGLY COMPETITIVE ENVIRONMENT, LONGEVITY HAS ITS ADVANTAGES.

Nature can be harsh. Lack of food, protection or the onslaught of the elements can eliminate greater than 95 percent of the young of a species.

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EXPERIENCE SCOTT WETZEL SERVICES, INC. WITH VISION.

Risk Management Planning and Support

Coverage disputes

Continued from page 84

look at the impact insurance coverage litigation has had on the legal profession.

"Twenty-seven years ago, when I started, I doubt there was single lawyer whose full-time practice was devoted to insurance coverage litigation," said Mr. Chrisham. "There simply weren't enough of these disputes to keep a lawyer busy."

Today, more than 200 law firms devote a portion of their practice to coverage litigation, he said.

Similarly, the growth of insurance coverage litigation has led to the routine filing of amicus curiae—friend of the court—briefs by both policyholders and insurers.

Nearly every insurance coverage case now is deemed to have national importance, so both policyholders and insurers monitor coverage litigation and file briefs that express their viewpoints.

Insurers have established the Insurance Environmental Litigation Assn., which regularly files briefs in coverage disputes nationwide. Formed in 1986, the group represents 20 national insurers.

Among the groups monitoring disputes on behalf of policyholders are the National Assn. of Manufacturers, which represents about 13,500 manufacturing companies; the Chemical Manufacturers Assn., whose members produce 90% of U.S. industrial chemicals; and the Mid-America Legal Foundation, which represents Midwestern corporations.

Policyholder attorneys also have been known to travel nationwide, pitching the idea of coverage litigation to corporate management.

"Policyholder counsel travel around the country telling corporate management they owe it to their shareholders to sue their insurance companies," said insurer attorney Mr. Seabolt. "And, they suggest that if they don't sue their insurers, they may be breaching their duties to their shareholders."

It is not only the quantity of coverage litigation that has grown over the past 25 years. Quality, too, has improved as policyholders have developed more sophisticated legal theories to use in seeking out coverage and insurers have developed more sophisticated defenses.

"Because the question of who will pay to clean America is so important, we often see issues being invented," said insurer attorney Laura Foggan of Wiley, Rein & Fielding in Washington. "A lot of policyholder lawyers have been inventive on behalf of their clients."

Much of this creativity has been spent arguing what the words "sudden and accidental" mean. The pollution exclusion clause in comprehensive general liability policies bars coverage for all pollution that is not "sudden and accidental."

Policyholders argue the phrase should be interpreted to bar coverage only for pollution that is expected or intended. Insurers counter that the phrase should be given a temporal interpretation that bars coverage for all gradual pollution.

State and federal courts nationwide are split on this crucial issue.

State supreme courts are the final arbiters of coverage disputes, but even after they have spoken, policyholders have been known to try to get a second bite at the apple.

Take Belleville Industries Inc., for example. The New Bedford, Mass., manufacturer tried to argue that even though the entire course of PCB pollution at an electrical capacitor plant occurred over many years, the court should look at individual polluting events within that period to find a "sudden and accidental" event.

The 1st U.S. Circuit Court of Appeals did not agree and called the policyholder's argument a "microanalysis" that would "eviscerate the exclusion for pollution" (*BI*, Aug. 5, 1991; July 22, 1991).

Policyholders are not alone in their creativity. Insurers have raised equally creative defenses.

One example is the so-called sophisticated insured defense. Under this line of reasoning, large corporations are deemed to be so sophisticated and knowledgeable about the insurance they buy that well-settled principles of contract interpretation need not apply.

Insurers, for instance, argue that one rule of contract interpretation—that ambiguities are construed against the party that drafted the contract or, in this context, the insurer—should not apply to large and sophisticated policyholders.

"This is an attempt by insurers to invent something that did not exist," said Mr. Pasich. "The policy language is standard, uniform language that was never negotiated by policyholders.

"Second, this argument has nothing to do with reality. What insurance carriers do in real life when making coverage decisions is look solely at the policy language. They never consider the size of the insured, the use of risk manager or the use of large broker."

In the final analysis, William Faulkner may have been right: Maybe there are no winners in battle.

Or almost none. "The only winners are lawyers," said Mr. Surdam. "Both policyholders and insurers lose something when you go to court."

Not only are attorneys the only winners, but also "the insurance program for the corporation is the loser in the long run if everything has to be a battle," said Ms. Hawkins of Weyerhaeser.

Further, once-congenial relationships between policyholders and insurers have been sacrificed in the coverage battle.

While many policyholders and insurers still have close working relationships, other relationships indeed have become more adversarial.

"I don't think insurance companies trust the policyholders any more than the policyholders trust the insurers," said policyholder attorney Mr. Pasich. "Today both sides question the motivations of the other.

"What should be cooperative, joint effort has become an adversarial relationship," he said.

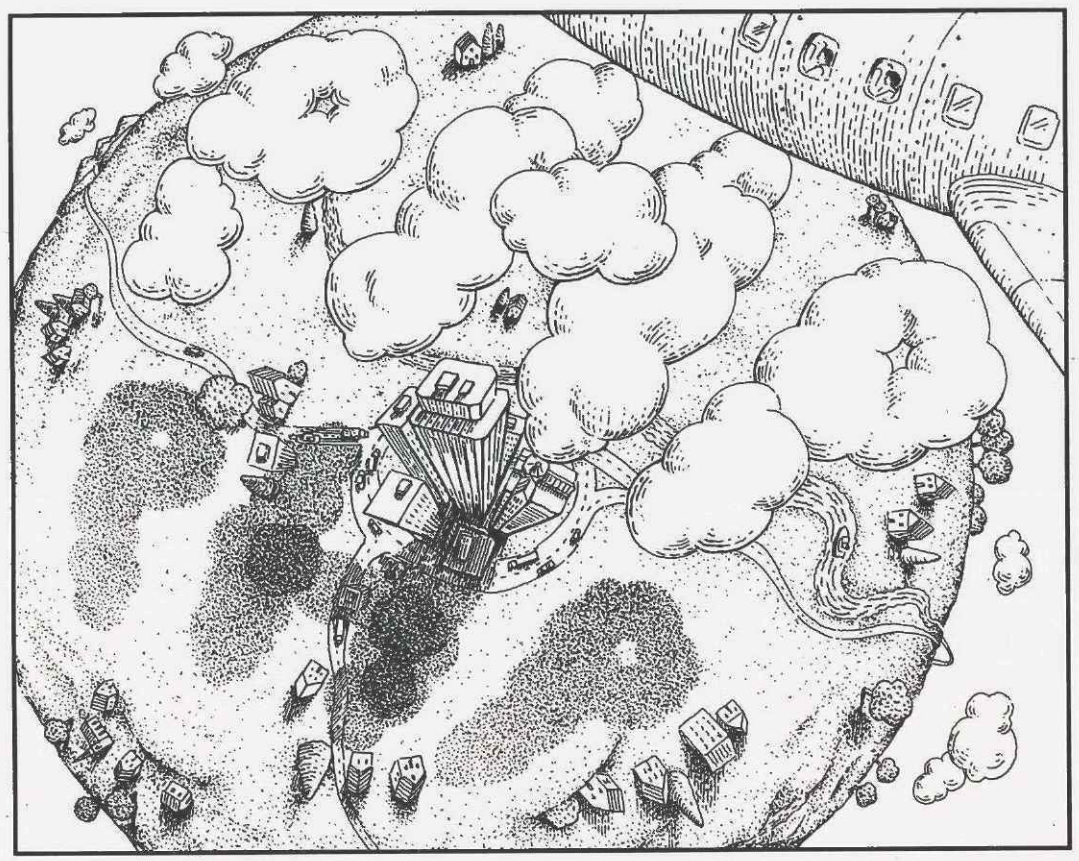
"There used to be tripartite relationship between the corporation, the insurance company and the defense counsel," added Mr. Seabolt. "But that has all changed. Today, people are shooting inside the tent instead of outside the tent."

In the end, the American public may be the biggest loser of all. Most Superfund sites remain untouched, partly because nearly all of the earmarked money is being spent on litigation. The RAND Corp. recently found that 88% of insurer money spent on environmental claims—$410 million annually—is consumed by transaction costs such as legal fees, leaving only $60 million to clean waste sites.

And ultimately it is the public that picks up the tab when huge claims force an insurer into insolvency, said Mr. Chrisham.

He likened filing a coverage lawsuit to standing on one's tiptoes at a parade. "It is OK for you, but if everybody stands on their tiptoes it's a problem." BI

Stacy Gordon, who recently resigned as BI's New York Bureau Chief to join a law firm, reported on legal issues from 1988 to 1992.



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A Conversation With:

Judge Jack B. Weinstein

U.S. District Judge Jack B. Weinstein celebrates his 25th year on the trial bench this year. Formerly chief judge of the U.S. District Court for the Eastern District of New York, Judge Weinstein is renowned for his innovations in handling mass tort cases.

In 1984, he was instrumental in negotiating the massive Agent Orange settlement (*BI*, May 14, 1984); later he steered the reorganization of the Manville Personal Injury Trust Fund (*BI*, July 16, 1990); and most recently he helped dispose of all of the cases pending in New York state and federal courts involving the anti-miscarriage drug DES.

In recognition of his innovative approach to the handling of mass tort cases, Judge Weinstein has been asked to be one of 10 federal judges trying to relieve the backlog of asbestos personal injury cases that currently plague the nation's courts.

Judge Weinstein discussed mass tort litigation and other topics this summer with Stacy Gordon, former *BI* New York bureau chief.

* * * *

In the last 25 years we have seen an explosion in the number of lawsuits filed. From your vantage point, are there now simply too many cases for our courts to be able to handle effectively?

No. In fact, the cases your readers are most interested in, the civil cases, have not increased disproportionately. As a matter of fact, there have been decreases steadily in the number of incoming civil cases.

However, there has been a large increase in criminal cases, primarily because of the so-called war on drugs. Most of these cases should not be in the federal courts. They should be in state courts or they should be handled administratively.

Would it be possible to handle certain types of mass tort cases in an administrative fashion?

With respect to mass torts, we are learning a good deal about how these cases should be handled. Some of them should be handled administratively. And, we can handle them much more effectively, particularly if we get a hold of the scientific aspects earlier in the cases.

We are already handling the vaccine cases administratively and black lung. And we can do this in other areas.

Could asbestos personal injury cases be handled administratively?

It is too late for asbestos, in my opinion. Those cases have been mishandled by the failure of Congress to step in early on.

But we have the breast implant cases, the stress syndrome cases, the lead cases and many other mass tort cases that will be coming down the line that might be appropriate to handle administratively.

You have been an ardent supporter of consolidation of mass tort cases. How can the federal courts resolve mass tort problems when there is 'leakage' to the state court system?

We can cooperate effectively with the state courts. For example, in the asbestos cases I worked very closely with New York Supreme Court Judge Helen Freedman. Together we were able to dispose of thousands of cases.

The same kind of cooperation was used to dispose of the New York state and federal DES cases. I expect that the stress syndrome cases and other cases will be handled in that way.

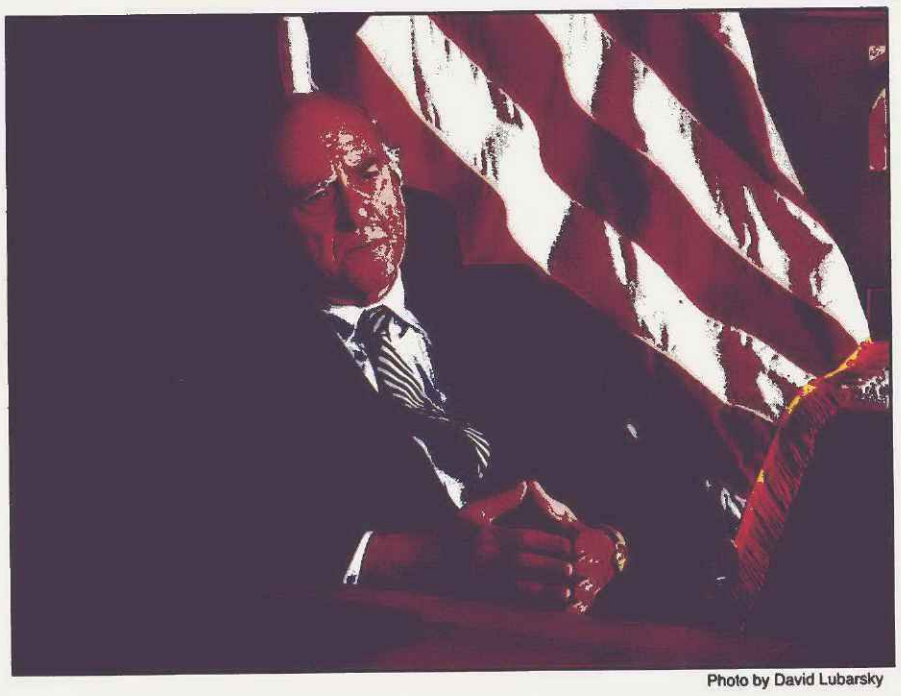


Photo by David Lubarsky

Do you view consolidation as a tool that raises the stakes in order to force both sides to settle a lawsuit?

No. It is not a question of forcing them. I think consolidation can make it possible in some instances to permit a reasonable settlement to the advantage of everyone.

In fact, in many instances it can reduce the stakes by making it possible to reach a more sensible settlement that includes funding for scientific research, medical monitoring and other matters, including putting off certain claims until the disease is manifest. It can give security to everybody at a much reduced cost.

It also reduces the transaction costs making it possible to give more to those actually injured with less cost to the insurance industry and the manufacturers.

Are there other ways to reduce the exorbitant transaction costs?

Yes. One way is to reduce attorneys' fees based upon time expended. Cutting the cost of discovery to defendants by providing for consolidated discovery so that you do not have to do the same thing over and over again. The use of scientific advisers to the court. . .there are many ways.

Should contingency fees be abolished in mass tort litigation?

No. I think particularly early in the development of litigation contingency fees are really necessary. But there comes a stage where plaintiffs' lawyers are not contributing a great deal to the individual cases, so that fees per hour or perhaps compensation based on results reached would be appropriate.

I do believe in adequate compensation for attorneys, but I think we have to take a better look at our whole fee system.

Would it be possible to resolve mass tort claims through a compensation system similar to the workers compensation system?

Not completely, but I do believe the scheduling of benefits with a movement away from the tort system is desirable because it will reduce transaction costs.

The key in many of these cases is, of course, science—getting the scientific /medical facts as early as possible. We have to get the scientific and medical community involved in an earlier stage.

Do you foresee a single solution emerging that would remove all asbestos cases from the nation's courts?

Currently, there is a group of state judges and a group of federal judges cooperating on a national scale with regard to how to handle the asbestos cases. There will not be a single solution. Our country is too diverse, too large and too exciting in the kinds of changes it makes for it to be possible to have a single solution. The very nature of our democracy and our heterogeneity is a constantly changing society that requires new initiatives.

Further, anybody who has been involved in this area has to appreciate how complex it is. Simplified solutions tend to be somewhat superficial and unworkable.

One solution that is being considered is the consolidation of asbestos personal injury claims. Does consolidation of these claims result in good claims being compensated with groundless claims?

I don't think so. I have tried as many as 65 cases at a time before one jury and I think jurors are capable of making the distinctions. They find for the defendant in some cases and find reduced verdicts in others. I do not think that efficiency and fairness are antagonistic.

Do you believe the federal government should play a role in compensating the victims of exposure to asbestos-containing products?

Yes. In the Navy shipyard cases, the federal government has stepped away from its responsibility. It is up to Congress to rectify the situation.

Do you see a problem with the vast inconsistencies in jury awards in mass tort cases?

There are some inconsistencies. But generally, I find jurors to be consistent and very rational. Sometimes jurors do make a mistake. But I am generally impressed with jurors. They bring a great deal of common sense to the process and they are very devoted.

People who don't understand the system don't appreciate how hard jurors work.

How should courts address fear of cancer claims, particularly in view of the fact that corporations have limited assets?

I think these claims are important. I think eventually we are going to change both the substantive and procedural law, as we have done in part already, so that such claims can be put on hold and thus avoid the statute of limitations problems.

We have to provide for the means of ultimate payment so that the potential plaintiffs can get some assurance that there will be money available when and if they become diseased.

What role should punitive damages play in mass tort cases?

Punitive damages are not desirable in mass tort cases and they should be eliminated.

What role will alternative dispute resolution play in our future?

There is going to be a good deal more ADR in the future. And, there will be privatization to some extent of the judicial process on a voluntary basis, such as arbitration of contract disputes, all of which means that there will not be a continuing expansion of the federal judicial system. 'Bigness' has its own disadvantages and should be avoided.

What role should health insurance play in the resolution of mass tort litigation?

One very critical factor which has not been given much attention is the health insurance problem. I held a series of meetings with the daughters of DES and one son. Their stories were really heartrending. I am very sympathetic with the problems they have. One problem that particularly struck me as warranting further study and help is that a number of them cannot get health insurance. They are fearful of cancer. They have had serious operations already. Their children are showing some signs of disease. And they cannot be insured.

We have got to do something for these people. We must take care of their insurance problems so at least they don't have this strain hanging over them.

This seems to me one of the clearest cases of the failure of the (insurance) system. I don't say that critically of the insurance industry. I understand their position. And, as someone who pays for insurance myself, I don't want to be overwhelmed with huge premiums. But in the DES cases, these daughters and sons and granddaughters and grandsons have never done anything wrong. And, their mothers never did anything wrong.

I think it is entirely unfair for our society to put these people under added strain by not providing a way for them to purchase insurance.

Do you support national health insurance?

I think it has to come. That is part of the basic problem. It must be solved or our industrial and commercial establishments cannot be competitive with foreign countries.

A lot has been said about competitiveness, but this is a key factor. In some cases, the insurance costs are one-third of the direct employment costs. Now that cannot continue.

Would national health insurance stem the flood of mass tort litigation?

I think it would enable us to start to get a hold on it. A national system is justified on two grounds: One is compensation, and two is deterrence. If you can assure everybody of adequate medical care, you would reduce the necessity in some instances of very high settlements to take care of future contingencies.

I think we have to address the problem more directly and honestly than we have. I think insurance companies and industrial establishments are two of the most responsible factors and should take a leading role.

Finally, after 25 years on the bench, is there one particular case or lesson you would like to share?

What repeatedly comes to mind is the importance of the individual in our system. Sometimes if you don't deal with people, you lose sight of the fact that judicial decisions affect real people.

I interviewed more than 600 veterans during the Agent Orange litigation. I saw in asbestos how whole families were hurt. These people need someone to listen to them.

It may well be that in America we will have to adopt the same pattern used by Japanese companies when there is a disaster. The company apologizes and asks the victims in face-to-face encounters how it can help.

If companies here acted as immediately as possible and adopted humane measures, we could avoid a lot of animosity and perhaps litigation. BI

A Picture's Worth



DEC. 12, 1983



MARCH 27, 1989



DEC. 20, 1982

A Thousand Words

Three years after graduating from college, I decided to become an editorial cartoonist. I packed my bags, bade farewell to the Travelers umbrella lighting the skyline of Des Moines, Iowa, and moved to Chicago. After two more years of training, I began free-lancing for *Business Insurance*.

Ten years later, I'm still here.

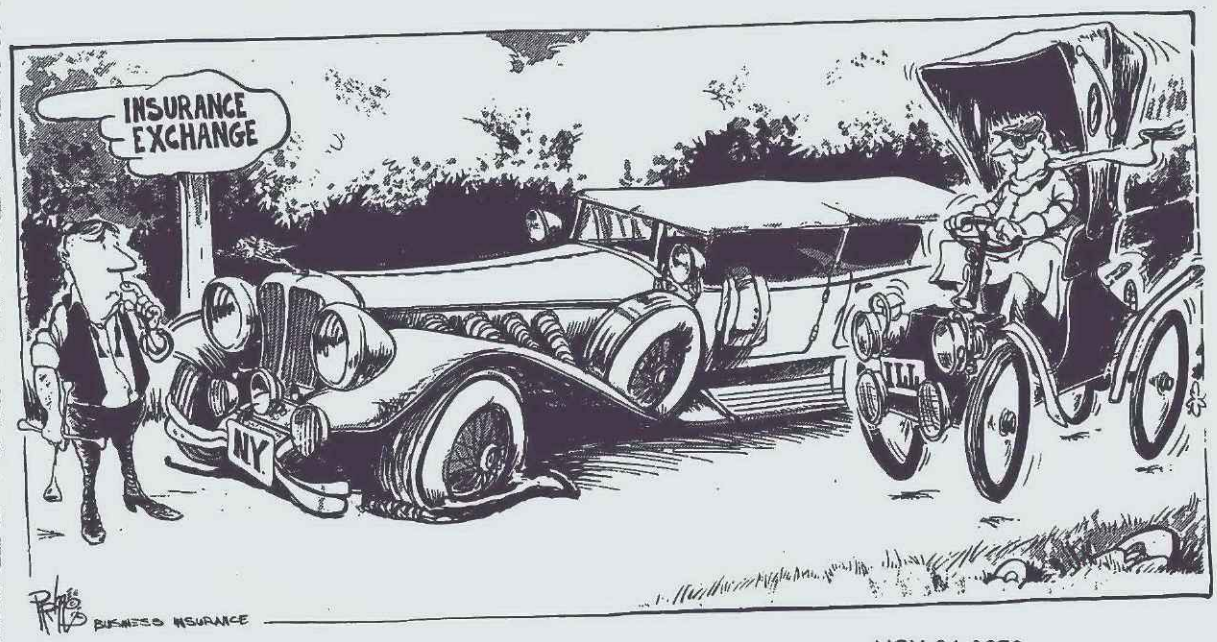
A frequent question asked of me is, "Who comes up with the ideas?" I must confess, I do. I brainstorm for minutes—or hours—to develop the appropriate metaphors. I find the chances for success tend to increase geometrically as deadline approaches.

The cartoons on this page represent a sampling of the cartoons that have appeared on *Business Insurance's* editorial page. *BI's* first cartoonist, Milt Priggee, now is working for the Spokane Spokesman-Review.

I frequently tempt fate as a color-blind person and draw color illustrations for *BI*. It's a good chance to improve my art, but editorial cartooning remains my first love.

—Roger L. Schillerstrom

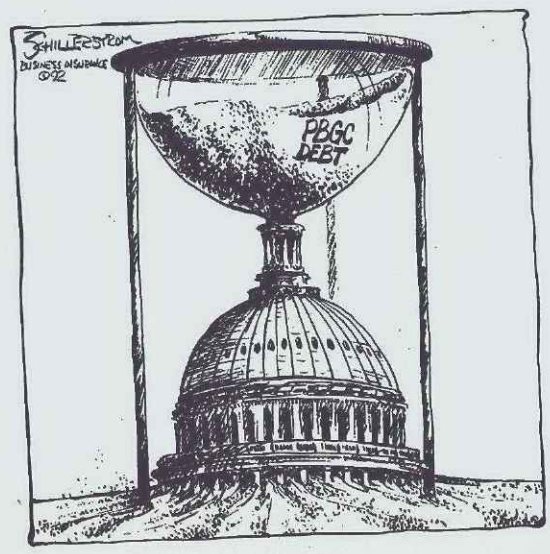




NOV. 26, 1979

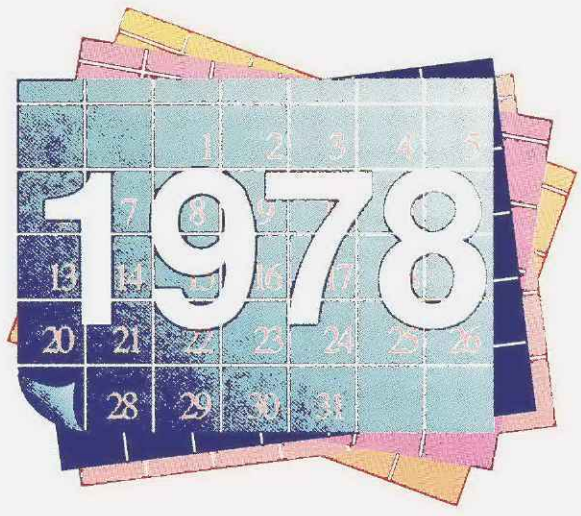


JUNE 9, 1986



FEB. 10, 1992

Looking Back



A group of 16 **asbestos producers** has reached an out-of-court settlement of $1.84 million in a series of suits filed by construction workers injured by handling asbestos.

The suits, which were filed more than five years ago, claim that the asbestos producers knew asbestos was dangerous at least 30 years ago but did not inform workers. The asbestos makers claimed that they implemented safety measures as soon as they were aware of the potential danger of asbestos (*BI,* Jan. 23, 1978).

* * *

About $40 million has been paid so far to settle claims against Farm Bureau Services Inc. resulting from the accidental substitution of the poisonous fire retardant **polybrominated biphenyl, or PBB,** for a nutrient in dairy cattle feed distributed in Michigan.

Settlements have been reached in almost 80% of the 955 claims filed, and the Farm Bureau estimates that by the time all the claims are settled, the payments will reach $50 million. The Farm Bureau is equally sharing the cost of the claims with Northwest Industries Inc., which accidentally substituted the PBB-contaminated material for the nutrients (*BI,* Jan. 23, 1978).

* * *

The Committee of Lloyd's has suspended Lloyd's of London syndicate 762, known as **F.H. Sasse & Others**, because it exceeded its surplus capacity, wrote too much insurance and could not meet its year-end financial audit.

Although all claims against the syndicate, which wrote a large number of U.S. commercial risks, are expected to be paid, it remains unclear whether a major reinsurance facility will ultimately pay for millions of dollars in losses (*BI,* Feb. 6, 1978).

* * *

ARA Services Inc. in Philadelphia has spent $500,000 to **revamp its benefit program**, but it expects to save more than that amount by stressing outpatient and preventive care.

Encouraged by its insurer, ARA instituted improved coverage for procedures that discourage costly hospitalizations, including outpatient care, extended care facilities, outpatient pre-admission testing and home health care (*BI,* Feb. 6, 1978).

* * *

Employees at American Can Co. in New York are testing a new **flexible benefits plan**.

The pilot program was designed by Hewitt Associates and is being underwritten by Metropolitan Life Insurance Co. The program, considered the most flexible offered by any major corporation, consists of a required core of benefits and optional benefits beyond the core (*BI,* March 6, 1978).

* * *

Insurers, brokers and risk managers are outraged by a proposal by the New York Insurance Department that would **severely restrict fronting arrangements.** The opponents claim such a move would hurt legitimate captive insurers.

The department's proposal, which is aimed at reinsurance arrangements between licensed insurers and unlicensed insurers, would prohibit fronting arrangements when the reinsurer is affiliated with the corporation whose risks are being insured. It also would prohibit fronting when there is a prior arrangement to reinsure the risks with a specific, unlicensed reinsurer.

This would severely hurt captives, many of which reinsure their corporate parent's risks from a licensed insurer (*BI,* March 20, 1978).

* * *

The Insurance Services Office Inc. has killed a proposal to **exclude punitive damages from liability insurance policies** in the wake of consumer complaints and severe insurance industry division.

The punitive damages endorsement, which had been filed nationwide in November 1977 and approved in 33 jurisdictions, was withdrawn late last month (*BI,* April 3, 1978).

* * *

The Supreme Court has let stand a lower court ruling that airlines can require stewardesses to stop flying as soon as they become pregnant.

The 4th U.S. Circuit Court of Appeals ruled last summer that United Airlines' **forced leave policy** was justifiable since pregnancy "could incapacitate a stewardess in ways that might threaten the safe operation of aircraft" (*BI,* April 3, 1978).

* * *

The New York Insurance Department, faced with a barrage of opposition, is backing off from its **controversial proposal to restrict fronting**.

The department says it now feels that the remedy was stronger than needed to correct the problems that exist, and it plans a more moderate approach (*BI,* April 17, 1978).

* * *

A California Superior Court judge has reduced a record $125 million punitive damage award against Ford Motor Co. to $3.5 million in a case involving the **crash and explosion of a 1972 Pinto**.

Continued on next page

REINSURANCE CONTRACT made this 31st day of October, 1917 between **THE CALIFORNIA CASUALTY INDEMNITY EXCHANGE**, of the State of California, and the **AMERICAN REINSURANCE COMPANY,** of Pennsylvania.

IN WITNESS WHEREOF the American Reinsurance Company has caused this Treaty to be signed by its President and Secretary, and countersigned by its duly authorized Underwriting Managers this 8th day of November, Nineteen Hundred and Seventeen.

AMERICAN REINSURANCE COMPANY

President

Secretary

THE CALIFORNIA CASUALTY INDEMNITY EXCHANGE

ACCEPTED BY:

It took 75 years of dedicated writing

In 1917, we first put our pen to this treaty. In 1992, after seventy-five years of a mutually beneficial relationship, they've renewed with us again. In fact, over half of our clients have been with us 20 years or longer. Formed to underwrite Workers' Comp for coal miners in Central Pennsylvania, we are now a multi-line, multi-national corporation with assets over $ 3.8 billion.

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Along with stability, we offer innovation. Systems and services especially designed to meet our clients' needs. We bring together specialists from across divisional, corporate and geographic lines to provide customized solutions for our clients. We have actually restructured

Continued from previous page

The judge said the jury award was "excessive as a matter of law." The judge also awarded $2.5 million to the victim of the crash, making the total award $6 million rather than the $128 million the jury had awarded (*BI,* April 17, 1978).

* * *

It is illegal to require women to contribute a greater percentage of their salary to a pension plan than men, the Supreme Court has ruled. However, the court said the **pension discrimination ruling** would not be retroactive because it would involve "devastating liability."

The case involved women employees of the Los Angeles Water & Power Department, who had been required to contribute 15% more than men to the retirement fund. The reason for the greater contribution, employers said, is that women on average live longer than men (*BI,* May 1, 1978).

* * *

After a long labor, **The New York Insurance Exchange** has been born.

The New York General Assembly passed a bill setting up a panel to draft a constitution and bylaws for the "American Lloyd's" by Jan. 1, 1979. The exchange could begin operations by April 1, 1979 (*BI,* July 10, 1978).

* * *

Business, insurers and health care groups have given a limited OK to the Carter administration's **national health insurance plan.**

They approve of the administration's proposal to phase the plan in gradually and to involve private health insurers in a "significant" way (*BI,* Aug. 7, 1978).

* * *

Industry observers are reporting that it is a **buyer's market for excess and surplus lines insurance** once again.

During the recent hard market, buyers having trouble placing their risks in the primary market were taking whatever coverage they could get—at whatever cost—in the surplus lines market. But now that the primary market has become much more aggressive and competitive, buyers are finding themselves in the driver's seat again with excess/surplus insurers (*BI,* Sept. 18, 1978).

* * *

The merger of Alexander & Alexander Services Inc. with R.B. Jones Corp., the nation's ninth-largest broker, will strengthen A&A's position in the Midwest.

If approved, it would be the **largest-ever acquisition of an insurance broker** (*BI,* Sept. 18, 1978).

* * *

The Internal Revenue Service says that premiums paid by a U.S. company to an offshore group-owned or industry captive are deductible as business expenses, as long as they are "reasonable" and based on "sound actuarial principles."

In its analysis of a case that involved the petroleum industry's Bermuda-based captive, Oil Insurance Ltd., the IRS concluded that **premiums paid to a captive are tax-deductible** (*BI,* Oct. 2, 1978).

* * *

The Labor Department and most employers are sharply divided over how to tailor benefits for workers over age 65 following passage of a law to raise the **mandatory retirement age** to 70.

In its guidelines for implementing the law, the Labor Department will allow limited cuts in life insurance, medical benefits and long-term disability benefits.

Many employers, though, had planned to slash these benefits for older workers (*BI,* Oct. 2, 1978).

* * *

Congress has given final approval to a bill to require employers to **treat pregnancy like any other disability**, and President Carter is expected to sign the bill into law.

The bill, approved at the end of the session after differences were worked out by a conference committee, will cause many businesses to revamp their maternity policies (*BI,* Oct. 30, 1978).

* * *

A class-action suit filed in Los Angeles seeks $1 billion in damages from 15 major U.S. asbestos producers, claiming the producers conspired to **conceal and distort information on the hazards of asbestos.**

The suit was filed on behalf of 5,000 workers in two Southern California shipyards. In an unusual twist, the suit seeks "restitution of profits," claiming the companies have been "unjustly enriched" by the profits of their continued production of asbestos and, thus, are indebted to the shipyard workers for $1 billion (*BI,* Nov. 13, 1978).

* * *

A new multiline reinsurance company, **Aneco Reinsurance Co. Ltd.**, is planning to tap the lucrative captive market.

The Bermuda-based reinsurer says it is interested in reinsuring the business of captives in its bid to become a major world reinsurance power. It also plans to retrocede some of its reinsurance business to captives, company officials say (*BI,* Nov. 13, 1978).

* * *

Five young former executives of General Reinsurance Corp. have launched **Trenwick Reinsurance Co. Ltd.**, a Bermuda-based reinsurance facility.

The new reinsurer's officers say Trenwick will market its services primarily to captive insurance companies expanding into third-party business (*BI,* Nov. 27, 1978).

* * *

Many employers are finding that **day care** is a benefit for them as well as for their employees.

Employers that have implemented the benefit often say that it helps them recruit workers and improve morale while reducing absenteeism and turnover (*BI,* Dec. 11, 1978).

* * *

The Council on Wage and Price Stability has liberalized the treatment of **benefit cost increases under the 7% wage ceiling.**

The council's revised guidelines say employers will not have to charge any added costs of maintaining pension benefits against the 7% ceiling if the increases are required by law or actuarial studies. Employers also may exclude the costs of complying with any new federally mandated benefit requirements and any added health benefit costs that exceed 7% (*BI,* Dec. 25, 1978).

* * *

All parties are denying liability for claims involving New York state's **Love Canal**, a case that may evolve into one of the most complicated liability cases ever.

Observers say that lawsuits may eventually total $2.65 billion, following the leakage of toxic industrial chemicals from an old landfill in the Love Canal section of Niagara Falls, N.Y. (*BI,* Dec. 25, 1978).

* * *

Commercial insurers are engaging in **extreme price-cutting**, slashing premiums by an average of 15% and by as much as 40% for some of their bigger customers.

Some observers are concerned that this new round of competition and rate-cutting will result in the same kinds of problems that plagued the industry during the last soft market in the early 1970s. That period of low rates and high levels of competition resulted in a very hard market a few years later (*BI,* Dec. 25, 1978). BI

Attached to and forming part of Reinsurance Agreement No. 620-0056 made and entered into by and between the AMERICAN RE-INSURANCE COMPANY, Princeton, New Jersey (hereinafter and thereinafter called the "Reinsurer") and THE CALIFORNIA CASUALTY INDEMNITY EXCHANGE, the CALIFORNIA CASUALTY INSURANCE COMPANY, CALIFORNIA CASUALTY & FIRE INSURANCE COMPANY and CALIFORNIA CASUALTY GENERAL INSURANCE COMPANY, all of San Mateo, California.

IN WITNESS WHEREOF the parties hereto have caused this Endorsement to be executed in duplicate this 16th day of April, 1992.

AMERICAN RE-INSURANCE COMPANY

Vice President

ACCEPTED:
THE CALIFORNIA CASUALTY INDEMNITY EXCHANGE
By: California Casualty Management Company,
Attorney-in-fact
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A Conversation With:

Joan T. Claybrook

Joan T. Claybrook was named president of Public Citizen, the Washington-based consumer organization formed by Ralph Nader, in 1982. Eight years later, Public Citizen came under fire from insurers after it published a report claiming that five major insurers would be financially vulnerable and potentially at risk in a severe economic downturn (*BI*, Oct. 29, 1990; Oct. 22, 1990).

The report contained several faulty calculations, and Public Citizen later withdrew some of the charges it made against some of the insurers.

However, not all of Ms. Claybrook's dealings with the insurance industry have been negative.

She serves as co-chairman of Advocates for Highway & Auto Safety, a joint consumer-insurer coalition designed to reduce traffic accidents. She also serves on the board of the Consumer Insurance Interest Group, an organization sponsored by the National Assn. of Professional Insurance Agents, to promote better understanding of insurance issues and to promote better state regulation of the industry.

Ms. Claybrook, an attorney, served as administrator of the National Highway Traffic Safety Administration under President Carter from 1977 to 1981. Prior to that, Ms. Claybrook founded Public Citizen's Congress Watch in 1973 and served as its director until her NHTSA appointment.

Ms. Claybrook discussed how consumers view the insurance industry with Associate Editor Mark A. Hofmann.

* * * *

How has the consumer movement's view of the insurance industry changed during the past quarter century?

I don't think the consumer movement engaged in insurance issues very much until the past 15 years.

Why was that?

The consumer movement itself didn't get started until the late '60s and had lots of other issues to deal with. Insurance is a complex issue and not many people knew much about it. I think that in the last dozen years, there has been growing concern about the rate-setting process, about the difficulty of understanding insurance contracts, about the responsiveness to consumer complaints, about the exemption from antitrust laws and its effect on the rate-setting process and on dispute resolution.

There have been some attempts to have reforms and changes, such as Proposition 103, McCarran-Ferguson reform legislation and some other actions at the state level.

Which issues seem to be the most important now?

I think that McCarran remains on the agenda, and solvency is of great concern.

Health care is a big concern. It's a big, big issue and it's now become a national issue. It's going to be confronted. I don't know what the outcome's going to be, but I would say it's at the top of the list.

Has Public Citizen endorsed any solvency regulation proposals?

No, we haven't.

Have you endorsed H.R. 9, which would strip insurers of many of their exemptions from federal antitrust laws under McCarran?

Yes.

What should risk managers and benefits managers be doing as commercial insurance consumers? Are there any areas where their interests dovetail with those of the consumer movement?

I do think that in the antitrust area there certainly is because it does affect the rate-setting process.

I've done a lot of work as part of a group called CIIG (the Consumer Insurance Interest Group), with the PIA and consumer groups working together on improving the management, the funding and the responsiveness of state insurance departments. And I think that buyers of commercial insurance do have an interest in that because the departments are designed to serve all of us. To the extent that they exercise effective oversight and keep track of solvency issues makes a big difference to commercial buyers.

Are there areas in which benefit managers and consumer groups would find common ground?

I think there is. Big companies have complained about the cost of health insurance. Small businesses have tremendous problems with the cost of health insurance. In many ways, I think they're discriminated against in terms of higher prices.

Are insurers more willing to listen to you than they were in the past?

I think they are.

I have a long history of working with insurance companies on auto safety. When I was administrator of the National Highway Traffic Safety Administration, I worked very closely with insurance company CEOs and talked with them a good bit about endorsing air bags and other safety benefits. During the '80s, we did do some work together.

The passage of Proposition 103 was like a bolt of lightning to the insurance industry, and I think they felt that they really had to take some new action, do something new and different, and there was a lot of discussion about what to do.



Photo by David E. Hittle

My feeling was that creating a new independent entity to fight for health and safety benefits was really the most important thing to do, and I think it's been proven. Advocates for Highway & Auto Safety has had amazing accomplishments. We have worked on big trucks and worked on radar detectors and we're now working on a theft protection bill. We've worked to pass state helmet laws. It's really quite remarkable in three short years with that little tiny staff what we've done.

You've said what the insurers are doing right. What are the insurers doing wrong? What should they be doing to better serve consumers, including commercial consumers?

I think Advocates is a good model. I think that the insurance industry ought to do it in other areas.

The insurers could certainly extend that to the health care area. I think that has been a big mistake not to have done that sooner.

I think the other area, which Bob Hunter has talked a lot about, is overhead cost because that can help control rates.

Through the use of interface and electronic data transmission?

There are so many things; there are too many to mention. And I think they're probably better at figuring out for themselves what that is, but I think they really have to look at the cost side.

What insurance issues are likely to command attention in the next decade?

I think health care. I hope McCarran-Ferguson won't. I hope insolvency won't. I hope loss-prevention is at the top of the list.

How badly did Public Citizen's 1990 report on insurer solvency hurt you? Would you use this kind of medium again on insurance issues?

Well, it did hurt us. We immediately acknowledged the mistake. There was one mistake that had an effect on three of the companies. Not many people acknowledge their mistakes and inaccuracies.

On the other hand, I think there were some very important effects of that study. Solvency was heightened as an issue. Some of the companies that we studied shortly after our report came out acknowledged some significant financial problems. Not insolvency—we didn't say any of them were insolvent.

The rating companies raised the biggest stink about our report. It was revealed shortly thereafter. . .that their rating systems weren't so hot, either—that they didn't just go by the numbers, but they went by what the insurance companies told them.

I think some of the failures that have occurred even though these companies had good rating shows the weakness of the rating system itself.

An officer of one of the companies that was cited in the Public Citizen report, American International Group Inc., recently wrote a memo saying that Hurricane Andrew presented an opportunity for insurers to increase rates. Do you see any justification for this?

I think there's a lot of anger by other insurers and embarrassment that they did this. Inappropriate is a mild expletive.

What have been the low points of the insurer-consumer relationship in the past 15 years?

I think perhaps there have been two low points. One was in 1985-1986, when the insurers started blaming their financial problems on the product liability system, on the tort system, which was shown to be false. Secondly, Proposition 103.

What have been the high points?

I think Advocates is the high point. I don't think there's any question of the success story of Advocates and also CIIG. I think they have shown there is common ground.

After all, the insurance industry should be totally consumer-oriented. It has so many common interests with individual citizens. It should want to have loss prevention; it has an economic interest in that. The public has an interest in that from a humane as well as an economic point of view.

There's such a common ground that there ought to be more high points, and I think that there will be in the future.

Concerning Advocates, was it difficult to build trust between two sides that had been antagonistic?

I think the key to the success of Advocates follows the philosopher (Khalil) Gibran's definition of marriage. He said that a successful marriage is like having two columns of equal strength and an organization where everything is equal in terms of power.

The insurers fund Advocates—we don't fund it—but the organization is such that there are two co-chairs, one from each side, and the board has equal numbers, each committee has equal numbers and it's a consensus decision-making process.

That's the equality part of it. The engine that drives it is the common view of the need for loss prevention.

Those two things combined make it a very successful venture. When you have an unequal relationship, that's where there's resentment and difficulty. Here, everything has to be done by agreement.

I think there's another key and that is that the CEOs of the companies are the participants. This hasn't been a lower-level effort; this is a top-level effort.

What can consumers, especially commercial consumers, do to stand up for their rights, to address any perceived abuses and keep insurers on their toes?

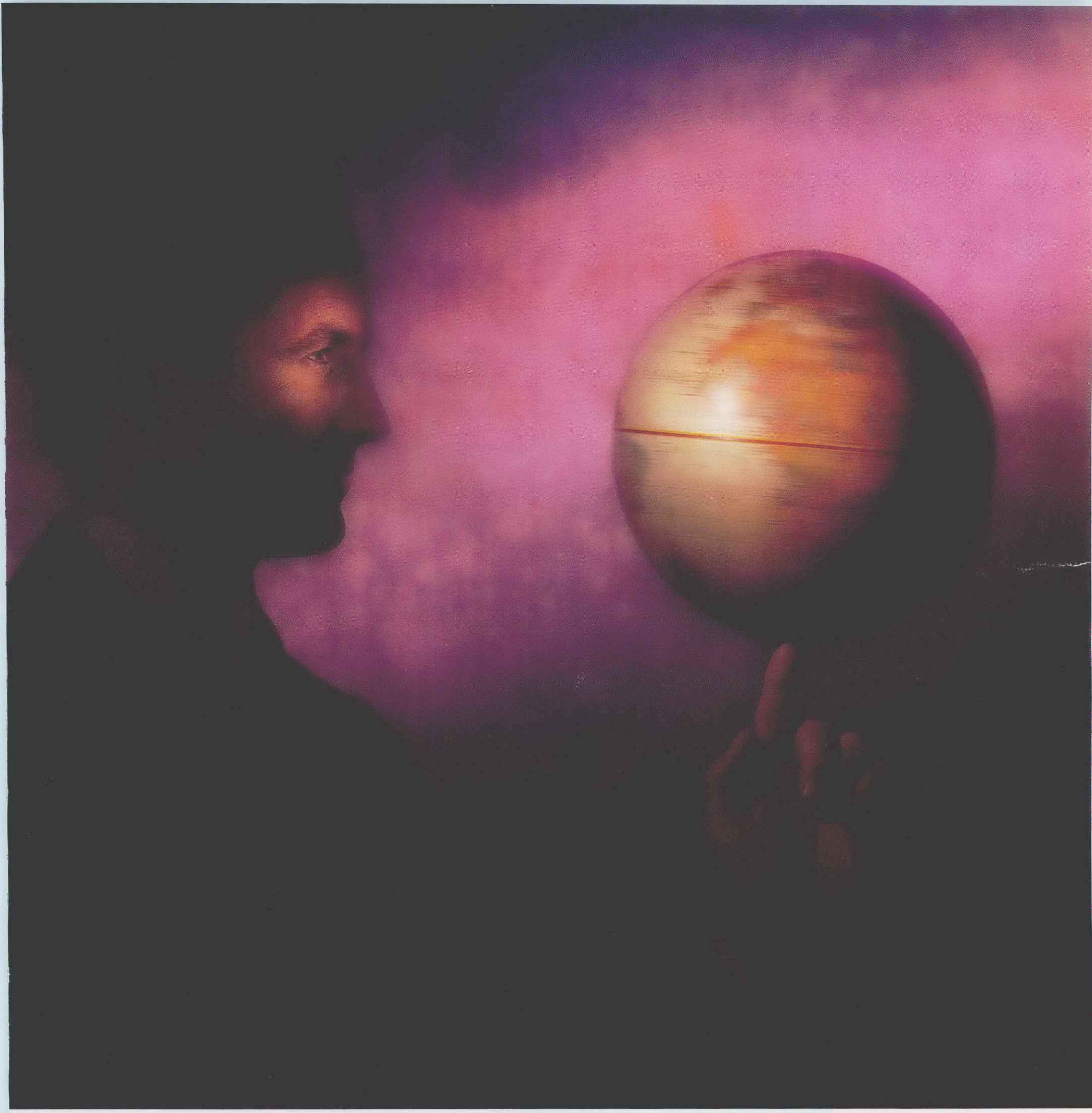
I'm not a commercial insurance buyer, so it's hard for me to answer that question. I think some of the basic consumer rights are the things that are necessary, which is the right to know and the right to access to decision-makers, the right to participate, the right to challenge, the right to be heard. All of those rights, I think, balance out the relationship in the marketplace.

Do you think buyers of commercial insurance and the general consuming public can band together to push for this sort of openness?

Perhaps they should. The buyers of commercial insurance aren't really organized as far as I know.

They have a group—the Risk & Insurance Management Society.

Well, perhaps we should get together with them. That's a new idea. BI



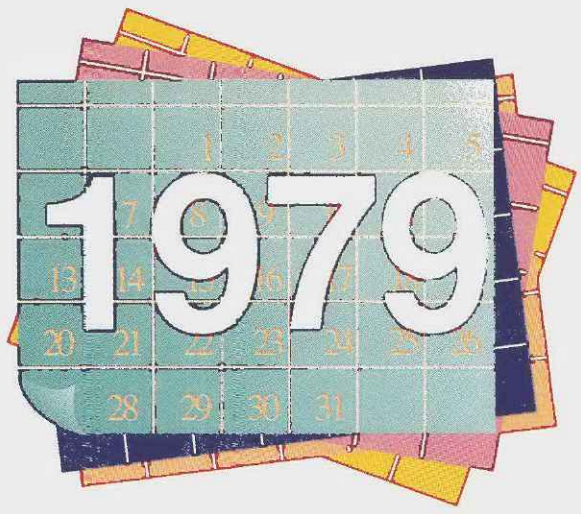
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Looking Back



The U.S. Tax Court has upheld the position of the Internal Revenue Service in a dispute concerning the **premiums Carnation Co. paid to its captive insurer**.

The Tax Court ruled that premiums paid to Carnation's Bermuda captive for underwriting Carnation's risk did not constitute insurance and, therefore, Carnation could not claim a tax deduction. The court also ruled Carnation could not classify the payments received by its offshore captive as foreign source income.

However, just two weeks earlier, the IRS and Ford Motor Co. had reached a settlement in their dispute involving premiums paid by Ford's foreign subsidiaries to the company's Bermuda captive.

In that settlement, the IRS charged Ford with earning as a commission 5% of the premiums paid by the foreign affiliates to the captive. Originally the IRS had charged Ford with earning as commission the total amount of premium paid to the captive by its foreign subsidiaries (*BI,* Jan. 8, 1979).

* * *

The Commerce Department's **model product liability bill** has drawn the enthusiastic praise of business groups.

Under the bill, wholesalers generally are exempted from liability; product alteration is a defense against liability; manufacturers are responsible for only the "useful life" of their products; claims must be filed within three years of injury; products are presumed not defective after 10 years; determination of punitive damages is up to a judge; and pain and suffering damages are capped at $25,000 (*BI,* Jan. 22, 1979).

* * *

A class-action suit filed on behalf of Vietnam veterans who claim they were injured by the herbicide **Agent Orange** could result in huge product liability for the manufacturers of the chemical.

The suit claims that the herbicide, which was used as a defoliant to kill trees and clear ground cover in Vietnam and contains dioxin, causes cancer.

A plaintiffs' lawyer says that if the herbicide is found to cause cancer, the three chemical companies named in the suit—Dow Chemical Co., Hercules Inc. and Northwest Industries Inc.—could face liabilities "far in excess of their net worth combined" (*BI,* Jan. 22, 1979).

* * *

Despite lawsuits challenging the practice, Blue Cross/Blue Shield plans say they will expand their move to deny claims for procedures they deem **medically unnecessary**.

The Blues are urging member plans to curtail payments for the "admissions battery" of routine tests done before hospital admissions, which Blue Cross/Blue Shield says often are unnecessary (*BI,* Feb. 19, 1979).

* * *

Drafts of guidelines for a **new law that treats pregnancy as any other disability** indicate that if employers provide dependent medical coverage, they will have to cover the pregnancy-related expenses of employees' wives.

In its guidelines, the Equal Employment Opportunity Commission says that since the new law requires employers to cover their employees' pregnancy like any other disability, they must extend such coverage to dependents (*BI,* March 19, 1978).

* * *

The first phase of the **Carter administration's national health insurance plan** would include the establishment of minimum mandatory standards for group health insurance programs.

According to Health, Education and Welfare Secretary Joseph Califano, the standards would apply to hospital and physician services, X-rays, laboratory tests and a wide range of outpatient services (*BI,* April 2, 1979).

* * *

The accident at the **Three Mile Island nuclear plant** will be the worst commercial nuclear accident in history. American Nuclear Insurers paid out more than $600,000 in emergency claims in the first several days following the accident at the plant; that amount is almost as much as the total liability payments for the country's 73 nuclear plants over the past 22 years. And, experts say that the $600,000 will be dwarfed by the liability and property damage claims that ultimately will be filed (*BI,* April 16, 1979).

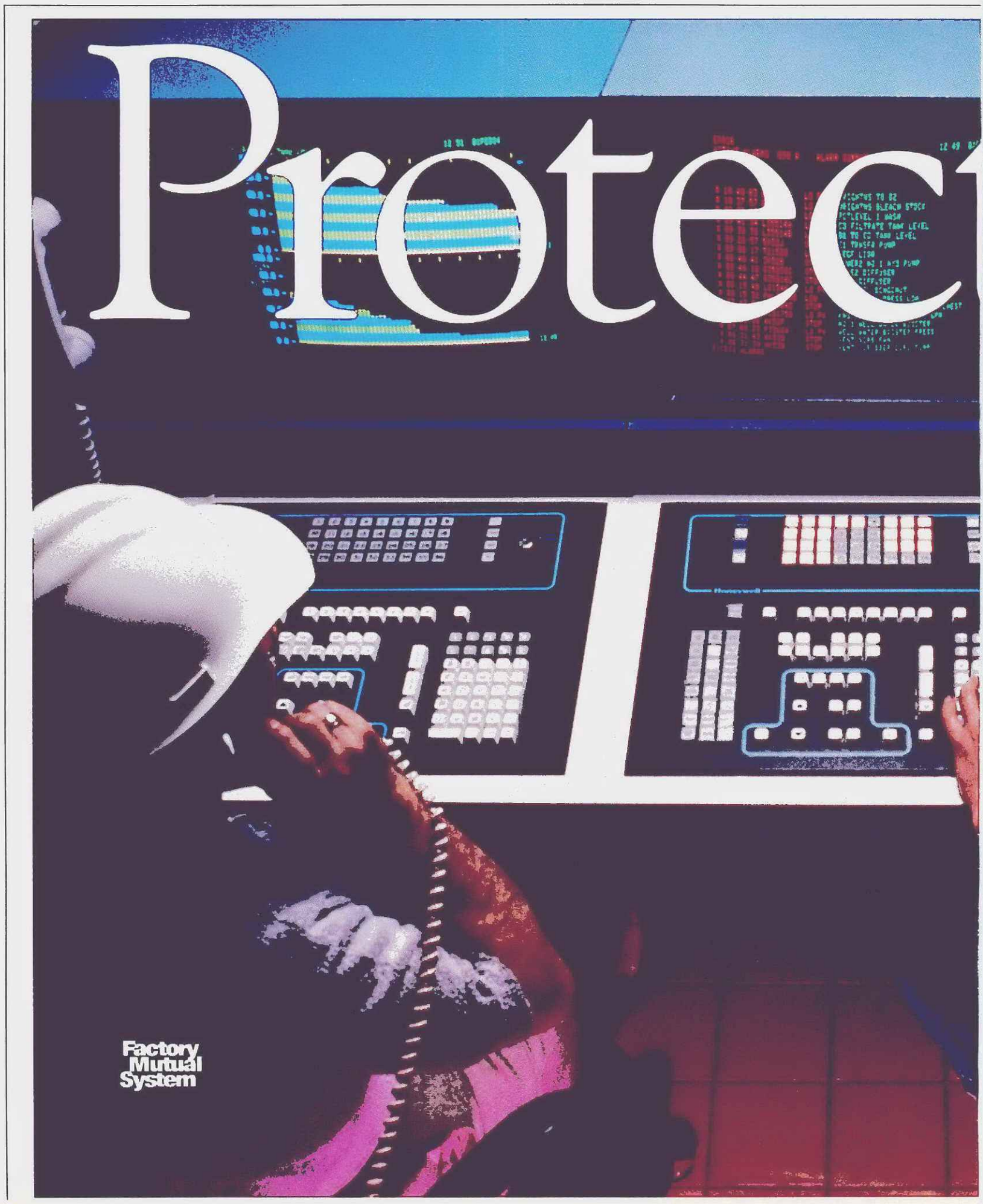
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Regulators in Illinois and Rhode Island have seized the assets of the financially troubled American Reserve Corp.'s two main insurer units in those states.

A few days earlier, regulators had ordered the subsidiaries—**American Reserve Insurance Co.** of Providence, R.I., and **Reserve Insurance Co.** of Illinois—to stop writing new and renewal property and liability insurance in all 50 states (*BI,* May 14, 1979).

* * *

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Workers comp rates in Florida will be cut 15% in July in the first test of the **wage-loss concept**.

Under the recently signed work comp reform law, Florida workers injured on the job after July 1 will only be compensated for the actual wages they lose. Workers will, of course, receive benefits for any period that they cannot work at all. But, once they can go back to some job, workers with permanent partial disabilities will have to show that they can't earn 85% of what they made before they were hurt.

The new Florida law also raises benefits, overhauls administration of the work comp system, places limits on insurers' profits, makes claimants pay their own attorney's fees and forces employers to provide rehabilitation services (*BI*, May 28, 1979).

* * *

A provision of the bill to amend the Employee Retirement Income Security Act of 1974 would allow states to **require employers to offer certain health care benefits**.

The Senate Labor and Human Resources Committee has approved the ERISA overhaul bill including the controversial provision that would overturn a series of federal district court decisions that a section of ERISA pre-empts states from imposing benefit requirements on employers (*BI*, May 28, 1979).

* * *

A complex maze of liability litigation is likely following the **crash of an American Airlines DC-10 in Chicago** that killed 274 passengers and two bystanders, making it the worst U.S. aviation disaster.

Involved in the possible dispute over liability, which experts say could reach $200 million, are the airline, the manufacturer of the aircraft and suppliers of components. These parties may be involved because the crash occurred when some malfunction—caused perhaps by faulty design, manufacture or maintenance, or simply by wear and tear—caused the engine to fall off the left wing during takeoff (*BI*, June 11, 1979).

* * *

Both Illinois and Florida are considering forming **insurance exchanges** similar to Lloyd's of London and the recently created New York Insurance Exchange.

In Illinois, a bill to create such an exchange was passed unanimously by the state Senate, which supports the idea as a way to bring money and jobs into the state. However, insurers in Illinois are more wary, and would like to see whether New York makes a success of its exchange.

The Florida Legislature also has passed a bill calling for the formation of an insurance exchange—but only after its economic feasibility is established by the insurance commissioner (*BI*, July 9, 1979).

* * *

The Labor Department has announced that four more **self-funded multiemployer trusts** are not employee benefit plans, but merely "funding vehicles."

And, state insurance officials are using the Labor Department's position to add ammunition to their battle to regulate the trusts (*BI*, Aug. 6, 1979).

* * *

The **possible bankruptcy of Chrysler Corp.** could trigger a sharp increase in premiums other companies pay for federal pension termination insurance.

If Chrysler folds, the Pension Benefit Guaranty Corp. could be left holding the bag for the automaker's pension obligations. Although the PBGC also would have a preferred lien on Chrysler's huge pension assets and a right to 30% of its net worth, it could still need more funds from other employers (*BI*, Aug. 20, 1979).

* * *

The support of the Carter administration, coupled with the efforts of an alliance of business, consumers and trial attorneys, may revive a proposal to allow companies to pool their product liability risks through federally chartered insurance cooperatives, or **risk retention groups** (*BI*, Sept. 3, 1979).

* * *

The nation's labor unions strongly oppose a new bill that would for the first time **tax employees' health care benefits**.

The bill, proposed by House Ways and Means Committee Chairman Al Ullman, D-Ore., would require employees to pay income taxes on any amount over $120 per month that their employers pay toward family health insurance, including dental, vision and prescription drug plans (*BI*, Nov. 12, 1979).

* * *

Many **U.S. corporations' assets in Iran** are underinsured against expropriation, a special concern as relations with Iran continue to deteriorate.

The Department of Commerce says that, at the end of last year, U.S. firms had holdings in Iran valued at $389 million.

Still, those assets appear to be poorly protected against the possibility of seizure under the government of Ayatollah Ruhollah Khomeini. Insurance sources say there is little expropriation coverage written in Iran (*BI*, Nov. 26, 1979).

* * *

Insurers say they may stop writing liability coverage for general admission rock concerts after 11 people were trampled to death before **a concert by The Who in Cincinnati**.

The fans were killed when 7,000 general admission ticket holders stormed the glass doors outside Riverside Coliseum.

Fireman's Fund Insurance Co. underwrote two spectators liability policies for the concert (*BI*, Dec. 10, 1979).

* * *

Brokers and insurers say that **employers' costs for group health insurance** continue to rise, with increases averaging 8% to 15%.

The only area of group coverage where prices are dropping is in group life insurance, industry experts say (*BI*, Dec. 10, 1979).

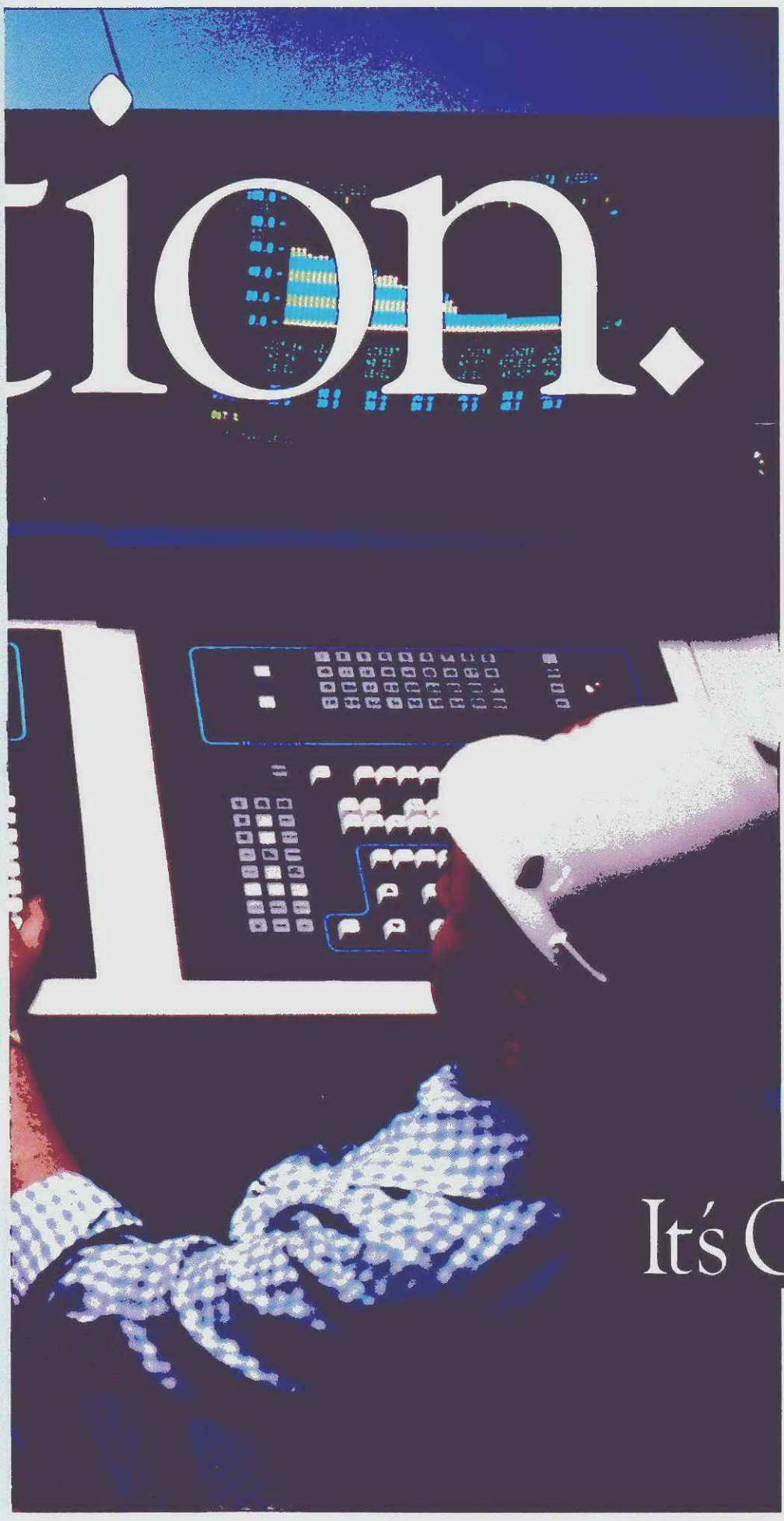
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The Department of Health, Education and Welfare predicts that the number of **health maintenance organizations** nationwide will double during the next 10 years, to 430 from the current 216 and they will serve 15 million to 20 million people by 1989, compared with the 8 million currently enrolled (*BI*, Dec. 10, 1979).

* * *

Marsh & McLennan Cos. Inc., the largest U.S. broker, has dropped plans to implement a profit-pooling agreement with Lloyd's of London broker **C.T. Bowring & Co. Ltd.** Instead, M&M plans to buy Bowring's parent outright with stocks and cash.

Bowring and Lloyd's are not pleased with the offer, however. The M&M plan appears to violate a Lloyd's rule that forbids more than 20% foreign ownership of any Lloyd's broker, and Bowring has issued a statement opposing M&M's unilateral merger offer (*BI*, Dec. 24, 1979). BI





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A Conversation With:

Jean Evans

Jean Evans is director of employee benefits with Educational Testing Services, one of the pioneer companies in the area of flexible employee benefits programs.

Ms. Evans has worked more than 20 years for the Princeton, N.J.-based company. In her current position as benefits director, Ms. Evans is responsible for what is regarded as a model flexible benefits plan.

ETS, along with a California-based unit of TRW Inc., in 1974 launched the first cafeteria-style benefit plans, which allow employees to select from a variety of benefits those that best fit their lifestyles and needs.

Ms. Evans recently shared her opinions on the evolution and status of flexible benefit programs with Associate Editor Michael Schachner.

* * * *

When and why did the concept of flexible benefits begin?

I know ETS and Hewitt Associates began talking about flexible benefits in 1972. Originally, we were trying to take into consideration the beginning of the two-worker family. We wanted to respond to the need some employees had for different kinds of benefits, but we also had to stay within a budget.

At the same time, at least one other company was talking about altering their traditional program. I think this was really the beginning.

When ETS implemented one of the country's very first flex plans in 1974, what was its primary goal?

The goal at that time was to provide employees with the benefits they said they wanted, but not to provide every employee with all the benefits.

We were a traditional company that offered medical insurance, life insurance and retirement benefits, but some employees said they wanted additional benefits like dental coverage. Others said they wanted more time off from work. We couldn't afford to give every employee everything they wanted, and we believed flexible benefits would at least allow them to make some choices.

That was the goal.

Over the years, have ETS employees displayed the ability to deal with this kind of choice?

I think so.

If you look at all the past and present litigation where employees have sued their employers, there isn't anything out there that I'm aware of where an employee has said, 'You didn't give me the information to help me make a right choice.' Based on this, I'd say employees have appreciated the right to choose. And, if in some cases an employee makes an improper choice, it's only a year's worth of a wrong choice. They can change the next year.



Photo by David Lubarsky

As an employer, how do you help prevent employees from making the wrong choices with regard to their benefits?

Because we can't counsel every employee, we have safety nets with regard to basic benefits. For example, an employee can't opt out of life insurance entirely. They have to take at least 25% of their salary. Also, they cannot opt out of medical coverage unless they can provide certification that they are covered through a spouse's plan. Most companies with flex plans do something like this, too. With the optional benefits, there are no minimums. That's what flex is all about.

All in all, probably 90% choose wisely. But there will always be the 10% that does what's easiest. You can't really prevent someone from converting all their flex credits to cash and spending it if that's what the person wants to do.

What is the No. 1 advantage that a flexible benefits program provides to your employees?

I think it's the fact that the employee gets to pick the benefits the employee wants at that time of life.

Let me offer an example: I had an employee call me not long ago. He said, 'Well, for years I have been taking all of my flex credits in cash in order to put my kids through college. I just paid my last tuition bill, and now I want to put something into retirement.'

This clearly demonstrates why flex benefits work for employees

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Continued from previous page
and why they like the concept.

What is the leading advantage that flexible benefits gives to the employer?

It's money. We can tell in advance how much the employee will receive because our contributions are based on salary. And for the benefits that are employee-pay-all, like dental coverage, when the rates go up, we pass that entirely on to the employee and they pay for the increased cost with the flex credits we give them.

Are flex plans economical and do they consistently hold down benefit costs?

In terms of being economical, they probably are. Money is spent more wisely, especially once the employees become aware of the fact that they're given a set amount of money or credits to spend on options. Once they realize this, they become more sophisticated in terms of allocating that money.

But the plans don't necessarily hold down costs, primarily because medical costs are rising dramatically. Flex plans may control employers' cost increases, but they don't actually hold down benefit costs.

'Flex plans may control employers' cost increases, but they don't actually hold down benefit costs.'

What are the benefits that you feel must be offered through a flex plan for it to be a solid plan?

Medical and life insurance benefits are absolutely necessary. Some additional benefits like dental and vision care and a medical spending account are very important. Beyond that, I think an employer's decision rests on how much complexity it wants to put into the program. Every additional benefit does add complexity.

Assuming that an employer is willing to offer more than just core benefits, what are some of the most well-received 'optional' benefits that can be provided?

Vacation is a very popular benefit when it's offered. Cash isn't really an option in a plan where the employee is given credits to spend freely because they can take their unused credits and convert them to cash. Where cash does come in handy is when it's offered in order to allow employees to purchase taxable benefits like financial planning.

Various life insurance options also make sense.

Are there any specific legal hurdles or barriers to offering flexible benefits?

There are no specific barriers, but there are rules we must abide by. The Internal Revenue Service's Section 125 says that in exchange for employers being able to provide benefits without taxation, those benefits have to be available and used in the calendar year in which the benefits are elected. It's a use-it-or-lose-it concept. Section 125 also says you have to offer a combination of taxable and non-taxable benefits.

Other than that, flex plans are governed by the same rules as a traditional benefit plan.

How have unions viewed flex plans, and have these perceptions changed much over the years?

Unions have traditionally viewed attempts by employers to introduce a flex plan as a takeaway.

When you look at the array of benefits that some unions have negotiated, especially in the medical area, any attempt to offer choice that might include higher deductibles for employees in exchange for money to be spent on other benefits is perceived as a takeaway. And I think this is still the case. Some unions are now willing to negotiate flexible benefits, but they're the exception rather than the norm.

What impact does providing a flex plan have on employee morale and motivation?

Flex plans preceded the current benefits philosophy of employee empowerment. By their very nature, flex plans empower the employee. They say to the employee, 'You have a choice. This is your decision and you can decide the shape of your benefits.'

Flex plans definitely bring the employee into the decision process and that does have a positive impact on morale.

What is the greatest cost to a company that offers flexible benefits to its workforce?

It has proven to be the administration. It's much easier to say to employees when they're hired, 'Here are the benefits we offer, sign up for them.' Under that format, you only allow employees to make changes when they get married or divorced or have a child. The administrative toll really goes up when you actively enroll and re-enroll everyone each year.

Have flexible benefits plans matured completely or is there still room for future growth?

As long as benefits and the tax treatment of benefits are regulated by the government, there won't be much in the way of different benefits we can offer. However, there may continue to be changes in the themes. For instance, we have seen the rise of managed care and dental HMOs.

But beyond that, there isn't much else. It's difficult for me to imagine different ways for us to provide the money to employees for them to select their benefits.

The one thing I do see changing is enrollment. I can envision more PC and phone enrollment. But otherwise, I don't see any huge change on the horizon. BI

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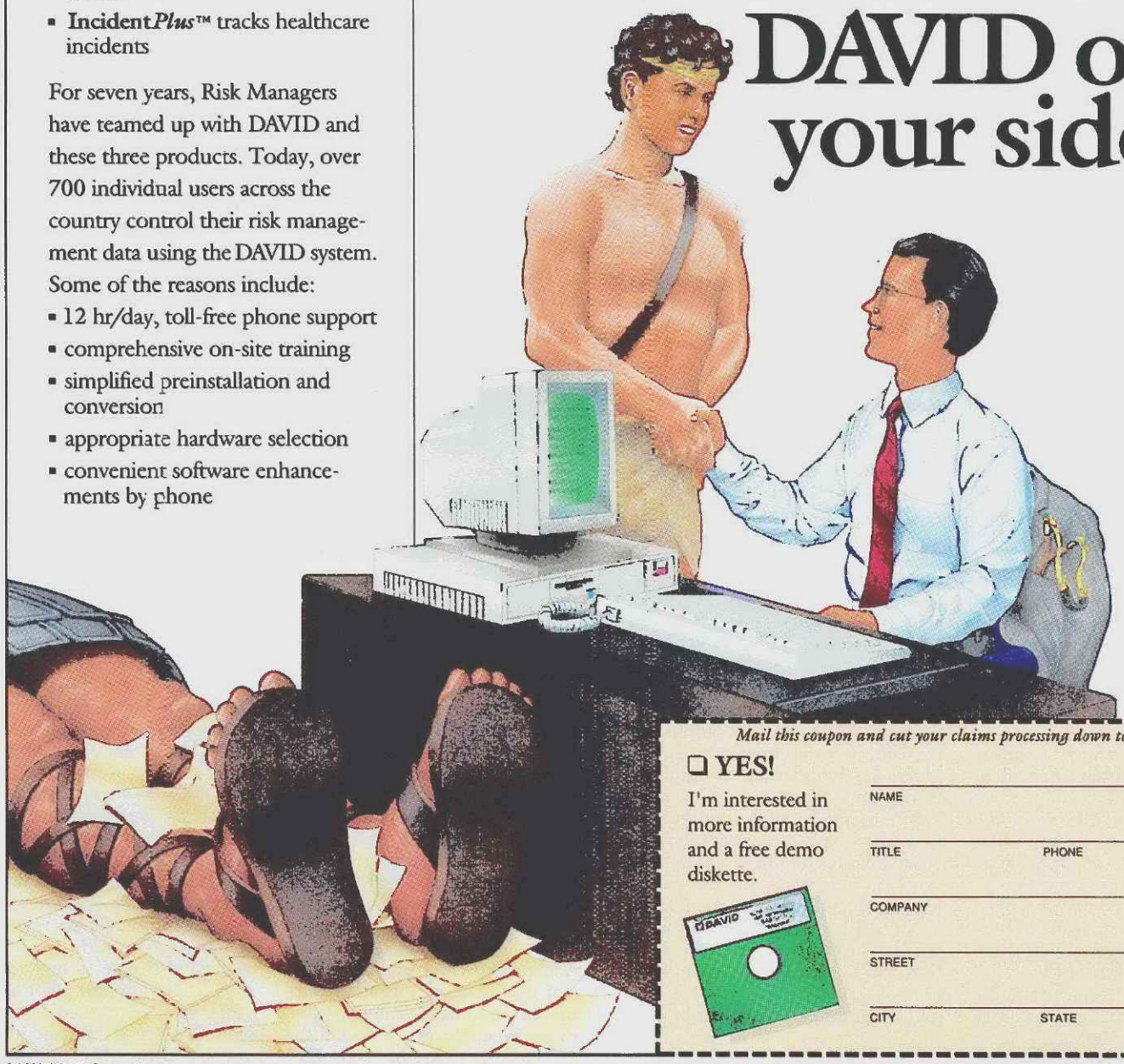
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Extinguishing Loss Control Apathy

Technology responds to property perils, but safety awareness lags



Illustration by Tony Griff

By Mark A. Hofmann

Despite an impressive array of new weapons in their arsenal, loss control professionals still have a ways to go before declaring victory over their most intransigent opponent: human nature.

While technology has kept pace over the past 25 years with rapidly growing threats to people and property, the evolution of safety awareness has progressed at a much slower rate.

Nevertheless, an increasingly sophisticated risk management community, prodded by regulatory developments like the Occupational Safety and Health Act, has helped enhance the loss control profession's status.

"The one challenge that continues that we faced 25 years ago, 50 years ago and 100 years ago is that the human element is still at the root," said Dennis Anderson, vp and director of engineering for Protection Mutual Insurance Co. in Park Ridge, Ill.

"My major disappointment in the profession is that safety consciousness in the public hasn't changed from a pretty apathetic position. The syndrome is, 'It won't happen to me,' " said Joseph M. Boslet, manager of loss control for Pennsylvania National Insurance Co. in Harrisburg, Pa., and founder of the Society of Chartered Property & Casualty Underwriters' loss control section.

"It's just a matter of safety professionals educating management more effectively," he said.

"There's still a sense that if I have a program in place, I don't have to change it," said Stan Couvillon, vp-loss prevention for Industrial Risk Insurers in Hartford, Conn.

"Despite advancements of sprinkler technology, you still read of loss-of-life fires" that could have been avoided, said Paul M. Fitzgerald, president and CEO of Factory Mutual Engineering & Research in Norwood, Mass. "Some building owners have taken a very aggressive approach. . .others haven't."

"One of the problems I've seen is the lack of commitment and support among top management for the loss control programs," said Helen Schreck, corporate loss-control specialist for the American Red Cross in Alexandria, Va. She said that this assessment does not apply to the Red Cross, where President Elizabeth H. Dole has put considerable emphasis on the need for adequate loss control.

Still, there's hope: Businesses today are more willing to institute loss control measures than they were 25 years ago, said Mac Livingston, president of CIGNA Loss Control Services in Philadelphia. "In the old days, (losses were) a cost of doing business."

"There's always a small segment of people who need to be educated. But I think that the customers we deal with demand this service," said Michael Burke, vp and chief engineer for Johnston, R.I.-based Allendale Mutual Insurance Co.

Loss control experts have been able to bolster their powers of persuasion with increasingly effective technological breakthroughs.

Most loss control experts cite the Early Suppression Fast Response sprinkler head as the single most important technological development of the past 25 years.

Factory Mutual Engineering & Research began development of the ESFR sprinkler in 1983 and introduced the product in 1988.

The ESFR sprinkler head was a technical breakthrough that reflected a change in fire protection philosophy, noted IRI's Mr. Couvillon: Its development represented a shift from simply controlling fires to suppressing them.

Before the ESFR, sprinkler systems were designed to keep the spread of fires to manageable proportions. This was accomplished by using a large number of sprinklers, not just on the ceiling but throughout storage racks as well.

But, as much of the goods stored in warehouses changed to high-value products made of a variety of synthetic materials, the old sprinkler systems became inadequate.

"In 1970, we started looking at ways to extinguish fires rather than just containing them," explained Frank Suppe, vp-chief engineering officer at Arkwright Mutual Insurance Co. in Waltham, Mass. Accomplishing that was a difficult task because loss control professionals had to factor the impact of what was stored in a building—and what those products were made of—into their calculations.

IRI's Mr. Couvillon cited the "enormous proliferation" of plastics as one of the greatest changes in exposures since the 1960s. Storing materials in plastic rather than metal containers changes the nature of the fire exposure in warehouses and other facilities, he said.

The increased use of plastics in packaging and storage has created "far more dangerous exposures," agreed Penn National's Mr. Boslet.

The advent of the ESFR sprinkler head was accompanied by the development of new fire detection devices, noted Gerald Maatman, president and chief executive officer of the Kemper National Insurance Cos. in Long Grove, Ill., and a former fire engineer. He called the development of mechanisms that detect the products of combustion the greatest loss-control technological breakthrough of the past quarter century.

Mr. Maatman said earlier detection devices, which relied solely on detecting heat to spot fires, often sounded alarms too late to save lives because people would have already died from smoke.

The ESFR is a "close second" in importance, he said.

These loss control breakthroughs would have been unlikely without an increased understanding of fires themselves.

"The last 25 years have been characterized by research as the era of large-scale testing," said Protection Mutual's Mr. Anderson. This involved actually building fires in test facilities and testing the effectiveness of sprinkler heads against them, he explained.

But recent advances in computer science have made those large-scale live-fire tests less frequent, said Mr. Anderson. The next 25 years will be marked by smaller-scale live-fire testing and increased use of computer modeling to project the spread and nature of fires, he said.

Computer models can be used to determine how a fire will spread through a facility, the heat it can generate and which gases would be produced. Then, the model can gauge the effectiveness of certain fire suppression devices on the hypothetical fire.

Computer technology now is progressing from modeling to creating so-called expert systems, a form of artificial intelligence that draws upon the knowledge of loss control professionals to solve problems.

Right now, "we use expert systems for on-line, real-time analysis" of stress points in operating machinery, said William H. Klemm, second vp at The Hartford Steam Boiler Inspection & Insurance Co. in Hartford, Conn. "You're not trying to replace the expert but to augment the expert.

"The biggest breakthrough has been a transition from preventive maintenance to predictive maintenance," said Mr. Klemm. Predictnve maintenance involves using technology like expert systems to monitor a piece of equipment to pinpoint needed repairs before they happen.

But not all technical breakthroughs have lived up to their promise.

The fate of halon—a fire suppressant used to protect computers and other equipment that would be damaged by water from sprinkler systems—is a case in point. Halon gas was determined to be an environmental hazard and was ordered to be phased out of use (*BI*, May 28, 1990).

IRI's Mr. Couvillon called the withdrawal of halon the "most disappointing" technological event of the past quarter century. There is no substitute for halon that can simply replace the gas, he said.

"We still don't have a perfect substitute for halon. It's a tough nut to crack," agreed Protection Mutual's Mr. Anderson.

Mr. Couvillon added that the halon experience raises new worries for loss control professionals seeking solutions to fires and other loss exposures.

"There's concern about what's it going to be 10 years from now. Will we have to pull this agent like we did halon?" he said.

The new demands of loss control brought a change in the nature of the loss control professional's role, noted Penn National's Mr. Boslet.

"In the profession we've gone from an inspection mode to a consultant mode," he said.

"It used to be you just pulled someone from the line and made him a safety inspector," observed Edmund T. Dorner, professor of safety at Illinois State University in Normal. "You now have to have somebody who can read and understand OSHA."

"It's clearly more technical," agreed Protection Mutual's Mr. Anderson. Twenty-five years ago, loss control professionals operated on a rule-of-thumb basis; now the discipline is increasingly dependent on sophisticated engineering knowledge.

For example, loss control engineers seek answers to questions in-

Continued on next page

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volving how sprinkler drop size and thrust velocity—the speed with which big water drops are thrown at the base of the fire—affect a blaze, Mr. Anderson said.

The greater sophistication required of loss-control professionals has been closely trailed by gains in their professional status.

"It has gained in status. Is it where it should be? No," said FME&R's Mr. Fitzgerald.

But, Mr. Fitzgerald and others agree the loss control profession is slowly moving toward the higher status it deserves, in part because the people who depend on loss control—risk managers—are growing more and more sophisticated.

"Clients are much, much more sophisticated. In the past, it was hard to get in the door. Now it's hard to leave," said James Deaderick, vp and worldwide loss control manager for Warren, N.J.-based Chubb & Son Inc.

Part of the reason for this demand is the intervention of the government into workplace safety, most notably through the OSH Act and the creation of the Occupational Safety & Health Administration to enforce the law.

"The major impact has been OSHA, with government regulation and all the things that trickle down from that. I think that really got management's attention," said Joseph Mullahey, senior vp-casualty loss control services with Johnson & Higgins in New York.

Societal demands for greater corporate accountability in the wake of incidents like the 1984 poisonous gas leak that resulted in thousands of deaths in Bhopal, India, has also focused attention on loss control, he said. "The public wants a risk-free society."

This desire, backed by an increasing willingness to take disputes to court, has put additional pressure on loss control professionals, he said.

Nevertheless, there's still a tendency among some managements to treat loss control as a Band-Aid to be applied when a problem arises rather than treating the discipline as an integral part of the operations review and planning process, said Mr. Mullahey.

There remains some "continued difficulty in convincing private industry that loss control is worth it. It's a tough sell to get them to recognize the value," said Kemper's Mr. Maatman.

The American Red Cross' Ms. Schreck said that although loss control is becoming a more professional, specialized field, the discipline is still not generally a stepping stone to management.

"Companies are starting to see the need for assigning (loss control responsibilities) to a particular person whose title is loss control manager or safety manager" rather than adding loss-control duties to someone whose existing job has little connection with the discipline, said Sawyer Stern, assistant risk manager for DeKalb, Ill.-based DeKalb Genetics Corp.

She said some of the major problems continuing to challenge loss-control professionals are convincing top management to support a loss-control problem in an "overt way" rather than simply paying lip service, keeping current with tough regulatory requirements and maintaining credibility with every layer of management.

But there seems to be movement in the right direction, Mr. Maatman added. For example, the increased reliance on self-insurance by both large and small companies has spurred new interest in and respect for loss control issues.

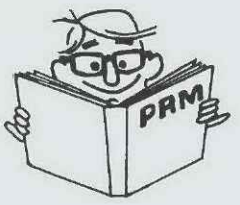
"I think there's still the assessment within the insurance industry. . .that we're an expense department," said Chubb's Mr. Deaderick. This image can be changed by putting an emphasis on the role that quality service, particularly loss control service, plays in account retention, he said.

A key in promoting loss control remains persuading others that it ultimately boils down to a dollar-and-cents issue, not a matter of technological wizardry.

"I think that the modern risk manager understands that his loss record affects his ability to be competitive," said Mr. Burke.

"A good loss control record is equivalent to a good credit rating," added Penn National's Mr. Boslet. BI

Associate Editor Mark A. Hofmann, based in Washington, has covered property loss control topics since joining BI in 1987.



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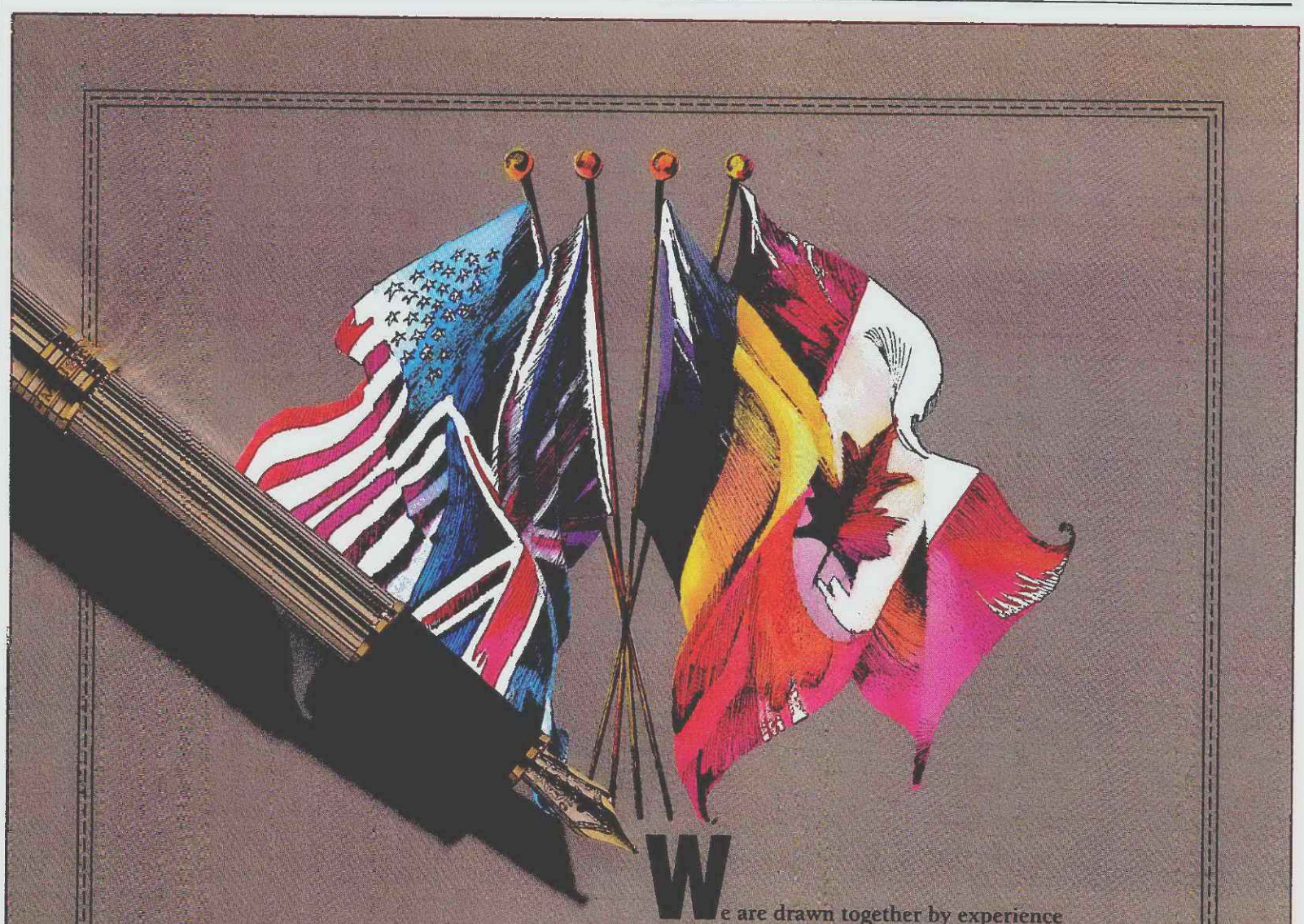
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A Conversation With:

Michael Burke

Michael Burke, currently Allendale Mutual Insurance Co.'s vp and chief engineer, joined Allendale unit Affiliated FM Insurance Co. as an account engineer in 1969. Two years later, he joined Factory Mutual Research Corp., which is owned jointly by the three Factory Mutual system insurance companies: Allendale, Arkwright Mutual Insurance Co. and Protection Mutual Insurance Co.

While at FMRC, Mr. Burke developed numerous engineering guidelines for a variety of hazards.

He rejoined Allendale in 1977.

Mr. Burke recently discussed loss control and loss prevention advancements with Associate Editor Mark A. Hofmann.

* * * *

How has the loss control profession been doing in keeping up with rapid changes in exposures?

That's really a difficult question to answer. I'm sure if you measured it by how our customers perceive it—which is probably the best way to do it—we'd maybe get a C.

If you measured it in terms of the effort that we're all putting into it, I think we deserve an A.

The difference is in what you set as a goal. What we'd like to set as a goal is to never slow a customer down in anything he's doing and to never add cost over and above what's necessary.

To me, that means we have to know what the customers are doing long before they do it. We have to have the answers for them long before they need them so that the protection they need, or whatever it is they need to do, gets built into the facility or into the change while it's happening.

On the other hand, if we come in as inspectors after they've done the change, then invariably we slow things down. Then it's at a point where we have to say, 'You have to stop doing this or do it in a different fashion or in some fashion delay what you're doing,' and then retrofit all the changes.

Twenty-five years ago, 15 years ago, that's the way you did business. You would inspect, you find changes they need, and then you say go back and do it a different way. It would be just like going into your house and trying to put in the plumbing after the house was built. It's easy to do when you're building it, but if you come in afterward, it's just a terrible thing to do.

The challenge is to figure out what our customers are doing. It's not a technological challenge—it's just a people skill.

The trouble is that learning—maybe 18 months ahead of time—that a new product is coming still may not be enough time for us to fully develop all of the protection skills we need.



Photo by H. Christopoulos

How about a real-world example?

A good example of this is the development of non-woven cloth. The cloth incorporates a lot of plastics and synthetics that are just pressed together. They have the ability to burn as badly as any storage material you'll have in the warehouse.

In the early stages of the cloth's development, our customers started sending us samples of it, saying, 'This is different. Tell us if we're creating new hazards.'

We ended up spending well over $1 million on full-scale testing to be able to tell them exactly what to do as they progressed. We still lagged behind. Even with the head start, we couldn't do enough work, enough testing.

But we're probably 10 years ahead of where we would have been if the customers didn't start coming to us.

The other area in which I see changing exposures is 'damageability.'

We're evolving into businesses and occupancies that don't create much fire hazard but that can be extensively damaged in the early stages of a fire before a sprinkler operates.

So in biotech, in high tech, and in a lot of things having to do with aerospace, just using automatic sprinklers doesn't do the job because if you've got a fire big enough to trigger a sprinkler, you've probably done $10 million worth of damage.

Working on that end—where there's not much of a hazard at all, but there's a product that can be so easily damaged—I think that we're getting to the point where we're doing a neat job.

We've created almost a separate science of air movement and smoke movement and modeled that in small scale. Then we modeled it arithmetically so we can start managing smoke movement so that the goal becomes not so much putting fire out, as it does managing whatever products are produced by the fire.

Was this kind of research possible before the advent of the personal computer?

It would have been possible before the personal computer, but it wouldn't have been practical before the inexpensive personal computer. All of that now is being done on the computer.

In fact, probably one of the biggest advances we're making is the ability to move research from the West Glocester, R.I., facility (site of the Factory Mutual Test Center) to computer solutions.

What advances in loss control technology in the past quarter century have been particularly effective?

I think what we've done is moved from actually duplicating the storage of industrial arrangements and setting them on fire to count the number of sprinklers needed—and that was pretty neat and is still not being done by a whole lot of people—to understanding what's really going on if you look at the fire.

It's kind of like if I somehow have a jet engine blowing 1,800-degree heat at you and at the same time spray a garden hose on you, I'm never going to wet you down. The heat is just going to vaporize the water as it comes.

We developed an understanding and an ability to model that interaction, so that instead of just looking at the quantity of water coming out of the sprinkler, we can look at size of droplet, momentum of droplet and velocity of the fire plume. And we can determine whether or not the water will actually get through that fire and get to the part that's burning.

By doing that, we can go off in two ways: We can go very much into the theoretical, and we can really start to model fire. By understanding what's really going on and getting down into the fire, we can start predicting what's going to happen.

In terms of practicality, understanding the fire has allowed us to design a whole new generation of automatic sprinklers. The impact of that sprinkler is remarkable.

In terms of economics, we're saving customers money. It used to be if we were protecting a fairly large warehouse, we would not only have to put sprinklers in the ceiling, but we'd have to go in the storage racks and put multiple laterals of sprinklers in. It might end up costing $5 a square foot to do that.

This latest sprinkler, called the Early Suppression Fast Response sprinkler, just goes in the ceiling. It's so powerful, so effective that it drives down through the fire plume and does the work of all those in-rack sprinklers.

So we've taken the price from maybe $5 a square foot to about $2 and delivered a product that is less troublesome and doesn't have to be redesigned every time you change the commodity.

That's the result of not trial-and-error, like in the old days, but of actually looking at that interaction of: What does the droplet have to look like coming out of the sprinkler; how fast does it have to be going to get the momentum it needs to overcome the fire; and how soon does it have to be applied?

When did that sprinkler become available?

It became available in 1988 for use in buildings.

What are the major disappointments in technology?

To me, the biggest disappointment is we've gotten really bright in designing sprinklers and designing applications and made them cheaper and cheaper to install, but none of them has been ideal for retrofit.

If you look at the industry or look at our customer base, the advances we make may impact only 5% of their properties.

Our hope was we would advance to a retrofit device, but we just plain weren't able to do that.

The other disappointment is the loss of halon.

Is there anything out there to replace it?

No. There are a couple of candidate replacements that probably will evolve over the next couple of years. But I think what we'll find is that a lot of our customers will take the approach 'once burned is enough.' They won't want to spray anything into the atmosphere unless they're fully sure it is OK.

We're trying to use this as an opportunity to design a more inherently safe building. We have some customers who said years ago that they didn't want to use halon, but they would design their facilities in a way that still produced the same outcome as if halon were used.

So, when it became obvious that we were losing halon, we adopted the philosophy of assuming there will never be a replacement.

If we get one, that's a bonus. But we assume that we'll never get one and really look at the goal of creating a fire-safe environment and identify things that can be done to still yield that level of safety.

Given the nature of the changes in exposures, would it be possible to design a truly fireproof building or perfect suppression system?

I don't know, but I don't know if I'd want to try anyway. To me, the fun of what I'm doing is seeing what our customers can challenge me with next.

So I'd rather not get so deeply into what everybody's doing that we have to follow an entire set of rigid rules to create this perfect building. I'd rather be involved with the customer early in the design of anything they're doing in creating something that's safe.

My point is that we probably could come in here and make this desk out of metal instead of wood and make the carpet out of something that's a little less friendly to us and do a number of things that would make this a pretty sterile environment that would be fire-safe. But I don't know if I'd like to work here then.

In terms of delivering a life-safe building, I think the industry has the ability to do that with automatic sprinklers and fire detection systems and products of limited igniteability. I think the industry's pretty much there.

The next step of creating a facility that doesn't burn is another story.

It's more a matter of recognizing the limited hazard so that we have a protection for it.

If you create this sort of fireproof facility and you don't protect it, then you have to police it forever. Then we have to talk about what we carry in here when we come to visit, what people bring in to personalize a room. We start losing that safety the minute people occupy it. BI

Looking Back



Courts in California and New York are studying 140 insurance policies covering Hooker Chemical & Plastics Corp. to decide who is liable for 500 claims arising from the **pollution of Love Canal** that seek more than $10 billion in damages.

The insurers that underwrote the coverage over a period of 16 years are involved in a maze of litigation with Hooker, which owned the site and operated it as a landfill from 1947 until 1952 (*BI*, Jan. 14, 1980).

* * *

Lloyd's of London has called in Scotland Yard to help investigate the $84 million loss of the **oil tanker Salem**.

Lloyd's believes that the tanker's $60 million oil cargo was sold secretly to South African interests before it sank off the Senegal coast Jan 17. Lloyd's suspects the tanker was scuttled to hide the theft.

The tanker's cargo was 100% insured in the London market, with Lloyd's taking about 60% of the risk (*BI*, Feb. 4, 1980).

* * *

The Carter administration's 1981 budget includes a proposal that would triple the federal funding to support **health maintenance organization** feasibility studies, planning, initial operating costs and expansion programs.

Funding for these programs would rise to $69 million in 1981 from the current $23 million. With this large increase in available funds, the administration estimates the number of federally qualified HMOs will increase to 139 from 105 (*BI*, Feb. 4, 1980).

* * *

Newport News Shipbuilding & Dry Dock Co. of Newport News, Va., is challenging federal guidelines requiring employers to cover the **pregnancy-related expenses of employees' wives** if the employers offer dependent health care coverage.

The suit seeks to overturn Equal Employment Opportunity Commission guidelines issued in March 1979 (*BI*, Feb. 18, 1980).

* * *

The Supreme Court has ruled that workers cannot be fired or reprimanded for **refusing to accept dangerous tasks**, though employers do not have to pay them for time not worked.

The court upheld a regulation by the Occupational Safety and Health Administration that allows employees to refuse to perform a task when they perceive a "real danger" of death or serious injury and there is not time to go through normal complaint channels (*BI*, March 3, 1980).

* * *

A California Supreme Court ruling that **women can sue DES manufacturers as a group** has opened the door to the theory of industrywide liability.

In the case, women are suing all manufacturers of diethylstilbestrol, which was given to pregnant women to prevent miscarriage but allegedly caused cancer in some of their adult daughters. Most of the daughters cannot identify the specific manufacturer of the drug their mother took.

The decision says that when a specific manufacturer cannot be established, all manufacturers must divide the liability based on their market share (*BI*, March 31, 1980).

* * *

Johns-Manville Corp. is suing 27 of its excess liability insurers over its asbestos liability coverage.

Among other things, Johns-Manville asked the court to determine whether claims should be handled under the exposure theory or the manifestation theory (*BI*, April 7, 1980).

* * *

The Financial Accounting Standards Board Statement No. 35 could hike the cost of performing **actuarial valuations for pension plans** as much as 15%.

Statement No. 35 requires pension plan sponsors to issue an annual report to employees containing net assets available for benefits, the actuarial present value of accumulated benefits and changes in both (*BI*, April 7, 1980).

* * *

New rules announced by the Occupational Safety and Health Administration give employees access to the medical records their employers have on file if there has been **workplace exposure to toxic substances** or harmful agents.

Under the new rules, employees may examine and copy an employer's records of toxic substance exposure, and unions also may examine the medical records with the written consent of the employee (*BI*, May 26, 1980).

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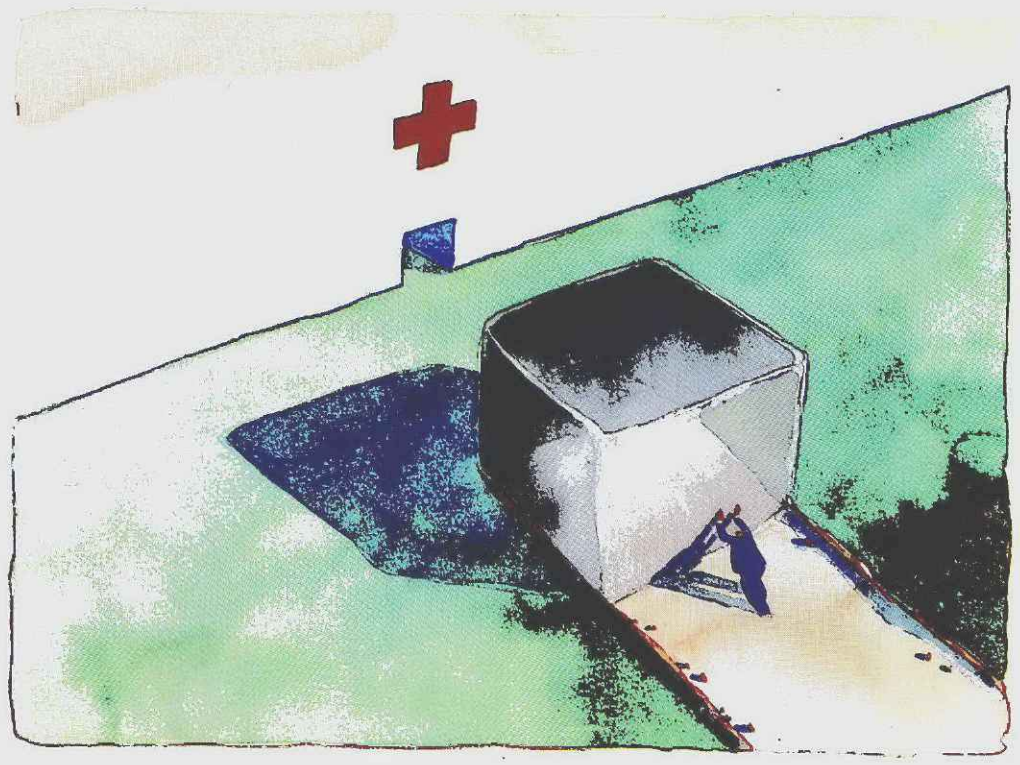
Insurers and state officials are trying to untangle the web of liability questions surrounding the eruptions of the **Mount St. Helens volcano** in Washington. Total claims from the disaster are expected to top $1 billion.

The insurance commissioner of Washington has instructed insurance companies to adopt liberal guidelines in determining coverage for the disaster, though insurers are still debating what is covered (*BI*, June 2, 1980).

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C.T. Bowring & Co. P.L.C. shareholders have approved the sale of Bowring to Marsh & McLennan Cos. Inc. for 44 million shares of stock and about $322 million cash. M&M shareholders also have approved the deal.

The controversial merger marks the first foreign ownership of a Lloyd's of London broker's parent firm (*BI*, June 2, 1980).

* * *

Employers are waging war on the cost increases in the $206 billion health care system.

Health care costs will reach $2.4 trillion by the year 2000 if current trends continue, so employers are scrambling to cut costs within their own companies and to form coalitions with other employers and, sometimes, health care providers to find ways to streamline the system (*BI*, June 2, 1980).

* * *

The Internal Revenue Service will not impose the **tougher pension vesting standards** it had planned, but it intends to stop automatically approving some pension plans.

The IRS action is part of its crackdown on plans that discriminate in favor of highly paid employees (*BI*, June 9, 1980).

* * *

If the Fisher Working Party's recommendations for **changes at Lloyd's of London** are accepted, a host of traditional practices would end. The Fisher report suggests, among other things, that the financial ties between Lloyd's brokers and underwriters be broken, that U.S. brokers be free to own Lloyd's brokerage subsidiaries and that rules and disciplinary procedures be established to better control the Lloyd's market (*BI*, June 30, 1980).

* * *

Employers are in the midst of an epidemic of **wellness programs**.

Companies are using a variety of ideas, ranging from corporate spas to fitness seminars, to cut their health care costs by keeping their employees from getting sick in the first place (*BI*, Sept. 1, 1980).

* * *

Some employees are getting a new benefit: **cash incentives to buy an American-made car**.

Several companies have begun programs to pay workers from $100 to $250 to help them contend with inflation and help spur the sagging auto industry (*BI*, Sept. 8, 1980).

* * *

Those who provide **hospice care** for the terminally ill say the success of the programs depends on the support of insurers.

And that support from insurers, which do not yet cover hospice care, depends on whether they feel there is demand from buyers and if they determine that hospice care is less costly than hospital care for the terminally ill (*BI*, Sept. 29, 1980).

* * *

Despite strong end-of-the session lobbying efforts, Congress did not pass the **Risk Retention Act** before the legislators recessed for the November elections.

The measure was stalled when Sen. Howard Cannon, D-Nev., combined it with legislation establishing a quasi-public company to promote foreign travel to the United States (*BI*, Oct. 6, 1980).

* * *

Attorneys predict an avalanche of **toxic shock syndrome** lawsuits against manufacturers of tampons.

At least 14 suits alleging tampon involvement in toxic shock syndrome, a potentially fatal illness, already have been filed against Procter & Gamble, maker of Rely tampons. Other tampon makers are named in other suits (*BI*, Oct. 13, 1980).

* * *

The U.S. Supreme Court has allowed **industrywide suits by victims of DES**.

The high court let stand a California court decision that allows the daughters to sue all of the companies that manufactured the drug during the time period their mothers took the drug.

However, the ruling applies only to those who cannot identify the manufacturer of the drug their mothers took (*BI*, Oct. 20, 1980).

* * *

A federal appeals court has ruled that liability insurance policies written during the years when workers handled asbestos are the only source of coverage for recently discovered asbestos-related diseases.

In its decision in ***INA vs. 48 Insulations Inc.***, the court accepted the exposure theory of liability in long-latent injury cases, rather than the manifestation theory. (*BI*, Nov.3, 1980).

* * *

Lloyd's of London will use its reserves to meet $36.5 million of the losses of the **Sasse syndicate**, leaving syndicate members liable for only $15 million of the $51.5 million in losses on U.S. and Canadian property risks in 1976-77.

Lloyd's is attempting to recover some of the money through litigation against the syndicated's reinsurers. Hearings in that litigation are set to begin next year (*BI*, Nov. 3, 1980).

* * *

Experts agree that when **President-elect Ronald Reagan** and the conservatives elected to Congress take over in January, business will have a powerful ally.

Among other things, they say, the changing of the White House guard will be the death sentence for a national health insurance plan, long pushed by liberal Democrats (*BI*, Nov. 10, 1980).

* * *

Liability coverage of $30 million may not be enough to cover claims resulting from the **fire at the MGM Grand Hotel** in Las Vegas that killed 84 people.

The first class-action negligence lawsuit filed seeks $175 million in damages on behalf of about 375 Mexicans staying at the hotel (*BI*, Dec. 1, 1980.

* * *

The U.S. House of Representatives passed the $1.6 billion **Superfund** hazardous waste cleanup bill, which already has been approved by the Senate. The measure, the Comprehensive Environmental Response, Compensation and Liability Act, is expected to be signed by President Carter soon.

The bill would allow the government to act quickly against dump sites that pose a pollution threat to nearby communities and then recover the costs from the companies ultimately found responsible. The measure will be funded largely by an excise tax on chemical companies (*BI*, Dec. 8, 1980).

* * *

Lloyd's of London underwriters have paid a $1 million life insurance policy on **former Beatle John Lennon**, who was murdered last week.

The policy, whose benefits were paid within 24 hours of the murder, was taken out by Mr. Lennon's record distributor, Warner Bros., to cover losses resulting from "non-appearance" (*BI*, Dec. 15, 1980).

* * *

The **proposed merger between Alexander & Alexander Services Inc. and Sedgwick Group P.L.C.** could form the world's largest insurance brokerage with estimated revenues of $672.6 million.

The A&A-Sedgwick merger is not expected to be completed before 1982 (*BI*, Dec. 22, 1980). BI



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London: Then and Now

Disasters, syndicate closings and rising rates also dominated the headlines of 1967

By Stacy Shapiro

Plus ca change, plus c'est la meme chose.

This famous French proverb also has meaning in London. To paraphrase: the more things have changed in the London market in the past 25 years, the more they have stayed the same.

Many of the challenges and concerns that the London market is facing in 1992 are a repeat of those experienced 25 years ago.

In 1967, conversations in the London market centered on catastrophic losses—just as they do today.

The talk of the town centered on the losses generated by Hurricane Betsy two years earlier in 1965, coupled with a fire at Chicago's McCormick Place exhibition hall, tornadoes in the Midwest and a massive munitions factory fire in Texas.

These disasters caused catastrophe capacity in London to contract, terms and conditions in North American reinsurance treaties to change and rates to increase.

While Betsy dominated discussions 25 years ago, today everyone is talking about Andrew and Hugo.

Many underwriters closed up shop following Betsy—just as they are going out of business now.

Underwriters' results also were hurt 25 years ago by the devaluation of the pound against the U.S. dollar, just as the pound is now losing value against the German mark.

"We are all in this business together, and while competition is healthy, it is senseless to indulge in cutthroat methods as has happened at times in various parts of the world and which only leads to disaster." While that sounds like something a market leader would say today, those words were spoken by R.W. Sturge during his October 1967 presidential address at the London Insurance Institute.

A quarter of a century ago, the debate over Britain's role in Europe was a topic of conversation in London. Sound familiar?

According to a 1967 article in Lloyd's Log, Mr. Sturge said he "hoped that it would be the pleasant task of one of his successors to record that a Common Market in insurance had been established in which British insurers were playing their full part as good Europeans—whether or not the United Kingdom had, by then, been admitted to membership of the European Economic Community."

Britain joined the European Community in 1972, and today British Prime Minister John Major holds the E.C. presidency. A single European insurance market is close to a reality. However, many in Britain still have misgivings about European unity as laid out in the Maastricht Treaty.

The situation in the London market in 1967 "is very similar to today in many ways," summed up Philip Wroughton, chairman and chief executive of London-based broker C.T. Bowring & Co. Ltd., a unit of Marsh & McLennan Inc.

"We have just had a big hurricane, and it would appear that rates could go upwards and it would appear that capacity has shrunk" as it did 25 years ago, Mr. Wroughton said. "The scenario has its similarities. . . .Some people say they have seen it all before. . .and then we emerged far stronger and we had some profitable years."

But the situation was not as grave in 1967 as it is today, said David Rowland, chairman of Sedgwick Group P.L.C. and most likely the next chairman of Lloyd's of London.

"The pillars of the London insurance market were then thought to be unshakeable," Mr. Rowland said. "It was a simpler world, a world where the chairman of Lloyd's wagged his little finger and everyone ran.

"Now there are questions about everyone in the insurance market (worldwide) because of the erosion of the asset base" of many financial institutions.

"But there lies the challenge and opportunity" for companies with fresh capital to enter the market, Mr. Rowland said. "Just think of the opportunities if you could offer buyers high-quality security."

"The capacity crunch is more severe now than it was then," said Sir Peter Miller, chairman of broker Miller Insurance Group Ltd. and a former Lloyd's chairman.

Twenty-five years ago, hundreds of syndicates were not closing and large insurers were not withdrawing from the market as they are today, he said.

Losses did not drive Lloyd's members to resign in the late 1960s "because they were richer," Sir Peter said. "There was no wholesale withdrawal of members as you have now," though no new members were joining.

The losses hitting the market today may be "much bigger," said Lloyd's non-marine underwriter Michael Harris. However, "in comparative terms. . .I think it was worse in 1965-66-67 than now because the market was smaller."

But, he added, "It's almost as bad now."

The losses from Hurricane Betsy did not hit the market as badly as the catastrophes are hitting London today, agreed Roger Elliott, chairman of Willis Corroon Group P.L.C.

One of the biggest changes between then and now is "the size of the claims," he said. "The sheer value has increased. . .$100 million losses are no longer headline news."

When Hurricane Betsy hit, "at first, we didn't think Betsy would cost Lloyd's much," recalled David Larner, who was information officer for Lloyd's in 1965. Mr. Larner retired from the Lloyd's public affairs department last year.

Betsy hit the tip of Florida and swerved into the Gulf of Mexico in 1965, devastating the oil fields off the coast of Louisiana. The storm caused $1 billion of insured damage —in 1965 dollars—with $100 million of the loss paid at Lloyd's.

However, it was not until 1967 that London underwriters started to feel the pinch of Betsy's losses as reinsurance claims finally rolled in, partly due to the "spiral" inherent in London market excess-of-loss reinsurance.

In 1967, the year before Lloyd's would announce its 1965 results, Lloyd's Chairman Ralph Hiscox expressed "quiet optimism" and "hope" that 1965 would "see an end to the bad patch through which Lloyd's, together with other insurance interests, had been passing."

However, the next year, Lloyd's announced a global loss for 1965, its first ever, of 37.7 million pounds ($105.6 million at applicable exchange rates) for its 5,828 members on a premium capacity of 461 million pounds ($1.29 billion).

Lloyd's would announce two more consecutive years of losses: 18.6 million pounds ($52.3 million) in 1966 and 1.6 million pounds ($4.5 million) in 1967.

These losses gave rise in 1970 to a report by Lord Cromer, which was never publicly released, that called for more types of members at Lloyd's to increase capacity. This report opened the market's doors to foreigners, women and investors with smaller capacity limits.

Twenty-one years later, Lloyd's would announce its first global loss since 1967 after a long string of profitable years. Lloyd's last year announced a then-record global loss of 509.7 million pounds ($983.7 million) for 1988. The 1989 global loss announced this year totaled a staggering 2.06 billion pounds ($3.85 billion). And, 1990's loss is expected to total more than 1 billion pounds ($2.12 billion).

The reason for the current string of losses at Lloyd's is that more than $32 billion of disaster losses have battered the insurance market since the October 1987 windstorms.

The losses are compounded by a concentration of billions of dollars of losses in five defunct Lloyd's LMX syndicates and several LMX specialist insurance companies (*BI*, Aug. 31).

While much of the current losses is due to catastrophes, a problem that Lloyd's did not have 25 years ago also is hammering results today: Asbestos and pollution losses have contributed to an unprecedented 100 syndicates being unable to close a total of 162 accounts.

As losses at Lloyd's have grown, membership has dropped to 22,259 members this year from 32,433 in 1989.

Comparing then and now, "I remember the distress and sadness" caused by Betsy in the London market as many syndicates shut down, said Lloyd's non-marine underwriter Michael Harris, who joined Lloyd's on the R.J. Kiln syndicate in 1965, one month before Betsy struck. "It's deja vu."

Everything was done manually then, including the use of the old adding machines, Mr. Harris said. "There were no electronic calculators. You had to see every underwriter on the slip and put every claim down manually in a ledger book using the adding machine."

While there was an LMX spiral in those days, it took longer for syndicates to feel the losses because all claims calculations were done manually, Mr. Harris said. In fact, Mr. Harris' syndicate was still handling claims from Betsy until about five years ago, he noted.

"Because it was slower, the spiral worked," he said. "Now, with the electronic transfer of funds, the spiral can't work."

Syndicates started "collapsing" in 1966 and 1967 "like they are now," but it was not until January 1968 "that the whole thing knee-jerked (and) prices started rising," Mr. Harris said.

But the attitude of the Lloyd's membership was different in 1967, Mr. Harris noted. "It wasn't a business; it was more of a club."

"In those days, the members were much closer to Lloyd's—they hunted together, went on vacation together —they were close members of the society," summed up former Lloyd's Chairman Murray Lawrence.

Today, Lloyd's members are comparatively poorer, and "we have 30,000 names around the world feeling very distant to Lloyd's."

Sir Peter noted that 1967 heralded an end of a three-year cycle "full of horrors" for the marine market, including losses from Betsy.

Rates for marine risks headed skyward, and brokers had to "scrape on their belly" to find enough capacity, Sir Peter said.

The non-marine market also had its share of losses, but there were no problems with long-tail losses from old years of account, he said.

A lack of capacity in London in the late '60s and early '70s meant that "brokers had to go to new markets," Mr. Lawrence said. "It was in those days that the alternative markets started. . .and you saw growth in captives and self-insured retentions. All of this was a function of the loss of capacity in the 1960s. You began to see in those days what we're all doing today."

Since the late 1960s, "the attitudes to captives have been painstakingly developed," said Tony Benson, corporate risk manager for Guinness P.L.C., who has been involved in insurance and risk management since 1969. "The failure to brace the new animal and some continued resistance (after the 1960s) caused insurers harm."

There also has been a breakdown in a tariff system imposed by the big U.K.-based insurance companies since the late 1960s, he noted. That system forced policyholders to place 65% of their coverage with one of the large, tariff insurers if one of those insurers were to participate on the coverage, Mr. Benson explained.

"All these things have been swept away," he said. "There's been a hugely increased—but not yet sufficient—acknowledgment of risk management" and its role in the insurance marketplace.

Today, the greatest threat to U.K. risk managers is not the attitude of insurers and brokers, but "the changes of law and society, especially E.C. law and environmental matters. There is a changing and tightening system of regulation in most systems of the world," Mr. Benson said.

The change in the London market has been great—yet in some ways small—in the past 25 years. What does 25 years from now hold?

"There will be an international clearing house for the risk business, and I hope it will be London," Mr. Rowland said. "I think London will continue as a marketplace where anyone from anywhere in the world comes to set up a business and participate in the risk."

"It will be a business that's mechanized to a degree that we can't imagine," Mr. Lawrence predicted. "And I suspect that syndicates' operations will be light-years different than what we do now. There might be syndicates in different countries in the world and far more joint ventures between syndicates and companies (creating a smaller number of) large and powerful bodies."

"I have a feeling the shop will be here," Mr. Elliott said of the London market. "I don't think there will be dramatic changes in the insurance needs of the individual." BI

International Editor Stacy Shapiro joined BI in 1980 and established its London bureau in 1981. She is a keen observer of changes in the London market.

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A Conversation With:

Richard Outhwaite

Richard Outhwaite has become one of the most famous—and to some infamous—underwriters in Lloyd's of London's history.

Marine syndicate 317, underwritten by Mr. Outhwaite and managed by R.H.M. Outhwaite (Underwriting Agencies) Ltd., grew fivefold in capacity between 1975, when it was established, and 1982, when Mr. Outhwaite became a leading underwriter in runoff reinsurance programs for Lloyd's syndicates and other insurers.

However, by the end of 1991, runoff policies written in 1982 had cost 1,612 members 187.4 million pounds ($326.1 million) in cash calls. Total underwriting losses had reached 233.3 million pounds ($405.9 million).

Earlier this year, during a lengthy trial, 987 members of the 1982 underwriting year agreed to a 116 million pound ($201.8 million) settlement to end litigation against 81 members' agencies that placed them on the Outhwaite syndicate. The settlement was made by the agents' errors and omissions insurers led by Stephen Merrett, who early in his career was joint underwriter of his father's Lloyd's syndicate 418 with Mr. Outhwaite.

Mr. Outhwaite has continued to write and showed a profit in every year between 1983 and 1988 and only a small loss in 1989, when Lloyd's posted record losses. However, his syndicate's capacity dropped sharply this year, and Mr. Outhwaite has announced syndicate 317 will not underwrite next year.

Mr. Outhwaite, who has worked at Lloyd's for 36 years, spoke with International Editor Stacy Shapiro.

* * * *

Why did you decide to write runoff reinsurance contracts in 1982?

There had always been a small market in runoff business. In fact, I wrote one in 1974.

But there wasn't a great demand because the only time there was a runoff policy was if a syndicate was closing down and wanted to reinsure its liability.

In 1981, we started getting inquiries, particularly through one broker, Winchester Bowring. For one reason or another, syndicates had gotten into some sort of difficulties as a result of the past and wanted to reinsure past years.

There were a lot more inquiries—a lot more business to be written—in 1981 to 1982 partly because the brokers thought (runoff policies were) a jolly good thing. So we wrote more of them in 1981 to 1982 just because there was more business there. When we'd written enough, we stopped.

What was the attraction of writing the runoffs?

I thought they were a jolly good risk, because syndicates had made their assessment of their reserve requirements and all that had been agreed to by the auditors.

If the syndicate had done its work properly and was properly audited, I would be basing a runoff reinsurance policy on a precise reserve figure. If the syndicate, for example, required a reserve of $5 million, then I might write reinsurance in excess of, say, $7.5 million, which would have been a margin never exceeded. The vast majority of the business we wrote, you would not expect to have any claims on whatsoever.

We never wrote business because we wanted premium income. We were always quite selective.

Why did you write 100% of some of these unlimited contracts?

Because I wrote what I thought was a good risk. If I thought it was a good—and not particularly big—risk, then I wrote 100%. If I thought it was quite large, then I didn't write 100%; some I wrote 25%, some 33.3%, some 50%. But generally, underwriters who wrote this sort of thing wrote 100% or a major line.

When did you realize things were going wrong, and what did you do about it?

We left our 1982 year open in the spring of 1985. By then, reserves had increased to an extent that we were now facing losses on some of the contracts.

It didn't look disastrous then; it looked like it would be contained. The auditors were prepared to close the syndicate, but with a qualified account.

We then spoke to a number of agents who had members on our syndicate and it was clear the only practical way to proceed was to leave the syndicate open.

During the years of 1986 and 1987, huge new loss advices started coming into the market, which completely transformed the position.

Why didn't you settle with the litigating members before the trial started earlier this year?

Because we felt that there had been no negligence in the underwriting.

What do you think was the trial's turning point?

I'm not sure there was a turning point in reality. But if there was a turning point, it must have come during the course of (Ulrich) von Eicken's evidence. (Mr. von Eicken, retired U.K. managing director of Munich Reinsurance Co., was an expert witness for the plaintiffs.)

Mr. von Eicken was not an expert in Lloyd's affairs because he wasn't involved in Lloyd's and it was always difficult to understand the grounds on which he was giving opinions. But he maintained opinions despite that, and (defense) counsel really couldn't budge him much. I think, surprisingly, he gained the judge's sympathy.

After my (testimony), our counsel was very pleased and thought that the case was absolutely won. But after Mr. von Eicken, they weren't so sure.

Do you think that Mr. von Eicken should have been on the stand for seven weeks?

Certainly not. He should have been on for about an hour.

If they'd ask him a simple question—'This is all about Lloyd's underwriting and Lloyd's procedures and reinsurance-to-close and so on, and have you any experience in that, Mr. von Eicken?'—he would've answered that he had no direct experience at all. Then the counsel would have said, 'In that case, I have no further questions,' and sat down.

What about Lloyd's Deputy Chairman Richard Hazell's testimony? (Mr. Hazell was Mr. Outhwaite's leading expert witness.)



Photo by Stacy Shapiro

Mr. Hazell was not helpful.

Can you add to that?

No.

You have said you were not involved in the settlement. Were you then surprised that the case was settled?

I was surprised, first, that there was a settlement, and secondly, on the quantum of the settlement. I thought it was a mistake to settle in the first place, because I think that we should have won our case. Secondly, I thought the quantum of the settlement was absurd. I can't say what it should have been settled at, but all I know is I'm quite certain it could have been settled for a great deal less.

Mr. Merrett was the leading E&O underwriter at the time. Some people think that perhaps a longtime rivalry between the two of you was a factor in settling.

I cannot answer that question. From my point of view, no rivalry exists. I can't speak absolutely for Stephen Merrett, of course, but I would be surprised if that was a factor. (Mr. Merrett's agency) has a group of names who are taking the same action against them for precisely the same reason. I wouldn't imagine it was in Stephen Merrett's interest to make a substantial settlement unless he felt it was absolutely necessary.

Since you will not underwrite next year, what will you do?

I'm going to act as a consultant, because we lead quite a lot of business and we can be of considerable assistance if Simon Barder (who will take over syndicate 317) wants to continue with that business.

I also have said that we've accepted the obligation to manage the runoff of the 1982 underwriting year and we accept it for all the years we've been underwriting, so I will continue to do that.

There has been talk that you will move into underwriting on the insurance company side of the London market.

Well, it's a nice thought, isn't it? But all I can tell you is that nobody's asked me. I saw in the Daily Telegraph that I was contemplating buying some Danish company. Unfortunately, I'd never even heard of them, let alone buy them.

I don't want to lie down and die just yet. . .It just depends on whatever opportunities might appear.

Do you think Lloyd's has a future?

Lloyd's will continue if it makes several major strategic changes. Some people think all we have to do is produce some good underwriting years and all will be well and people will flock in again.

Under present conditions, there will never be a significant influx of capital without having limited liability and a limit on the time that your investment is bound in Lloyd's. For that, we need a solution to the open year problem.

Without those two things, we will never get a significant increase in our capital base, which Lloyd's has to have. Otherwise, Lloyd's will just wither.

Do you have ideas for how Lloyd's can close open years?

Undoubtedly, (closing 62 syndicates' open underwriting years) will involve some central pooling of residual liabilities. But there are many different ways of organizing that. The current way—the establishment of CentreWrite Ltd. by Lloyd's—is a complete waste of time.

Why?

Because they have done nothing.

I also think the premium (charged by CentreWrite) is amazingly unfair to the names on the open year because it isn't related to a proper calculation of their liabilities.

Did your syndicate ask for a quote from CentreWrite?

We discussed syndicate 317's open 1982 year with (CentreWrite Chairman) Robin Jackson, but it's been made clear that they are not interested in looking at any syndicates with that scale of reserves. This was before the task force report, but things haven't changed particularly.

If CentreWrite isn't the solution, then what is?

The idea of CentreWrite—a central organization set up to take runoff from open years—is not wrong in principle. It's a question of how it is established and what it can do. The present basis is totally insignificant and unsatisfactory.

Lloyd's wants to appear to be providing a solution to the open year problem, whereas in practice they are doing absolutely nothing about it.

Your scenario, then, looks as if Lloyd's might not have a future.

Unless there are certain basic and radical changes made within five years, I think that's right. I think (incoming Lloyd's Chairman) David Rowland is well aware of the thrust of all this, and my own feeling is that he and a number of others will actually push Lloyd's in some direction so that it does have a chance of a future.

Do you think it might be too late?

I can't tell, but it certainly will be too late if nothing is done.

I'll just comment, then, that although I'm not actually underwriting next year, I'm totally committed to the future prosperity of Lloyd's. I want Lloyd's to go on. I want these changes to be made so that it's got a chance.

I've been in Lloyd's all my life. I'm not sure how I'd take to life outside it. If I have the opportunity, I'd love to do something at Lloyd's.

If someone asked you to write runoff reinsurance of Lloyd's syndicates now, would you?

I would be the best qualified person. I reckon I know more about runoff business than anyone in the world. I would be delighted to have a look at the business, but I wouldn't think of writing it because I couldn't stand the hassle. BI

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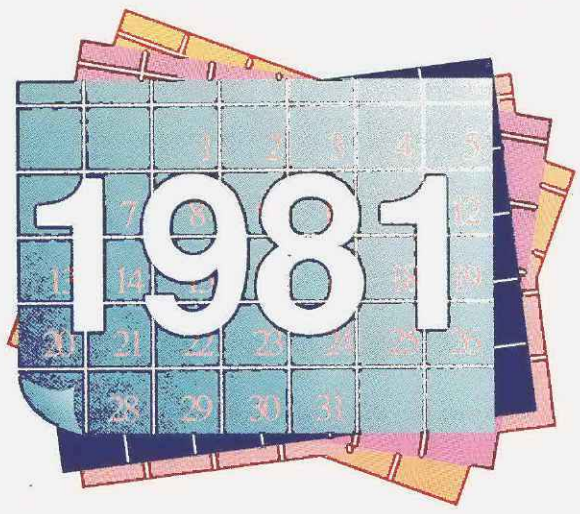
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Looking Back



Major health insurers say that **group medical insurance** rates are up an average of 30% over last year, and some increases may be as high as 60%. The insurers attributed the hikes to inflation and increased utilization (*BI*, Jan. 26, 1981).

* * *

The 52 American hostages freed from Iran are coming home to a bundle of tax-free benefits. The **Hostage Relief Act of 1980** provides tax-free salaries and hazardous-duty pay, medical expenses and education benefits for dependents for up to two years for any hostages hospitalized for illness or injuries resulting from their captivity (*BI*, Jan. 26, 1981).

* * *

The major recommendation of the President's Commission on Pension Policy is that every U.S. employer should be required to offer a pension plan that immediately vests 3% of each worker's annual wage.

The panel said that unless **private pensions are made mandatory**, a two-tiered system will develop. Those employees covered by private plans will prosper, but those with only Social Security benefits will face poverty in old age (*BI*, Feb. 2, 1981).

* * *

Companies with billions of dollars of **claims against Iran** say they will continue to try to attach Iranian assets if the arbitration system set up by the recent hostage agreement does not hold up.

There currently are about 380 lawsuits in U.S. courts seeking to attach $3 billion in Iranian assets as compensation for expropriations and losses during the violence of the Islamic revolution (*BI*, Feb. 2, 1981).

* * *

MGM Grand Hotels Inc. has purchased back-dated liability policies that could add as much as $170 million to the coverage for losses in the fatal fire at the MGM Grand Hotel in Las Vegas.

The coverage, which was placed by Frank B. Hall & Co., is dated Nov. 1, 1980—20 days before the fire that killed 84 people. Before buying the additional coverage, MGM had only $30 million in liability coverage, far too little to cover losses (*BI*, Feb. 9, 1981).

* * *

A New York appellate court has ruled that **DES victims** can sue drug manufacturers that acted in concert to market the product, even if the specific manufacturer of the drug that caused the victim's injury cannot be identified.

The decision is the first to apply a concert-of-action theory in a case involving diethylstilbestrol. The drug was given to pregnant women to prevent miscarriages and later linked to cancer in their adult daughters (*BI*, March 2, 1981).

* * *

A U.S. Circuit Court of Appeals has ruled in favor of the Internal Revenue Service in the dispute over Carnation Co.'s **tax deductions for premiums paid to its captive**.

The ruling upheld a Tax Court decision.

Industry observers say this decision is a significant setback for companies seeking to apply to their captives the tax advantages of traditional insurance arrangements (*BI*, March 16, 1981).

* * *

An Internal Revenue Service regulation threatens **501(c)(9) trusts** sponsored by trade associations. Under the IRS ruling, the tax-free trusts can be used by one company or by a trade group in which employees of members work in the same geographic area, but not by a trade group whose members are spread out around the country (*BI*, March 23, 1981).

* * *

The Equal Employment Opportunity Commission will appeal a federal court ruling that employers do not have to offer **equitable pregnancy benefits** to spouses of male employees.

In a landmark case, U.S. District Court Judge J. Calvitt Clarke Jr. overturned a 1979 EEOC guideline that says if an employer's health insurance plan covers the medical expenses of female employees' spouses, it must equally cover maternity ex-

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Continued from previous page
penses of male employees' wives (*BI*, April 6, 1981).

* * *

Although neither American Airlines nor McDonnell-Douglas Corp. will reveal details of the agreement, it appears that insurers for American will pay the majority of the losses in the **1979 crash of an American DC-10 in Chicago**.

The two companies apportioned liability for the crash, which killed 273 people, based on the portion of the responsibility for the crash that was related to McDonnell-Douglas' alleged faulty design and to American's poor maintenance of the aircraft. Insurance industry sources say that American will be responsible for all the hull claims and 75% of the liability claims (*BI*, May 4, 1981).

* * *

The nation's **air traffic controllers**, threatening a nationwide strike for June 22, are demanding a 25% increase in retirement benefits. The 15,000-member Professional Air Traffic Controllers Organization says PATCO members need higher retirement benefits because so many suffer job burnout (*BI*, June 1, 1981).

* * *

Under **Vermont's new captive law**, companies are allowed to form the kind of pools for product liability coverage that would be allowed under the long-delayed federal Risk Retention Act.

The Vermont law is the first to create the domestic captive insurer category of industrial insured, which would allow pooling (*BI*, June 8, 1981).

* * *

A proposal by the Financial Accounting Standards Board could threaten pension plan growth.

The FASB proposal would treat **unfunded retirement benefits**, which now are cited as a footnote in financial statements, as a liability on corporate balance sheets (*BI*, July 13, 1981).

* * *

Only the owner and the operator of the Hyatt Regency hotel in Kansas City, Mo., appear to have anywhere near the liability coverage that will be needed to pay claims resulting from the July 17 **collapse of skywalks at the hotel**.

Even if investigators ultimately find designers or builders responsible for the tragedy that killed at least 111 people and injured about 200 others, their coverage will not come close to the estimated $100 million in claims that will result (*BI*, July 27, 1981).

* * *

A federal court ruling allows a **self-funded multiple employer trust for employee benefits** to qualify as exempt from state regulations under the Employee Retirement Income Security Act.

Under the ruling, an association set up by employers for a specific purpose, such as self-funding health insurance benefits, can be considered an ERISA benefit plan (*BI*, Aug. 3, 1981).

* * *

Although the **Major League Baseball strike** has ended, the dispute over strike insurance is heading into extra innings.

Underwriters still are considering whether to reimburse baseball owners for their losses for the seven days of games that were canceled between the July 31 strike settlement and the end of last week, when the insurance would have run out. Although a pact was reached July 31 in the 50-day-old strike, the players had not ratified the deal before the end of the policy period (*BI*, Aug. 10, 1981).

* * *

The **cost of providing employee benefits** has risen an incredible 763% since 1951, according to the U.S. Chamber of Commerce.

The annual cost of benefits provided to the average worker rose to $5,560 in 1979 from $644 in 1951. During the same period, the Consumer Price Index rose only 190% (*BI*, Aug. 17, 1981).

* * *

Oregon is about to become the first state to use **open rating for workers compensation insurance**.

Although Minnesota was the first state to pass an open rating law requiring workers comp insurers to compete on price, that law will not be fully in effect until mid-1983; Oregon's law takes effect next July.

Oregon officials said they took the action to try to bring down workers compensation rates, which are among the highest in the country (*BI*, Sept. 14, 1981).

* * *

Although both insurers and manufacturers are pleased by Congress' passage of the **Risk Retention Act**, they are divided about what its effect will be. Buyers say the new law will bring more competition, more accurate rating and, possibly, lower rates. But insurers say that few risk retention groups actually will be formed and so its impact will not be significant (*BI*, Sept. 21, 1981).

* * *

The early returns are in, and they show that **wellness plans can save money** for employers.

Employers are finding that they can save millions of dollars by helping their employees stay well. New York Telephone Co. says its wellness programs, by "conservative" estimate, saved the company $2.7 million in 1980 in absence and treatment costs (*BI*, Sept. 21, 1981).

* * *

After the breakup of its ill-fated romance with Sedgwick Group Ltd., Alexander & Alexander has taken **Alexander Howden Group Ltd.** as its London mate.

Eight years after the two companies first talked about combining, they have reached an acceptable $295 million tender offer for Howden (*BI*, Sept. 28, 1981).

* * *

In the broadest asbestos liability decision yet, a District of Columbia Court of Appeals has applied the **triple-trigger theory**, meaning that all insurers of a manufacturer from the time a claimant was exposed to a harmful product through the appearance of the injury are liable for damages.

In *Keene Corp. vs. INA*, the court also said the policyholder, even if self-insured during any portion of the period, is not liable for any of the damages (*BI*, Oct. 12, 1981).

* * *

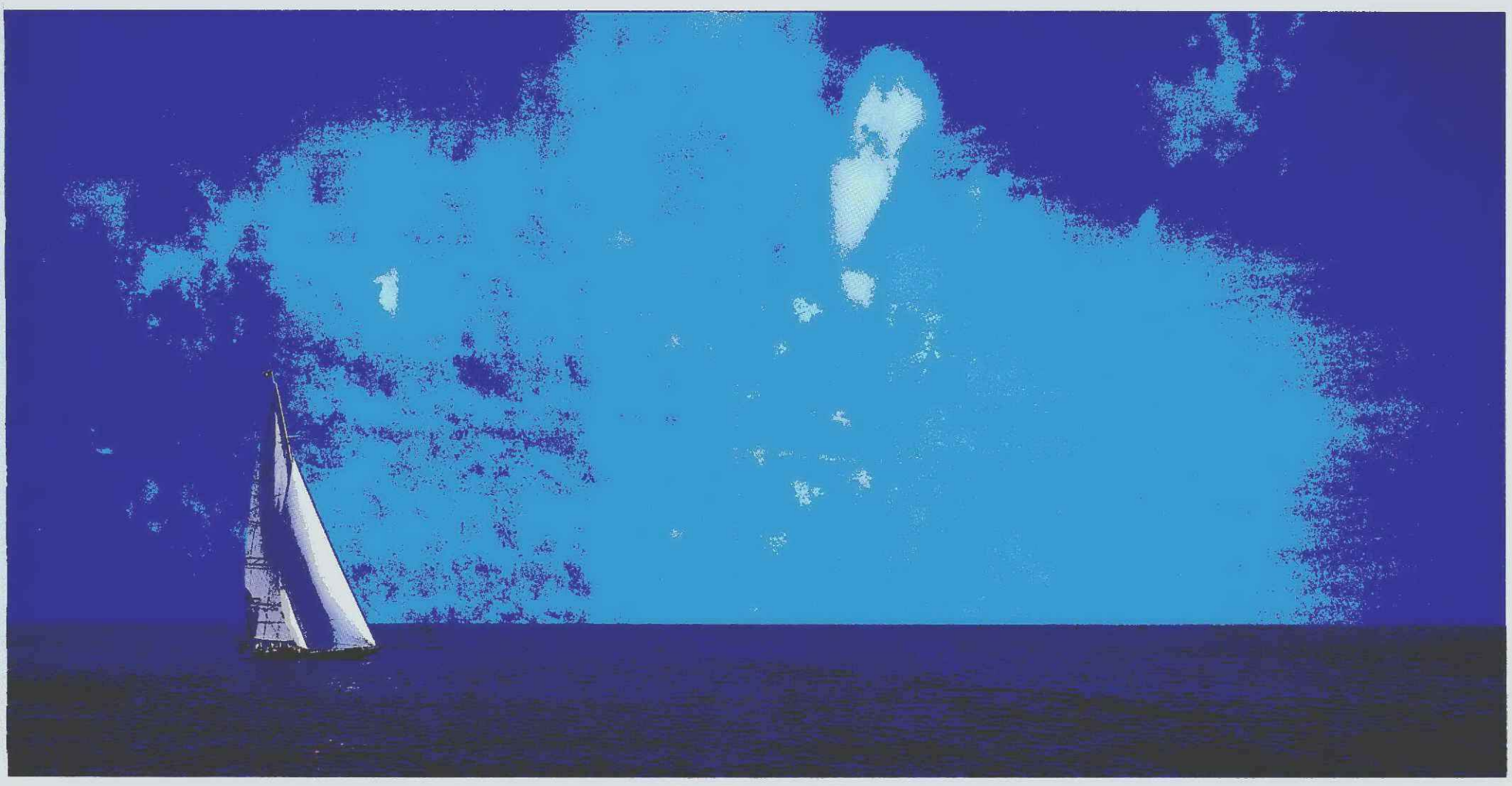
Insurers for Hyatt Corp., facing $3 billion in claims arising from the **collapse of the skywalks at the Kansas City Hyatt Regency hotel**, are suing the insurers of the other defendants.

Northbrook Excess & Surplus Lines Insurance Co., Hyatt's first-layer excess insurer, filed a suit to determine the role of insurers for the hotel's owner, Hallmark Cards Inc., and subsidiary Crown Center Redevelopment Corp.

One of Hallmark's primary insurers, Commercial Union Insurance Co., says it has taken no action because Hyatt's management contract provided that it take responsibility for all liability once it began running the hotel (*BI*, Nov. 23, 1981).

* * *

The **Illinois Insurance Exchange** is off and running. Its three underwriting syndicates have a total of $9 million in initial capitalization (*BI*, Nov. 30, 1981). BI



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A Conversation With:

Theodore Benna

Contrary to myth, says Theodore Benna, Section 401(k) was not buried in the tax code.

The reality, says the managing vp at Noble Lowndes, is that many benefit experts had known about Section 401(k), which permitted so-called cash or deferred pension plan arrangements, since it was added to the tax code in 1978.

"Many people, including myself, knew about it and said, 'Gee, that's nice. But I don't know what will ever be done with it,' " he recalled.

Until one Saturday afternoon in early 1980, neither did Mr. Benna. That was when an idea came to him, as he was working on a project for a client that was considering moving from a cash bonus plan to a deferred profit-sharing plan.

"Clearly, it was not my idea. I'm not that smart. I'm not that inspired. I believe it was revealed to me through prayer," he said.

What was revealed to Mr. Benna was marrying the concept of pretax employee contributions with matching employer contributions—something that wasn't clearly spelled out in the tax code or in regulations.

"My attitude with IRS rules was that if they don't say you can't do something, then you can. We took an aggressive position," he said.

Overcoming considerable skepticism—two major insurers turned him down as a marketing partner—Mr. Benna set up the first 401(k) plan on Jan. 1, 1981, for his own firm, The Johnson Cos. The consultant was acquired by Noble Lowndes in 1990.

After some initial caution, 401(k) plans have taken off like wildfire. Today, more than 90% of companies with at least 1,000 employees have a 401(k) plan, and approximately $250 billion in assets are held by the plans.

* * * *



Photo by David Lubarsky

After your own plan was established, did 401(k) plans catch on right away in the corporate world?

No, it really was a struggle. My senior partner's attitude was if you can do this, why haven't the big benefit consultants already done it?

We decided to market it ourselves after being rebuffed by two major insurers. We also were concerned about the IRS, about what its reaction would be after this hit the marketplace.

In terms of marketing, we had great difficulty getting attention from the press. We really worked hard to get the New York Times and Wall Street Journal interested, and didn't have success initially.

Why didn't your competitors initially push 401(k) plans? Why weren't the biggest names in benefits consulting the first to design these plans?

No one spent time focusing on it.

Could you envision that 401(k) plans would become so popular when you came up with the matching contribution concept?

I expected it because I knew major companies had aftertax thrift and savings plans. I was convinced they would convert those plans to pretax. I was not shocked. I expected major companies to adopt 401(k) plans.

Was the 401(k) plan an immediate hit in 1981, 1982 or 1983?

As newspaper articles appeared on the plans, we got thousands of phone calls. Once financial writers latch on to something, it does not go away. Once one article was published, I got calls from other people who were going to do their own articles on 401(k) plans. In late '81 or early '82, it seemed whatever publication you picked up, there was something on 401(k) plans.

How was the corporate response?

Some of the major companies were willing to take an aggressive position and go ahead with the plans before IRS regulations were out in the fall of 1981. Other companies took a more cautious position. They said, 'Well, what this guy is talking about may be valid, but we really don't want to go ahead until the regs are out.'

Were the regulations a turning point?

Things began to boom before then. But, when the regulations came out in late 1981, it was a day of great relief to me. Until then, there was a question whether salary reduction arrangements were going to be supported.

Were there some big-name companies that led the 401(k) movement—companies that once they set up a 401(k) plan, thousands more would follow?

The two earliest big ones we worked with were J.C. Penney and Bethlehem Steel. At Bethlehem, we were asked, 'What will prevent Congress from shooting this down?' I said the best way of dealing with that was to get as many participants in as short a time as possible. That way if a threat develops, we'll have a participant base to tackle that issue.

As you know, such a threat did come up when the Treasury Department in late 1984 proposed wiping out 401(k) plans. The primary reason for survival was that we and others were instrumental in getting participants to send letters to Congress saying, 'Hey, what are you dummies doing? This is the best thing we have going for us.'

From the perspective of the employer, what has made 401(k) plans so popular?

What drove the plans was interest at the highest levels at major companies. Individuals were contributing $20,000 or more after tax at a 50% effective tax rate. A senior executive certainly had an interest in saving $10,000 or more taxwise by doing pretax what they have done aftertax.

After news articles began to hit, human resource staffers at companies got pressure from upper management asking, 'What are you guys doing about it?'

In addition, for companies without a pension program, it was attractive because it was the only program that may have cost them around 1% of pay and still was reasonably attractive. Financially, it was something employers could do that would be better than nothing.

It is not uncommon for participation rates in 401(k) plans to be 70% or 80% of eligible employees. What made the plan so popular among employees?

It is a combination of the tax savings and the matching contributions. Other factors include professional money management, access to higher rates of returns and the convenience of payroll deductions. Left on our own, most of us will not save the kind of money that can be saved in a 401(k) plan.

The Tax Reform Act of 1986 imposed a lot of new penalties on 401(k) plans. How did tax reform affect the design of plans?

What tax reform did was to make 401(k) plans a broad-based benefits program. The attractiveness to the highest-paid executives is less because of cutbacks in the maximum deferrals that are allowed and reductions in the base tax rates.

Tighter non-discrimination rules in the tax act also made it more difficult for executives in the $50,000 to $70,000 range to make the maximum contributions.

How else did tax reform change 401(k) plans?

More than anything, loan provisions were added as a counter to the tougher withdrawal provisions and the new 10% penalty (on pre-retirement distributions).

How did participation in the plans change after tax reform?

I haven't seen any significant change that could be attributable to tax reform.

Is the market for 401(k) plans glutted?

It certainly has become mature. Most companies with more than 1,000 employees have them. There still, though, is significant growth possibility below that.

If employers could do one thing to convince employees to contribute more to their plans, what would it be?

Educating them about the need to save long-term. The significance of putting in $1,000 now and accumulating interest for 30 and 40 years is just dramatic.

Where will the plans be 25 years from now?

We will see an explosion of investment options. Within the next few years, we will see plans offer a dozen options. It will happen because account balances are becoming pretty large. There will be more and more people with $50,000 and $100,000 account balances.

Assume I have a $100,000 account balance. Suppose I want to diversify. It should not be all in one equity fund. You are going to see firms having three or four equity funds. The other advantage is that it further reduces employer fiduciary liability.

You said before that you knew 401(k) plans would become popular. Did you anticipate just how popular they would become?

Yes. I'm not shocked that they are used as widely as they are today. I'm not saying that in a boastful way. It is an honest answer. I expected they would be very major.

Are we better off with 401(k) plans?

Absolutely. There has been a phenomenal change in this way: When you present retirement programs to employees, you see the under-40 group's eyes glaze over. It is so nebulous and far off.

Definitely, 401(k) plans have changed that because employees have to be involved. Employees have to decide: 'Do I participate? If so, how much do I put in? How will I invest it?'

Clearly, it has had a major impact in terms of bringing employees into that type of decision-making a lot earlier than ever before. I think that is healthy.

What has happened is that we have moved away from the thinking that the government or the employer is going to do it for me. There is no question that there has been a major shift to 'Hey, I have got to take some responsibility for doing something myself.' I don't think that is bad.

What would the pension world be like without 401(k) plans?

The ultimate difference is there would be significantly less dollars saved through the retirement system. The accumulation of savings is exploding. The growth of dollars in these plans will keep growing dramatically. And, the plans are very efficient. By that I mean, the participation cuts across all income. It is a pretty darn effective program for the tax costs involved.

If I were to change anything, it would be to restrict money going out of the system before retirement for other purposes.

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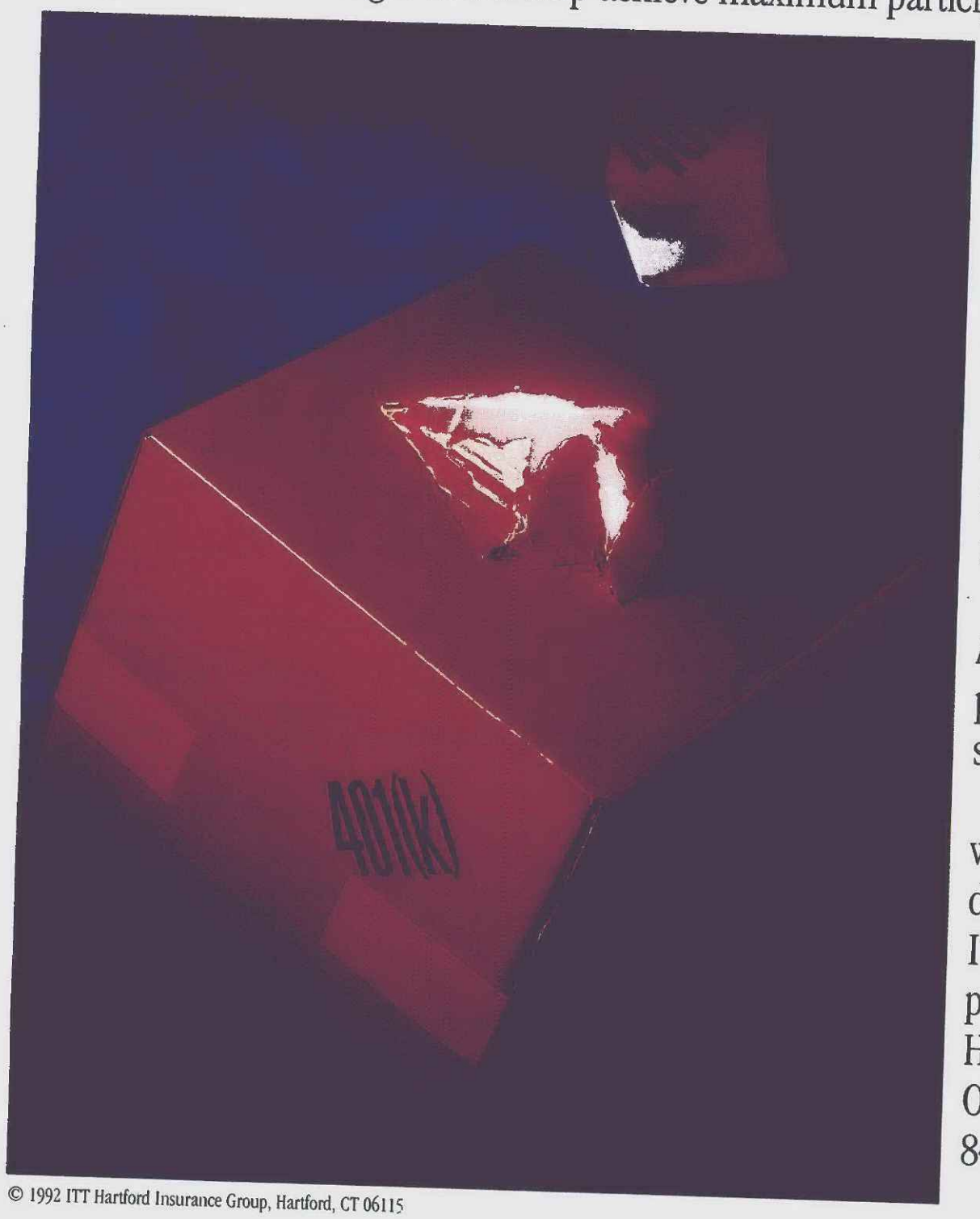
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Looking Back



The Reagan administration plans to make employers pay most of the health care costs of older workers.

The administration is expected to unveil legislation next month that would **shift most medical and hospital costs from the Medicare program** to employer plans for active employees over the age of 65 (*BI*, Jan. 11, 1982).

* * *

The sluggish economy and the rapidly rising cost of health care may cause **the first benefit decreases in recent years**, because employers no longer can pay the tab, experts say.

Recession-battered employers are asking their workers to accept benefit concessions, and experts say that such concessions are likely to be considered at negotiations involving auto, rubber, trucking and other unions this year (*BI*, Jan. 18, 1982).

* * *

Air Florida has up to $500 million in liability coverage for injury and death claims in **the crash last week of a Boeing 737 jetliner into the Potomac River**.

At least 76 people died when the Tampa-bound jet crashed as it took off from Washington's National Airport. The hull loss was valued at $12 million, and sources say liability claims could range from $25 million to $40 million (*BI*, Jan. 18, 1982).

* * *

In at least two states, courts have found unconstitutional parts of **tort reform laws that bar product liability suits** in cases where injuries were caused by old products.

Successful challenges were mounted against tort reforms in North Carolina and Florida (*BI*, Feb. 1, 1982).

* * *

If the World Airways DC-10 that skidded off an icy runway at Boston's Logan Airport Jan. 23 is declared a total loss and insurers pay the agreed value of $48.5 million, it would be **the largest single aircraft hull loss ever**.

The airline has at least $350 million in insurance to cover the liability claims resulting from the accident. Some 194 passengers and 12 crew members survived the crash, and two passengers—a father and son—are missing (*BI*, Feb. 1, 1982).

* * *

Employers could be faced with thousands of dollars in added benefit costs in the wake of a federal court decision mandating equitable **pregnancy benefits for employees' spouses.**

The federal court upheld the Equal Employment Opportunity Commission position that, since employers must provide the same benefits to their pregnant employees as they provide for any other type of disability, employers must extend the same treatment to the pregnant wives of covered employees (*BI*, Feb. 1, 1982).

* * *

A.H. Robins Co. Inc. and Aetna Casualty & Surety Co. are going to court in May to decide how a decade of primary and excess liability insurance should pay for **claims related to the Dalkon Shield** intrauterine contraceptive device, which Robins manufactured.

Robins says Aetna must defend and pay bodily injury and wrongful death claims arising out of use of the IUD during one or several policy periods. But, Aetna says it is not obligated in cases in which a claimant's injury was diagnosed or discovered after the last day of the last policy period.

Aetna provided continuous primary and excess liability coverage to Robins from March 1968 to February 1977 (*BI*, Feb. 22, 1982).

* * *

The U.S. Supreme Court has refused to rehear the ruling of a District of Columbia appeals court in *Keene vs. INA*, which said that all insurers on the risk from the time a worker was exposed until the injury was diagnosed are liable. This has become known as **the triple-trigger theory**.

Other courts have said that liability is triggered by exposure to asbestos, or that it is triggered when the disease is manifested (*BI*, March 15, 1982).

* * *

A new survey says that few employers are implementing higher deductibles as a way of making their employees become wiser consumers of health care.

Fewer than 4% of the 582 major employers surveyed by Hewitt Associates require **annual medical care deductibles** of $150 or more under their group health plans for salaried employees (*BI*, March 22, 1982).

* * *

General Motors Corp. is implementing the first **profit-sharing plan** in its history.

In an attempt to regain profitability, the huge automaker is including the profit-sharing plan as part of a package of benefit and other contract improvements promised to the United Auto Workers union in exchange for wage concessions (*BI*, March 29, 1982).

* * *

A federal court judge in Pennsylvania has become the first judge to uphold a 1980 federal law that gives **multiemployer pension funds** the power to demand enormous payments from employers that withdraw from the funds.

In dismissing a request for a preliminary injunction to bar a Pennsylvania multiemployer fund from demanding more than $850,000 in withdrawal liability payments from Republic Industries Inc., the judge upheld the constitutionality of the Multiemployer Pension Plan Amendments Act (*BI*, April 5, 1982).

* * *

The proposed 131% **Pension Benefit Guaranty Corp. premium increase** to $6 may be the shape of things to come, employee benefit experts say.

The proposed premium hike, which still must be approved by Congress, could be the first of several boosts if large corporations with huge pension liabilities collapse (*BI*, April 19, 1982).

* * *

The U.S. House of Representatives will consider a bill that would allow employers to take **tax deductions for self-insured loss reserves and for premiums paid to captive insurance companies**.

The measure would alter the Internal Revenue Code to allow the deductions and, if it becomes law, it

Continued on next page

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Continued from previous page
could revolutionize the way companies fund risk, according to its backers, a coalition of risk management interests known as the Loss Reserve Deduction Committee (*BI*, April 26, 1982).

* * *

A Nevada judge's stern criticism of **the safety of the Jeep CJ-5** could add ammunition to scores of product liability suits pending nationwide against American Motors Corp.

The judge ruled that the design of the 1975 Jeep was defective and ordered AMC to pay $4.1 million in compensatory and $1 million in punitive damages to a man injured in a Jeep accident (*BI*, May 3, 1982).

* * *

Although the Consumer Price Index shows that inflation is slowing, employers are not seeing any relief from high group health insurance costs. Average increases for **renewals of group medical insurance** in 1982 are as high or higher than the average 30% hikes reported by major health insurers in 1981 (*BI*, May 31, 1982).

* * *

As part of a court agreement, Minnesota Mining & Manufacturing Co. has agreed to set up a $525,000 trust fund to provide back pay to as many as 1,000 female workers who were required to take **unpaid maternity leave** between Aug. 24, 1967, and Dec. 31, 1973.

3M announced the offer as part of a settlement of eight years of litigation between the manufacturer and the Equal Employment Opportunity Commission (*BI*, June 14, 1982).

* * *

The insurance industry would like to introduce **a new comprehensive general liability policy** that would require all risks to be written on a claims-made or a claims-discovered basis with a definite aggregate limit.

The first revision of the CGL since 1973, the proposed form would put some controls on potential long-term losses from still-undiscovered risks. The form, written and released to the industry by the Insurance Services Office Inc., assigns coverage to carefully defined time periods and limits (*BI*, July 12, 1982).

* * *

Congress' drive to trim billions of dollars from the federal budget will cut into the pension benefits received by federal and military retirees. Under an agreement reached between House and Senate committees, **cost-of-living adjustments to federal and military pensions** will be delayed one month during each of the next three years. In addition, pension benefits for retirees under age 62 will only be boosted to reflect one-half of the increase in the Consumer Price Index.

Currently, pension benefits for all federal and military retirees are increased annually to match the CPI (*BI*, Aug. 23, 1982).

* * *

A New York bankruptcy court will establish important precedents in handling mass health injury litigation through reorganization if **Manville Corp.'s Chapter 11 petition** is upheld. Manville follows UNR Industries Inc. in seeking relief under the Federal Bankruptcy Act from its mounting claims related to asbestos injuries and deaths.

Manville currently faces 16,500 asbestos lawsuits and expects an additional 32,000 (*BI*, Sept. 6, 1982).

* * *

In 1982, for the first time since 1977, **no comprehensive product liability tort reform legislation** was passed in any state. And none is likely to be passed the rest of the year.

Part of the reason for the lack of activity is that the insurance market for product liability coverage has eased and business lobbyists are concentrating now on federal legislation (*BI*, Sept. 20, 1982).

* * *

Alexander & Alexander Services Inc. has reversed itself and decided to sue **former directors of Alexander Howden Group P.L.C.** over their alleged misuse of $56 million in funds belonging to Howden, which A&A acquired this year.

A&A had offered to settle the dispute quietly in return for a French villa, several valuable paintings, a Panamanian company and shares of a petroleum company. But, after A&A discovered that the directors had overstated the value of these assets, it canceled the agreement and sued for full recovery of the funds. The former Howden directors being sued include prominent Lloyd's of London underwriter Ian Posgate (*BI*, Sept. 27, 1982).

* * *

The decisions in **lawsuits resulting from the recent Tylenol tragedy** may set liability precedents, legal experts say, especially over the issue of whether Johnson & Johnson is liable for deaths and injuries of people who took the poisoned drug even if the lethal potassium cyanide was added after the product reached retailers' shelves.

Seven people in the Chicago area were killed when they took cyanide-laced capsules of Extra-Strength Tylenol, and officials have few leads in the poisonings (*BI*, Oct. 11, 1982).

* * *

A Missouri Circuit Court judge has said that Hallmark Cards Inc.'s insurer should pay at least one-third of claims arising from **the collapse of skywalks at the Hyatt Regency Hotel in Kansas City**.

In his ruling, the judge rejected arguments by Commercial Union Insurance Co. and broker Marsh & McLennan Cos. Inc. that the CU coverage was excess to coverage held by Hyatt Corp., which operates the hotel. Hallmark owns the hotel through its subsidiary Crown Center Redevelopment Corp.

So far, $32.4 million in claims have been paid in the skywalks collapse, which killed 114 people and injured at least 200 others in July 1981 (*BI*, Oct. 18, 1982).

* * *

Arkansas regulators are becoming increasingly concerned about the **shuffling of assets among Baldwin-United Corp. subsidiaries**, as they investigate the affairs of two Arkansas-based life insurance companies owned by Baldwin-United.

The regulators are attempting to determine what restrictions should apply to the holding of stocks, bonds or paper of an insurer's affiliates as part of its admitted reserves. They also must determine whether such assets should be valued at market or book value (*BI*, Nov. 1, 1982).

* * *

An employer can be sued for **punitive damages for alleged violations of the Employee Retirement Income Security Act** of 1974, a federal judge says.

U.S. District Court Judge Cynthia Holcomb Hall ruled that "allowing punitive damages in appropriate circumstances. . .will further the express policy of ERISA to protect the interests of plan participants and beneficiaries" (*BI*, Nov. 1, 1982).

* * *

The possibility that President Reagan will adopt **a tax on employer-provided health benefits** is worrying many benefit managers.

The Reagan administration has said that taxing health insurance premiums could raise billions of dollars in new revenues to ease swollen federal deficits as well as help curb soaring health care costs (*BI*, Dec. 13, 1982). BI

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40

New Kid on the Block

Managed care is not yet 25 years old, but it has revolutionized the health industry

By Christine Woolsey

DRG, EAP, EPO, HMO, POS, PPO, UR.

Today they buzz around employee benefit managers like a swarm of bees, spelling one thing: managed care.

Twenty-five years ago, though, they were unheard of. At that time, the earliest facilities that would be transformed into a health care cost control measure—health maintenance organizations—were just taking root as a means to deliver care to people living in rural areas.

While the federal government was instrumental in helping managed care programs—especially HMOs—get started, it was Corporate America that played the key role in promoting managed care in the private sector. In fact, many of the offshoots of early managed care plans were created just to meet the specific needs of different companies.

The powerful managed care industry that has emerged over the past two decades has changed the financing and delivery of medical care forever.

A sampling of its growth:

- Twenty-five years ago, there were fewer than 30 health maintenance organizations in the United States. In 1991, more than 38.6 million people were enrolled in 550 HMOs nationwide.
- More than 970 preferred provider organizations, none of which existed a quarter century ago, offer their services to roughly 89 million Americans.
- From its infancy just 10 years ago, utilization review has grown into a multibillion-dollar industry of 300 to 400 firms. Armed with telephones and computer programs, these companies now play a key role in what used to be a private relationship between doctors and patients.

What's behind it all?

"The answer is simple. We have the finest health care system in the world, and it's one that more than 35 million people can't afford," said Dr. David Ottensmeyer, president and chief executive officer of the Lovelace Medical Foundation in Albuquerque, N.M., a research organization that studies environmental health.

Health care consumes an ever-increasing share of the nation's resources: 13.2% of gross domestic product in 1991, compared with 6.3% in 1967.

Looked at another way, health care cost $248 for each American in 1967; by 1991, that figure had soared to $2,868, according to the Health Care Financing Administration.

Managed care programs—particularly utilization review—grew in part because some providers let greed dictate how they practice medicine.

"Managed care developed because of a change in the motivations of physicians," asserted Doug Leland, vp of Berwyn, Pa.-based Intracorp, the nation's largest freestanding utilization review company. "My perception is most doctors before the 1960s were motivated by fulfilling a social need."

For many, the motives changed once they discovered that practicing medicine was so lucrative.

"Medical and surgical residents aren't trained about billing, but when they get out of school they learn quickly," observed Dr. W. Bryan Latham, president of MedFacts, a South Miami-based medical cost management firm. "The emphasis for doctors is on making money, especially in areas of the country where people are wealthy and can afford health care."

That mindset helped create today's health care crisis. After the passage of Medicare and Medicaid, doctors' incomes soared because they were being compensated for care they used to perform for free as charity or not perform at all.

In the early 1980s, when government entitlement programs began to cut back payments to providers, doctors and hospitals responded by increasing their charges for private-sector payers—what's now called cost shifting.

Insurers and employers soon began to feel the pinch, which resulted in the birth of managed care.

Even though the managed care industry mushroomed during the past decade or so, its roots can be traced much farther back.

The idea of HMOs—or prepaid group medical practice—has been around since the early 1900s, but most experts point to the Kaiser-Permanente Medical Care Program as the genesis of today's HMO industry.

During the 1930s, Kaiser operated an internal prepaid group practice. Participating doctors accepted a fixed prepayment for providing medical services to Henry J. Kaiser's steel mill employees in Fontana, Calif., and his shipyard workers in Vancouver, Wash.; Richmond and Long Beach, Calif.; and Portland, Ore.

Cost control was not the goal of the program. Rather it was designed as an industrial medicine program—providing health care for workers who were at a higher

Continued on next page

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A Conversation With:

Dr. Paul Ellwood

Continued from previous page

risk of injury in areas where extensive medical facilities were not available.

When Kaiser opened its prepaid group health plan to the community in 1945, it was widely viewed as an experiment with an uncertain future.

Today, Oakland, Calif.-based Kaiser-Permanente is the world's largest privately sponsored group model HMO, with more than 5.9 million employees and dependents in employer groups enrolled as members.

County medical care foundations in California also served as models for some of today's HMOs. They consisted of loose groups of physicians who wanted to maintain independent fee-for-service practices but also wanted to participate in capitated prepayment programs, like Kaiser's.

One of the first of these plans was the San Joaquin Foundation for Medical Care, founded in 1954. The organization was "the forerunner of the independent practice model HMO and the PPO," said Boyd Thompson, an independent health care consultant in Stockton, Calif, and an executive director of the San Joaquin Foundation from 1954 to 1974.

HMOs today come in many different makes and models, but all basically revolve around the concept of prepaid, rather than fee-for-service, medical care.

The most common types are:

- Group model HMOs, like Kaiser, which contract with physician groups—general practitioners and multispecialty groups—to provide services to HMO members.
- Staff model HMOs, which directly employ physicians.
- Independent practice associations, which are based on the San Joaquin County Medical Foundation. IPAs are groups of physicians who maintain private practices but provide some services to HMO subscribers.

Although these early models of managed care achieved some success in California, the HMO movement did not really get off the ground elsewhere until the early 1970s, a few years after the creation of Medicare and Medicaid.

Managed care mavericks like Dr. Paul Ellwood, now president and chief executive officer of InterStudy, an Excelsior, Minn.-based HMO research firm, began to tout the virtues of prepaid group practice to the federal government as a natural solution to the cost and quality-of-care problems that followed the creation of Medicare and Medicaid.

"By passing Medicare, we suddenly enfranchised a lot of people, and they began using a lot of medical care. So costs went up," said Dr. Paul Gertman, CEO of Clinical Information Advantages Inc., a Waltham, Mass., company that develops software systems for physicians to improve their productivity.

Government officials soon began calling for action.

In January 1968, Rep. Claude Pepper, D-Fla., called the health care system "perhaps America's most poorly organized institution" and urged industry leaders to work with the government to make the system cheaper and more efficient (*BI*, Jan. 1, 1968).

"We have witnessed an unprecedented spurt in hospital daily service charges in the first full year of Medicare and an increase of 16.5% between December 1965 and December 1966," said Rep. Pepper, who sponsored a Medicare-type proposal during World War II.

"Since World War II, all consumer prices have risen 66%, but the index for hospital daily service charges has increased 354%."

Rep. Pepper suggested that a 12-member committee representing both the House and the Senate look into the unusual increases in health care costs and, among other things, investigate whether prepaid group practice plans offered good, affordable care.

"In 1969, Paul Ellwood talked to policy officials about prepaid group practice and how it would improve the quality of health care and place more emphasis on preventive services," recalled Robert Patricelli, president and CEO of mutli-speciality UR firm Value Health Inc. of Avon, Conn.

"In those days, HMO meant Kaiser, basically. There was no suggestion of managed indemnity plans independent of HMOs," noted Mr. Patricelli, a former deputy secretary of health, education and welfare in the Nixon administration.

"I had begun to give up on insurance companies or the private sector (embracing prepaid health care), so my next strategy was to use Medicare to precipitate the use of HMOs," Dr. Ellwood said.

Many of President Nixon's health care analysts and policy officials were from California and were familiar with Kaiser and the concept of prepaid group practice, he said.

A new use of HMOs developed as national health care expenditures, including public and private programs, increased to $74.4 billion in 1970, nearly a 175% increase from $27.1 billion a decade earlier. As a share of GNP, health care expenditures costs had grown to 7.3% from 5.3% in 10 years.

Dr. Ellwood and others now pre-

Continued on next page

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A Conversation With:

Dr. Robert J. Becker

Dr. Robert J. Becker, chairman and co-founder of the Utilization Review Accreditation Commission and founder of one of the country's first managed care firms, became involved in utilization review in the early 1980s when health care costs began to skyrocket.

Dr. Becker, who had spent 26 years in private medical practice specializing in allergy and clinical immunology in Peoria, Ill., tackled UR problems for Medicare, Medicaid and the private sector.

From 1980 to 1982, he was president of the American Assn. of Professional Standards Review Organizations.

In 1982, he founded HealthCare COMPARE, one of the first independent managed care companies in the country. He was president and chairman until 1990, and is still a director and chairman emeritus.

Dr. Becker co-founded the Utilization Review Accreditation Commission in 1989.

In addition, he is co-chairman of the Utilization Review Section of the American Managed Care and Review Assn. And, he established Becker Consulting Corp. in 1991.

Dr. Becker discussed the evolution of utilization review and the challenges it faces with Associate Editor Laura Mazzuca.

* * * *

How and why did you become involved in utilization review?

I became involved because of my activity in medical care as a practicing physician. In the early '70s, there were payers in the community who were complaining about health care expenditures, which went from $26.9 billion in 1960 to $248 billion in 1980.

I also recognized the profound effect on the private sector from cost shifting, particularly in a community with a single employer.

I was concerned that if physicians would not do something about it, somebody else would and the quality of care would suffer.

How has the utilization review industry evolved?

Initially, the important thing was site of service. If you look at health care payments per capita for inpatient vs. outpatient in 1987, inpatient was much larger. As high-tech methods developed and providers adjusted to utilization management, outpatient services increased.

Then the question was asked publicly that had been asked privately for a long time: What's the appropriate treatment? Do you treat a toxic thyroid surgically or medically? How do you treat cardiac disease—with a bypass or with drugs?

Companies like Medical Intelligence and Value Health Sciences have developed appropriateness-of-care criteria, which have been used by UR companies.

UR additionally has addressed the cost of health care in negotiated contracts with providers.

How many UR vendors are there, and how much annual revenue do they generate?

In 1982, there were maybe two companies. Today, there are probably 400 U.R. firms that generate between $2 billion and $5 billion in revenues.

How has the use of UR changed medical practices?

In the early 1980s, there were no such things as monitoring and accountability for providers, so they did what they wanted to do.

As UR developed, accountability became more predominant because of the effect on reimbursement for health care.

When I founded HealthCare COMPARE, it wasn't unusual to have a doctor call and say, 'I would like to have certification for three kids in the Smith family because one has to have a tonsillectomy, and the other two have tonsils. So let's get all three of them done.' Now no physician asks for that, because they know it won't be approved.

When UR first came on the scene, many physicians resisted it. What is their attitude today?

Nothing has changed. Primary care physicians probably spend 5% to 10% of their time in UR—answering the phone and filling out forms.

There are some physicians who have adjusted, but basically they do not like UR. As a matter of fact, if I were still practicing medicine, I don't think I'd like it, either. But I would have recognized the necessity and adjusted to it.

The good physicians have always been thoughtful and careful. Their problem isn't with the decisions made in UR, but with the amount of time and effort they take.

I think physicians have rightfully increased their fees because of these administrative activities. They are justified in being reimbursed for their time and effort.

Over the years, what UR methods have worked best, or worst?

Preadmission certification has worked best. And case management has proved that health care can be more caring, gentle and considerate of the individual by treating him at home or in a place more comfortable than a hospital.

The worst thing about utilization review is not the methods, but some of the players that have been generated. There have been a lot of small, mom-and-pop shops with a nurse, a book and a telephone that have done everyone a disservice—patients, physicians and the UR industry.

Will UR specialization—like drug usage, psychotherapy, etc.—become even more focused in the future?

Areas like child psychiatry and substance abuse lend themselves to UR, because they have no laboratory tests or definitive ways to identify appropriate use.

There are also some transitional areas that may lend themselves to UR. It wouldn't surprise me to see networks of specialists in illnesses like cardiovascular disease, gastrointestinal disease, dermatology, allergy and immunology.

What do you think of the growing trend of lifestyle monitoring?

As far as the government or employers mandating it, I really don't think they will. That's like telling a heavy man, 'You've got to lose weight because I want you to.' He's not going to do it.



Photo by Michael A. Marcotte

There are also legal ramifications. You can't deny somebody care because he doesn't lose weight.

What you can do is reimburse providers for paying attention to lifestyle. That physician is more expensive, but in reality, he is doing a better job. The payers of health care must recognize that careful health care delivery from a disease prevention standpoint is worthwhile and should be reimbursed.

What impact has the Utilization Review Accreditation Commission had on the industry?

I think it's playing a major role. If we are asking for provider accountability, then we should be accountable.

URAC, which was established about 2½ years ago and has been in operation for about 15 months, established national standards that are really pertinent to how UR should be done.

There are probably close to 40 UR vendors that have already been accredited. Probably another 150 to 200 have asked for applications, and 30 or 40 have applications pending.

So it's been a slow, gradual process. But as more states mandate UR accreditation, this will escalate that activity.

Will the increase in self-monitoring by employers and doctors mean a drastic change in the UR industry?

In the late '70s and early '80s, self-monitoring was called "delegated review," where hospitals did their own review for Medicare and Medicaid, and it wasn't very effective.

I think that self-monitoring as it relates to health and medical care results is the perpetuation of bad habits. If there are bad practice habits in the community, self-monitoring will only crystallize them. Self-monitoring by hospitals and physicians is not going to occur. And if it does, it will only occur after the physicians practice good medicine which has resulted in computer practice profiles. We haven't reached that point of sophistication yet, but when we do, self-monitoring may be appropriate.

How will physicians' growing use of software with practice parameters change UR?

Medical Intelligence Co., Value Health Sciences and practice parameters being developed by the American Medical Assn. in conjunction with Rand Corp. all are very important in identifying the appropriateness of health care.

Those practice parameters initially are going to be too loose. But as they're used by UR companies, I think the pendulum is going to swing in the opposite direction and some parameters may become too tight. Eventually there will be a swing back to the middle, and parameters will pay attention to both the agendas of the physicians and efficiency in care.

In eight to 10 years, when they have reached their appropriate level, there will be significantly less UR.

But UR firms will be involved in developing those parameters, so UR activities will be much more pervasive in years to come.

Would a national health care policy threaten the UR industry?

I don't think there's any question that there is going to be major health care legislation in 1993.

But this country is not a Sweden, Germany or Canada. We have a wide diversity of populations, communities, health care resources and providers. We also have health care problems that none of the other countries have to the extent we do, like an aging Medicare population, violence, the AIDS problem and poverty.

Because of all this, it's going to be mighty difficult to develop a unified system without some monitoring of what's being done.

I don't think the government has the ability to monitor and do all the things necessary. They're going to need some assistance, so some variation of the UR industry is going to be necessary. And if the UR industry is smart, it will adapt to provide the appropriate services to the federal or state government.

Some employers are still uncertain about the success of UR. How do you address these critics?

UR has been a lifestyle trend. You have to look at the whole industry to see what's happened over the past 15 years and continues to happen.

In 1982, there were over 800 days of hospitalization per thousand population. There is now somewhere between 500 and 600 days per thousand, and that figure is dropping. I don't think UR can take sole credit for this, but it has been one of the major forces.

HealthCare COMPARE's first clients saved a lot of dollars, because they went from tremendous overutilization to normal utilization. When you're going from 1,000 days per thousand to 700, you're saving a lot. When you bring this down to 600 days per thousand, you're saving money but not as much. And, it's harder—it takes more work.

What future trends do you see for the UR industry?

I see utilization review activity becoming even more the norm in the practice and delivery of care. The mainstream will pretty much be HMO-type, managed care organizations, with access to care and limitations to the benefits.

There won't be the extended benefits there are now. There will probably be less of the very sophisticated scientific procedures. Instead of going from X-ray to CAT scan, ultrasound to MRI, they'll go right to the MRI, which will be more efficient and won't deny the diagnostic procedure, but will eliminate unneeded procedures.

Eventually, exclusive provider organizations are going to be able to predict health care costs. When they can do this, they may charge health care costs on a capitated basis. Then you'll get the managed care system of 1995 and 2000, which will have the kind of firm, yet scientifically significant utilization management that will pay attention to volume and care. BI

NATIONAL ASSOCIATION OF UTILIZATION MANAGEMENT NAPUM

and discounts."

At the same time, the pressure on companies began to mount.

Before the 1980s, "businesses like IBM, Boeing and Caterpillar could just increase the cost of their products to offset increases in health care costs," noted Dr. Robert Hertenstein, medical director-group insurance for Caterpillar

ble of getting around. True UR has never been able to save more than 2% to 3%" of medical costs.

"Remove your utilization controls and see what happens to costs," responded Charles Jacobs, president and CEO of Interqual, a cost containment firm in Marlboro, Mass. "That's what I'd say to critics." BI

Whaddya Know?

How well do you remember the big—and small—events of the past 25 years?

To test your knowledge, we have assembled two short tests—one for risk management specialists and one for employee benefit specialists. The answers can be found throughout the stories in this issue. If you're really stumped, you can check out page 151—but no cheating, please.

If you answer all 20 questions correctly, you are risk manager/benefit manager of the year material. Seventeen to 20 puts you ahead of the pack; 13-16 is fair; and 10-12 indicates that you should be reading *BI* a little more closely each week. Fewer than 10 correct? Find a new job.

Employee Benefits

1. **Which two senators are considered the founding fathers of the Employee Retirement Income Security Act?**
   a. Mike Mansfield and Charles Percy
   b. Jacob Javits and Harrison Williams
   c. Edward Kennedy and Everett Dirksen
   d. Albert Gore and Russell Long

2. **Which benefit consultant does not belong with the others?**
   a. A.S. Hansen Inc.
   b. Hewitt Associates
   c. William M. Mercer Inc.
   d. Meidinger Inc.

3. **What was the initial per-employee premium charged by the Pension Benefit Guaranty Corp.?**
   a. $1
   b. $2.60
   c. $5.50
   d. $8.50

4. **Which president signed the Employee Retirement Income Security Act into law?**
   a. Lyndon Johnson
   b. Richard Nixon
   c. Jimmy Carter
   d. None of the above

5. **What year was Section 401(k) added to the Internal Revenue Code?**
   a. 1976
   b. 1978
   c. 1980
   d. 1982

6. **One of the goals of the Retirement Equity Act of 1984 was to:**
   a. Raise the mandatory retirement age.
   b. Limit 401(k) contributions.
   c. Expand women's pension rights.
   d. Reform pension discrimination laws.

7. **When did Medicare authorize the use of diagnosis-related groups—or DRGs—for hospital payments?**
   a. 1978
   b. 1983
   c. 1986
   d. 1990

8. **In 1984, the use-it-or-lose-it rule made headlines. What benefit did this IRS rule affect?**
   a. 401(k) plans
   b. Flexible spending accounts
   c. Profit-sharing plans
   d. Long-term care plans

9. **A VEBA is essentially the same thing as a:**
   a. 501(c)(9) trust
   b. 401(k) plan
   c. Minimum premium plan
   d. Flexible spending account

10. **Which company adopted the first cash balance pension plan?**
    a. Citicorp
    b. Wells Fargo Bank
    c. Chase Manhattan Corp.
    d. BankAmerica Corp.

11. **What year was the HMO Act passed?**
    a. 1970
    b. 1973
    c. 1976
    d. 1979

12. **A blue-ribbon commission on health care reform released a controversial report in 1990. After what congressman was the commission named?**

13. **Which employers are not covered by ERISA?**
    a. Employers with fewer than 25 employees
    b. Employers with fewer than 100 employees
    c. Public employers
    d. Railroads

14. **Name the person who has not been executive director of the PBGC.**
    a. James Lockhart
    b. Kathleen Utgoff
    c. David Ball
    d. Edwin Jones

15. **When did Congress repeal Section 89?**
    a. 1985
    b. 1987
    c. 1989
    d. None of the above

16. **How many HMOs are operating in the United States?**
    a. 220
    b. 550
    c. 800
    d. 1,000

17. **Defensive medicine is:**
    a. Medications designed to prevent illness
    b. Ordering excessive tests to minimize malpractice risks
    c. Medical care for hypochondriacs
    d. Health care for the military

18. **What year were the COBRA health care continuation provisions passed by Congress?**
    a. 1979
    b. 1983
    c. 1986
    d. 1985

19. **The average lifetime AIDS health care claim costs:**
    a. Less than $30,000
    b. About $70,000
    c. About $125,000
    d. More than $200,000

20. **Under Allied-Signal Inc.'s national managed care plan:**
    a. CIGNA Corp. promised to keep its administrative fee under 10%
    b. CIGNA developed a nationwide network of HMOs exclusively for Allied-Signal
    c. Allied-Signal employees must go to CIGNA HMO doctors to receive benefits
    d. CIGNA guaranteed that Allied-Signal's health care costs would not rise more than a specified percentage over three years

Risk Management

1. **A group of London brokerage executives were dubbed the "Gang of Four." Who were they and what were they famous for?**

2. **The triple-trigger theory of how coverage should apply to asbestos injuries was first adopted in what 1981 ruling?**
   a. *INA vs. 48 Insulations*
   b. *Keene vs. INA*
   c. *Beshada vs. Johns-Manville*
   d. *In re Asbestos Insurance Coverage Cases*

3. **What year did the American Society of Insurance Management become the Risk & Insurance Management Society Inc.?**
   a. 1969
   b. 1972
   c. 1975
   d. 1978

4. **Match the insurance commissioner with the state.**

a. Al Lewis	1. Illinois
b. Bill Gunter	2. California
c. Bruce Bunner	3. New York
d. John Washburn	4. Florida

5. **How many risk managers were named to President Nixon's National Commission on State Workmen's Compensation Laws in 1971?**

6. **Which food products company waged a celebrated battle against the IRS beginning in 1976 over deductions for premiums paid to its captive?**
   a. Pet Foods
   b. Borden Inc.
   c. Carnation Co.
   d. Kraft Co.

7. **In 1976, the federal insurance administrator warned insurers not to increase rates excessively. Who issued that warning?**
   a. Earl Pomeroy
   b. J. Robert Hunter
   c. B.P. Russell
   d. John Bogardus

8. **Which offshore facility was established first?**
   a. ACE Insurance Co. Ltd.
   b. X.L. Insurance Co. Ltd.
   c. Oil Insurance Ltd.
   d. Corporate Officers & Directors Assurance Holding Ltd.

9. **Which of the following brokerages was not acquired by Alexander & Alexander?**
   a. Alexander Howden Group
   b. The Crump Cos.
   c. Reed Stenhouse
   d. R.B. Jones Corp.

10. **MGM Grand Hotels purchased back-dated liability coverage following the 1980 fire at its Las Vegas hotel. What broker placed the coverage?**
    a. Marsh & McLennan
    b. Fred S. James
    c. Frank B. Hall
    d. Arthur J. Gallagher

11. **In what year were U.S. citizens first allowed to become members of Lloyd's of London?**
    a. 1967
    b. 1969
    c. 1971
    d. 1973

12. **Which state enacted a pioneer wage-loss workers compensation law in 1979?**
    a. Minnesota
    b. Florida
    c. New York
    d. California

13. **Which of these men has not served as chairman of Lloyd's?**
    a. Peter Green
    b. Peter Miller
    c. Robin Jackson
    d. Ralph Hiscox

14. **Which one of these parent/captive combinations is incorrect?**
    a. Gulf Oil-Insco
    b. Texaco-Heddington
    c. Phillips Petroleum-Walton
    d. Exxon-Erieview

15. **Which two insurers merged in 1981 to form CIGNA Corp.?**

16. **Manville Corp. was the second asbestos producer to seek bankruptcy protection from asbestos injury claims. What was the first?**
    a. Owens-Illinois Inc.
    b. 48 Insulations Inc.
    c. UNR Industries Inc.
    d. Raybestos Corp.

17. **Which one of these risk managers was not elected president of RIMS?**
    a. Richard Heydinger
    b. William Mather
    c. Thomas Hallett
    d. Arthur Bostwick

18. **The New York Insurance Exchange and the Insurance Exchange of the Americas wrote their last policies in the same year. What year?**
    a. 1986
    b. 1987
    c. 1988
    d. 1989

19. **Which consumer group spearheaded the drive that resulted in the approval of Proposition 103?**
    a. Public Citizen
    b. Consumer Union
    c. Citizen Action
    d. Voter Revolt

20. **The Wellington agreement, which led to the creation of the Asbestos Claims Facility, was named after Harry Wellington. Who was he?**
    a. Executive vp of Aetna Life & Casualty
    b. Dean of Yale Law School
    c. Chairman of Manville Corp.
    d. A prominent plaintiffs' attorney

Looking Back



Tylenol maker McNeilab Inc. is suing its insurers to recover at least $110 million in expenses related to **taking Extra-Strength Tylenol off the market**.

Eight excess and umbrella liability insurers and one all-risk property insurer are named as defendants (*BI*, Jan. 10, 1983).

* * *

Congress is considering generating new revenue by making employer contributions to **employee benefit plans taxable income** for employees and ending some of the tax advantages of 401(k) salary deferral plans (*BI*, Jan. 10, 1983).

* * *

Liability costs will total about $100 million in the **collapse of skywalks at the Hyatt Regency Hotel** in Kansas City, Mo.

This is the amount of state and federal out-of-court class settlements reached among Hyatt Corp., Hallmark Cards Inc. and plaintiffs in the disaster, which killed 114 people and injured at least 200 others. Hyatt managed the hotel and Hallmark owned it (*BI*, Jan. 17, 1983).

* * *

Associated International Insurance Co. of Los Angeles, which fully insured **American Benefits Ltd.** between May and July of 1982, says it will pay claims that were incurred during that period.

But coverage for the rest of the estimated 70,000 people for whom the multiemployer trust provided health insurance is in doubt (*BI*, Feb. 14, 1983).

* * *

The Communications Workers of America has asked a federal court handling the breakup up of American Telephone & Telegraph Co. to stop the proposed divvying up some of the assets of the **two giant AT&T pension plans** among the seven new Baby Bells to be formed next year.

These companies would then set up their own pension plans. Most AT&T workers subsequently would not be able to carry their pension credits with them if they moved from one regional company to another (*BI*, Feb. 21, 1983).

* * *

MGM Grand Hotels is suing its broker, Frank B. Hall & Co. Inc., and 21 insurers to force payment on the first $95 million of $170 million in **back-dated liability insurance** on the 1980 fatal fire at the MGM Grand Hotel in Las Vegas (*BI*, March 21, 1983).

* * *

Legislation approved last month by Congress to raise $165 billion in new revenues to bail out the Social Security system will raise **employers' Social Security payroll taxes** to 7% on Jan. 1, 1984, from the current 6.7% (*BI*, April 4, 1983).

* * *

The **Insurance Exchange of the Americas** in Miami is now open and writing coverage (*BI*, April 11, 1983).

* * *

The Equal Employment Opportunity Commission has agreed to draft new regulations that will require employers to offer workers aged 65 to 69 a choice of enrolling in a **group health plan or choosing Medicare as their primary insurer**. (*BI*, April 18, 1983).

* * *

The Caribbean island of **Barbados is the newest domicile for captive insurers.**

The Barbados Exempt Insurance Act of 1983, passed less than three months ago, creates tax-exempt status for foreign insurers (*BI*, May 9, 1983).

* * *

Employers would face huge cost increases if legislation is enacted **barring sex-based insurance premiums**.

Two bills now before Congress would retroactively eliminate the use of gender as an insurance rating factor. Either one would push costs up, insurers and employers say (*BI*, May 18, 1983).

* * *

Continued on page 119

Evaluating the health coverage needs of a whole company takes great skill. Not only do you have to know what to look for, you have to know what the impact will be.

Offering a choice of programs makes the task even more baffling. Keeping employees happy with the quality of care, and management happy with the cost, is a puzzle that can be very difficult to solve.

You need more than just an insurance company. You need a partner. One who can give you the information you need when you need it, in a form you can understand. With our integrated processing system, we have the capability to review your employees' claim status quickly and accurately. And because on the average, we process claims within five days, employees won't have to rely on their superior powers of deduction to know where they stand.

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Continued from previous page

A national homebuilders group is fighting Delaware's insurance commissioner over the right to operate a risk retention group.

The **Home Owners Warranty Corp.** is asking the regulator to rule that its captive, HOW Insurance Co., is a bona fide risk retention group under the 1981 federal law (*BI,* May 30, 1983).

* * *

Gulf Oil Corp.'s Bermuda captive, **Insco Ltd.**, is no longer underwriting marine insurance for unrelated parties or reinsurance for Gulf-related marine and property risks. Insco directors voted to close Insco's marine insurance underwriting operations immediately (*BI,* June 6, 1983).

* * *

The broker and insurer involved in coverage for the **1980 MGM Grand Hotel fire** are asking a court to void part of the company's once-touted retroactive coverage.

Frank B. Hall & Co. Inc. and its Union International Insurance Co. unit are asking a Nevada court to void the first $35 million of the coverage Hall arranged after the fatal blaze. They charge that the hotel breached its agreements with them in its settlements with victims (*BI,* June 13, 1983).

* * *

Dow Chemical Co. says that bad publicity, legal expenses and rising insurance premiums have forced it to stop producing **Bendectin**, an anti-nausea drug prescribed for pregnant women.

People who attribute their birth defects to their mothers' use of the drug say Dow is simply trying to limit its liability (*BI,* June 20, 1983).

* * *

The Supreme Court has ruled that employer health plans cannot offer better **maternity benefits** to female employees than to wives of male employees covered under the plans.

The decision is expected to raise annual health care costs by 5% to 7% for employers that do not currently offer equitable benefits (*BI,* June 27, 1983).

* * *

The Supreme Court ruled last week that an employee's **sex no longer can be a factor in calculating retirement benefits** (*BI,* July 11, 1983).

* * *

Sen. Edward M. Kennedy, D-Mass., is planning to introduce a bill under which employees would be **fully vested in a pension plan after only five years of service** (*BI,* Aug. 22, 1983).

* * *

Although it has been more than four years since the revolutionary government took control, few U.S. businesses have received payment for their **expropriated Iranian property and assets**.

An international tribunal set up as part of the deal that freed 52 American hostages in January 1981 so far has authorized awards of more than $78.1 million to corporations and individuals seeking to recover property lost in the revolution. Some $4 billion in total claims are pending (*BI,* Sept. 5, 1983).

* * *

Although Korean Air Lines and its insurers are liable for claims from survivors of the **KAL jet shot down by the Soviets**, uncertainty about why the plane wandered into Soviet air space is bringing other defendants into the picture.

One suit names as defendants Boeing Co., which made the ill-fated jet; Litton Industries, which made the plane's inertial navigational system; and the estates of three KAL crew members who also died in the crash (*BI,* Sept. 12, 1983).

* * *

Two **victories for self-insurers** were chalked up recently in Delaware and San Francisco.

In Delaware, state regulators are losing their battle to restrict the risks that can be covered by product liability risk retention groups.

In San Francisco, a U.S. Circuit Court of Appeals said employers self-funding their workers compensation risks in nine Western states can take tax deductions for reserves to pay uncontested work comp claims (*BI,* Oct. 17, 1983).

* * *

Standard & Poor's Corp. now is rating insurers' claims-paying abilities, giving risk managers an alternative to A.M. Best Co. for information about the financial health of insurers (*BI,* Oct. 24, 1983).

* * *

More than 130 U.S. industrial companies are pressing a lawsuit in an attempt to have **owners, operators and insurers of hazardous waste sites**, rather than site customers, pay for government-ordered cleanup of the dump sites.

Major corporations, including Union Carbide Corp. and Ford Motor Co., are pressing the suit against the owners, operators and insurers of a waste site in Indiana (*BI,* Nov. 14, 1983).

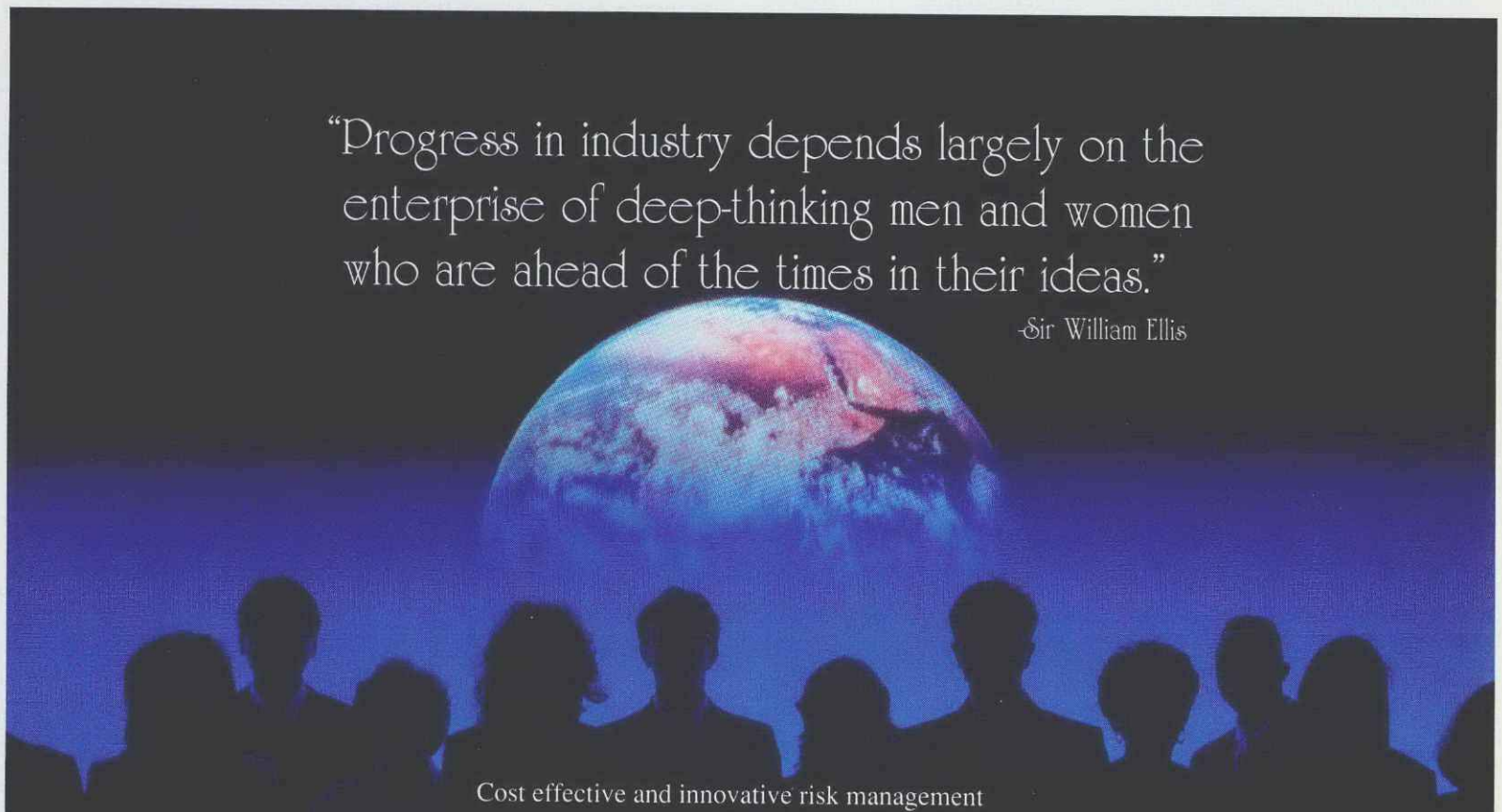
* * *

The **Factory Mutual System** is abandoning its 140-year-old premium deposit plan, which required buyers to pay up to five times their annual premium cost in advance for a three-year policy.

Instead, the Factory Mutual insurers, which specialize in highly protected risks, will allow policyholders to pay annual premiums based on standard rates and receive a 15% annual dividend (*BI,* Dec. 19, 1983).

* * *

The termination of two defined benefit pension plans at Mesta Machine Co. in Pittsburgh, which has filed for Chapter 11 reorganization, could result in a $56.1 million claim against the Pension Benefit Guaranty Corp., the **largest claim in the PBGC's history** (*BI,* Dec. 26, 1983). BI



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UNITED STATES

ALABAMA
McGriff, Seibels & Williams, Inc.
Thames Batre' Mattei Beville & Ison

ARIZONA
The Mahoney Group

CALIFORNIA
Barney & Barney
Bolton and Company
Woodruff-Sawyer & Co.

COLORADO
Van Gilder Insurance Corporation

CONNECTICUT
Arthur A. Watson & Co., Inc.

FLORIDA
J. Rolfe Davis Insurance Agency, Inc.
Seitlin & Company

GEORGIA
Hamilton Dorsey Alston Company
Palmer & Cay/Carswell, Inc.

HAWAII
American Mutual Underwriters, Ltd.

ILLINOIS
Mack and Parker, Inc.

INDIANA
Insurance & Risk Management

IOWA
Cottingham & Butler, Inc.
La Mair-Mulock-Condon Co.

KANSAS
Insurance Management Assoc., Inc.

KENTUCKY
Powell-Walton-Milward, Inc.

LOUISIANA
Gillis, Ellis & Baker, Inc.

MAINE
Morse, Payson & Noyes Insurance

MARYLAND
Early, Cassidy & Schilling, Inc.
Riggs, Counselman, Michaels & Downes, Inc.

MASSACHUSETTS
Fred C. Church, Inc.

MICHIGAN
General Underwriters, Inc.

MINNESOTA
Brandow Howard Kohler & Rosenbloom, Inc.

MISSISSIPPI
Fox-Everett, Inc.

MISSOURI
The Daniel and Henry Co.
Gilbert-Magill Company

NEBRASKA
The Harry A. Koch Co.

NEW JERSEY
National Insurance Associates

NEW MEXICO
Bundy, Seligman & Thomas

NEW YORK
Adams & Porter Inc.
Hatch-Leonard/Markin-Shaw, Inc.

NORTH CAROLINA
Cameron M. Harris & Company

OHIO
The McElroy-Minister Company
The James B. Oswald Company
Picton-Cavanaugh, Inc.
Schiff, Kreidler-Shell, Inc.

OKLAHOMA
North American Insurance Agency

OREGAN
Jewett, Barton, Leavy & Kern, Inc.

PENNSYLVANIA
Clair Odell Group
Engle-Hambright & Davies, Inc.
The HDH Group, Inc.

RHODE ISLAND
Starkweather & Shepley, Inc.

SOUTH CAROLINA
Boyle-Vaughan Associates, Inc.

TENNESSEE
Treadwell & Harry Insurance Agency

TEXAS
Roach Howard Smith & Hunter
John L. Wortham & Son

UTAH
Fred A. Moreton & Company

VERMONT
Kinney, Pike, Bell & Conner, Inc.

VIRGINIA
DeJarnette & Paul, Inc.
Henderson & Phillips, Inc.

WASHINGTON
Parker, Smith & Feek, Inc.

WISCONSIN
Laub Group Inc.

CANADA

ALBERTA
Harding Hall & Graburne Insurance Inc.

MANITOBA
Ryan Gateway Insurance Brokers, Inc.

NEW BRUNSWICK
Wilson Insurance Ltd.

NEWFOUNDLAND
Anthony Insurance Inc.

NOVA SCOTIA
Fraser & Hoyt Insurance Ltd.

ONTARIO
Tower-Chisholm Ferguson Limited

QUEBEC
P. Brunet Assurance Inc.

SASKATCHEWAN
Cherry Insurance Ltd.

INTERNATIONAL

BRUSSELS, BELGIUM
Menage & Jowa S.A.

SAO PAULO, BRAZIL
Adams & Porter Ltda.

LONDON, ENGLAND
Robert Fleming Insurance Brokers Limited

DUBLIN, IRELAND
Coyle Hamilton Limited

AMERSFOORT, NETHERLANDS
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A Conversation With:

G. Robert O'Brien

G. Robert O'Brien, executive vp of CIGNA Corp. and president of its Employee Benefits and Health Care Group in Bloomfield, Conn., is one of the health insurance industry's leading proponents of managed health care.

As chairman of the Healthcare Leadership Council, a group of health care industry chief executive officers committed to reforming the U.S. health care system, Mr. O'Brien and his colleagues are vigorously advocating that the public and private sectors pool resources in order to improve access to health care and reduce rising costs.

Under Mr. O'Brien's guidance, CIGNA in 1990 acquired EQUICOR Inc., then one of the nation's leading providers of managed care services. Mr. O'Brien was also instrumental in coordinating the 1988 landmark managed health care risk sharing agreement between Allied-Signal Inc. and CIGNA.

Mr. O'Brien discussed the state of the health care system with Associate Editor Michael Schachner.

* * * *

Is the current health care delivery system satisfactory?

Absolutely not. Maybe it was adequate in the past, but over the last 10 or 15 years it has become less adequate because we're not reaching all Americans and care has become very expensive.

What should be done to guarantee basic health insurance to the approximately 37 million uninsured people in the United States today?

This group is made up of three separate segments: the unemployed poor, the employed poor, and the employed.

The federal government should be responsible for the first group. The middle group should be covered by a partnership between the public and private sectors. And, the third group is the responsibility of the private sector. Insurance carriers have to begin accepting all employers without underwriting individuals out of the program.

What responsibility should the health insurance industry bear for rising health care costs?

We are probably guilty of being too selective in our cost control efforts. I think we have focused too much on bits and pieces and lost sight of the big picture.

For example, when we began focusing on controlling inpatient costs, we lost touch with outpatient services and those costs went through the roof. We were naive to think that controlling a few things would lead to controlling overall costs. This just hasn't happened.

What can be done now to lower health care costs?

From a cost standpoint, the only option we really have is managed care. It has proven itself to be more cost-effective than indemnity programs, so by implementing managed care countrywide we can retard the escalating costs we're still seeing.

Is managed care here to stay?

Definitely. If you apply a broad definition of managed care, every single request we receive today for a quote on new business includes something in regard to what we can do with managed care. That doesn't mean everyone is buying it, but everyone is sensitized to the fact that they ought to understand what it means.

What do you tell employers when they ask you, 'What will managed care do for us?'

I say that it will assure quality of care and it will save money. And, we can demonstrate how much it will save because we have enough experience dealing with it.

Is managed care in reality a euphemism for denying services?

'In no way is managed care equivalent to denying care. If it was, my whole family wouldn't be in it.'

Absolutely not. Managed care companies like CIGNA, Metropolitan Life and Prudential are not telling physicians not to provide good care. What we're saying to doctors is that if in their medical opinion they feel a person needs a specific service, then perform it. In no way is managed care equivalent to denying care. If it was, my whole family wouldn't be in it.

Is it inevitable that the federal government will take over the nation's health care system?

No, and there are a variety of reasons why the federal government won't take over health insurance. The biggest reason why is cost. It would cost billions of dollars on an annual basis.

Second, can you imagine how many people they'd have to hire, educate, train and organize over a short period of time to deliver the type of care people have grown accustomed to? I think federal intervention is totally impractical.

If a federal takeover of the health insurance system were to happen, what would it mean to the average American?

It would mean several things including lousy service, long queues for various services, prices would get out of control because there would be no competitive pressures to keep costs down and quality would be less than what people expect today.

If the government did get involved in health care, would there be any role left for the insurance industry?

I think there would still be a role for the private sector in some form. It would probably be similar to the way Medicare is handled now, where we're the third party that pays the claims.

Does the 'play or pay' concept now supported by a number of prominent lawmakers have a future?

I hope not. Play or pay is the first step toward a universal federal system, which I have already said wouldn't work.

With play or pay, you'd have the low-cost employers enrolling themselves in the private sector, while those with high costs would go straight to a public health care program, which would just add costs to the public portion of the plan. Just like a total federal takeover, play or pay is badly flawed.

Why is there such a push for the government to take action with regard to health care?

Things are much different today than they were a decade ago. There has been a lot of restructuring in Corporate America, which has left many middle-income and white-collar people without access to health care. These are the individuals that contribute to political campaigns and also write letters to Congress. As a result, the level of awareness has been raised several notches from where it was 10 years ago.



Photo by Frank Marchese

Where does the most fat exist in the health care system?

I firmly believe it's in the number of hospital beds. There are many communities that cannot support the number of hospitals they have, but you never see a board of directors putting a hospital out of business.

I'd say at least 20% of the beds in existence are in excess of what we need. That adds up to hundreds of thousands of beds nationwide. This, combined with too many medical procedures being performed, is what continues to drive costs up. Take a drive across the country and look in the local newspapers and you'll see all sorts of advertisements for clinics and hospitals. The reason why is that they have beds to fill.

What is the best way to get a grip on skyrocketing mental health and substance abuse treatment costs?

Costs related to behavioral health now account for about 20% of overall health care costs in a normal fee-for-service setting. But, if we were to manage this facet of health care the way we're starting to manage basic medical costs, we could greatly reduce behavioral health care costs. And, we'd still achieve quality care, because the providers would have credentials.

Will there ever be truly vertical health care, where one entity like CIGNA owns a hospital, employs the physicians and controls all the other elements of the delivery system?

No, I don't think so, though staff model HMOs are close to that now.

Why I say no is that we can already contract with physicians and hospitals to provide the services we need, so there's really no need for us to own the entire system. And, I think people receive better medical care when there is competition among providers.

What will the commercial health insurance industry look like five to 10 years from now?

The traditional indemnity programs of yesteryear are a thing of the past. So, any viable company in the future will have to be heavily into managed care. It's a direction we're going now. Any company that has a 100% indemnity focus will have a very hard time surviving.

What will managed care look like five to 10 years from now?

I expect to see more physician group practices as doctors find the need for more supportive consulting skills. This will force carriers like ourselves to contract with more groups as opposed to individuals.

What this will add up to is better quality of care and lower costs.

If you had the power, what would you do to change the health care system?

The health care system in the United States is so large and complex that no one individual has all the right answers. But if I could, recognizing that in our culture people want the best medical care possible when they need it, I would attempt to create a partnership between the public and private sectors where the public ensures access for the poor and near poor and private industry meets the needs of those who are employed. BI

From Deliverymen to Problem-Solvers

No longer mere producers, brokers stress sophisticated service over sales

By Douglas McLeod

In 1967, the Dow Jones Industrial average hit 943, the national debt stood at about $300 billion and the largest U.S. insurance broker pulled in $91.8 million in revenues.

Times have changed.

U.S. corporations and their risks have become larger and more complex. Brokers have responded accordingly, expanding globally and developing an array of sophisticated risk and benefit management services.

In addition, the last 25 years have brought a tremendous wave of broker consolidation. Large brokerages have acquired scores of smaller U.S. rivals, merged with one another and combined with counterparts in Europe.

As their clients sought alternatives to traditional insurance, brokers increasingly have become consultants. Brokers used to earn their keep placing insurance; now much of it comes from providing self-insurance and captive management, loss control, claims management, benefit cost containment and other services.

Brokers also face problems today that either didn't exist a quarter century ago or were far less urgent:

- An erosion of the bonds of "utmost good faith" that cemented the industry before it was shaken by litigation and financial scandals in the 1980s.
- The huge impact of long-tail liability claims.
- Rising concern over insurer security in the wake of multibillion-dollar failures.
- The question of whether the federal government should regulate commercial insurance.

"It's amazing what's changed in 25 years. It's sobering," observed Tinsley H. Irvin, chairman of Alexander & Alexander Services Inc. in New York.

"Twenty-five years—that's 10 eternities ago," said Robert E. Gallagher, chairman and chief executive officer of Arthur J. Gallagher & Co. in Itasca, Ill.

"The whole business has been restructured and it's going through restructuring today," noted Richard Miller, the Nashville-based CEO of Willis Corroon Group P.L.C.

A look at the list of the largest U.S. insurance brokers in 1973—the first year *Business Insurance* compiled such a list—shows a lot about what has happened to the business (see chart).

Marsh & McLennan Cos. Inc., perennially the world's biggest broker, recorded $167.8 million in 1972 gross revenues while A&A, now the world's second largest, generated $69 million.

By 1991, those figures had ballooned to $2.8 billion for M&M and $1.4 billion for A&A.

Overall, the 20 largest U.S. brokers produced revenues of $598.9 million in 1972, with 21,665 employees. By 1991, the 20 largest U.S. brokers generated $8.68 billion in revenues—with a much larger portion produced outside the United States—and employed 97,751 people.

Most of the firms on the Top 20 list in 1973 don't exist as independent brokers anymore.

Reed Shaw Osler Ltd. became Reed Stenhouse, and was acquired by A&A. A&A and Reed Stenhouse also absorbed R.B. Jones Corp., Insurance Consultants Inc. and Schiff Terhune International.

Synercon Corp., Mr. Miller's old firm, was bought by Corroon & Black Corp., which later merged with Willis Faber P.L.C. to form Willis Corroon Group.

Sedgwick Group P.L.C. absorbed Fred S. James & Co. Inc. and E.H. Crump Cos. Inc.

Bayly, Martin & Fay International Inc. was acquired by Rollins Burdick Hunter Group Inc., whose parent company, Aon Corp., expects to complete a takeover of Frank B. Hall & Co. Inc. by the end of this year.

Interspersed with these mergers and acquisitions were scores of additional takeovers of agents and brokers in the United States, Europe and elsewhere.

"There has been an incredible consolidation of insurance brokers," Mr. Irvin observed. "We have seen the disappearance of an incredible number of proud names."

In 1967, "there was no such thing as a major broker. There were 100,000 independent insurance agents all over the country," agreed Robert H. Hilb, president of Hilb, Rogal & Hamilton Co., successor to the old Insurance Management Corp.

"The change obviously has been that from 100,000 insurance agents at that time there are 40,000 left," Mr. Hilb said.

> 'The personal relationship is (still) important (but) now it's driven more by creativity than by golf scores.'

Driving this global merger and acquisition trend have been the needs of an increasingly large, sophisticated and international client base.

While 60% of the world's insurance premiums may have come from U.S. risks 25 years ago, that number may amount to less than 40% now, Mr. Irvin observed. And, while the United States accounted for perhaps half the world's gross production of goods and services in the 1960s, it probably accounts for less than 25% today, he said.

A worldwide network of offices and sophisticated risk management capabilities are "almost a prerequisite" to survival today, Mr. Irvin said.

These services "get harder and harder to maintain on a regional and local level," agreed Arthur F. Quern, chairman of Rollins Burdick Hunter Co. in Chicago. "Now it's a global demand."

Another factor encouraging consolidation has been financial pressure during prolonged soft property/casualty markets.

"That dynamic has continued today because of this depression we're in," said Mr. Gallagher, referring to the soft market. "The balance sheets of companies on the distribution side have been hammered as badly as companies on the risk assumption side."

Tremendous changes in clients' risk and benefit management needs over the last quarter century have profoundly changed the way brokers operate.

One of these has been the explosion of alternatives to traditional insurance, including captives and various other self-insurance mechanisms.

"One-third of the best units of risk have left the normal first-dollar insurance market and have gone to the alternative market," Mr. Gallagher said. "And it will never come back, because buyers have more control over their risk and they like it."

The result: Brokers are spending less time placing traditional insurance and more time providing captive, self-insurance and other risk management services.

"Twenty-five years ago, brokers were considered producers," said Mr. Miller. "We were considered the production arm of the insurance industry."

But today, "we are consultants more than we are producers. The horizons have broadened dramatically," he said.

"Risk managers are looking at ways to solve problems other than by buying traditional insurance," agreed David A. Olsen, chairman of Johnson & Higgins in New York. "We see a lot more consulting-oriented work as problem-solvers, not merely as brokers."

"There's no doubt that the major emphasis has shifted away from sales to service," said H. Felix Kloman, a vp and principal with Tillinghast in Stamford, Conn.

With that shift, broker/risk manager relationships will increasingly be modeled on relations between benefit consultants and human resources departments, said Mr. Kloman. In that role, brokers will provide fee-based self-insurance, claims, risk and information management services.

In fact, he predicted, brokers' insurance placement duties will shrink so much in the next 15 years that 90% of their business with Fortune 1,000 clients will

Continued on next page

Two decades of growth and change

Business Insurance first ranked the 20 largest U.S. brokers in 1973. Twenty years later, many familiar names remain, but more than half of the original group has disappearred through mergers and acquisitions.

1973

Company	1972 revenues[1]	Employees
1. Marsh & McLennan Inc.	$167.8	$6,295
2. Johnson & Higgins	82.0[2]	3,000[2]
3. Alexander & Alexander Inc.	69.0	2,700
4. Frank B. Hall & Co. Inc.	62.4	2,100
5. Fred S. James & Co. Inc.	53.5	1,900
6. Corroon & Black Corp.	22.5	575
7. Reed Shaw Oslter Ltd.	22.0	1,150
8. Rollins Burdick Hunter Co.	14.6	526
9. R.B. Jones Corp.	13.6	576
10. Synercon Corp.	12.5	493
11. Bayly, Martin & Fay Inc.	12.3	500
12. Harlan Inc.	10.2	413
13. Insurance Consultants Inc.	8.4	286
14. Associated Risk Managers Inc.	7.4	243
15. E.H. Crump Cos. Inc.	7.0	318
16. Cook Treadwell & Harry Inc.	6.6	344
17. Dale & Co. Ltd.	6.0	425
17. Insurance Management Corp.	6.0	264
19. Schiff Terhune International	5.1	200
20. Brokerage Resources Inc.	5.0	120
20. Ter Bush & Powell Inc.	5.0	237
Total	$598.9	21,665

1991

Company	1992 revenues[1]	Employees
1. Marsh & McLennan Cos. Inc.	$2,804.0	23,400
2. Alexander & Alexander Services Inc.	1,382.4	15,600
3. Johnson & Higgins	933.1	8,219
4. Willis Corroon P.L.C.	545.1	11,393[3]
5. Rollins Burdick Hunter Group Inc.	526.0	5,275
6. Sedgwick Group P.L.C.	498.4	12,889[3]
7. Frank B. Hall & Co. Inc.	461.6	4,775
8. Minet Group P.L.C.	343.1	3,670
9. Arthur J. Gallagher & Co. Inc.	231.7	2,341
10. Acordia Inc.	210.0	2,248
11. Jardine Insurance Brokers Inc.	118.7	1,190
12. American Business Insurance Inc.	116.0	1,471
13. Hilb, Rogal & Hamilton Co.	115.2	1,425
14. Redland Group	76.7	356
15. Hogg Robinson Inc.	73.2	875
16. Norwest Insurance Inc.	72.0	610
17. Poe & Associates Inc.	48.5	583
18. Lawrence Agency Corp.	45.9	610
19. Kaye Insurance Associates L.P.	42.8	375
20. K&K Insurance Group Inc.	39.6	446
Total	$8,684.0	97,751

[1] In millions [2] Estimate [3] Includes non-U.S. employees [4] Canadian-based

Source: *BI* survey

GRAPHIC BY JOHN J. BOHORQUEZ

The world's largest brokers—10 years later

In the 10 years since *BI* first ranked the world's largest brokers, three companies—Corroon & Black, Willis Faber and Stewart Wrightson—have merged to create the fourth-ranked broker.

1983 Company	1982 revenues[1]
Marsh & McLennan	$924.3
Alexander & Alexander	573.3
Frank B. Hall & Co.	364.9
Sedgwick Group	351.5
Johnson & Higgins	323.7[2]
Fred S. James & Co.	241.3
Reed Stenhouse	236.9
Corroon & Black	172.1
Willis Faber	169.3
Stewart Wrightson	125.7

1992 Company	1992 revenues[1]
Marsh & McLennan	$2,804.0
Alexander & Alexander	1,382.4
Sedgwick Group	1,281.1
Willis Corroon	1,120.9
Johnson & Higgins	933.0[2]
Rollins Burdick Hunter	526.0
Frank B. Hall & Co.	461.6
JIB Group	354.1
Minet Group	343.0
C.E. Heath	294.9

[1] In millions [2] Estimate
Source: *BI* survey

GRAPHIC BY JOHN J. BOHORQUEZ

Brokers

Continued from previous page

be on a fee basis rather than a commission basis.

Brokers have had to develop into problem-solvers rather than "deliverymen," Mr. Quern agreed. And risk managers—having long since outgrown their role as mere insurance buyers—have propelled brokers toward their new role.

"One of the clear trends is that the client has become far more qualified and more sophisticated and, therefore, has forced change in the type of services offered by the broker," Mr. Kloman observed.

Brokers used to deal directly with clients' top management, almost supervising the risk management department, he said. "That has completely been reversed in most cases. Today the relationship is much more one of equals."

"We are seeing a more sophisticated buyer increasingly driven. . .to demand access to knowledge, access to specialization," Mr. Quern said.

"We believe that risk managers need to be as smart as—or smarter than—their brokers to ask the right questions," agreed Cheri J. Hawkins, assistant treasurer for Weyerhaeuser Co. in Tacoma, Wash.

"Risk management has become more sophisticated, which pushes brokers out to a new level," said Ms. Hawkins, a former president of the Risk & Insurance Management Society Inc. "We need the service. We don't necessarily need every new (insurance) product that comes down the line."

As relationships with clients have come to depend more on professionalism, social contacts have become less important.

"You (used) to go to the same golf club with a guy and he never thought about going anywhere else. Now he wants value for the money," Mr. Hilb observed. "We no longer backslap. We earn (the business) by doing a completely and totally professional job."

"It used to be the good old boy, what-can-you-do-for-me-personally kind of thing," said Richard C. Heydinger, director of risk management for Hallmark Cards Inc. in Kansas City, Mo. "I certainly don't think that's the norm today."

"I still think the personal relationship is extremely important," Mr. Quern said. But "now it's driven more by creativity than by golf scores."

As broker-risk manager relations became more professional, others—notably those between brokers and underwriters—became less trusting.

"One's word is no longer necessarily one's bond, as it used to be," lamented John A. Bogardus Jr., former chairman of A&A and one of the broker's directors.

In earlier days, "if I made a deal with an underwriter, and coming back from lunch a hurricane came through and destroyed a building we were talking about, there was no question it would be covered, even if (our agreement) was just verbal," he said.

Now, "everything has to be in writing, and very precise."

Larger and more complex markets—along with technological advances like faxes and electronic fund transfers—have created an impersonal atmosphere that is partly to blame for the loss of trust, Mr. Bogardus suggested.

"The intimacy has gone out of the business."

Scandals that shocked the market in the 1980s further eroded that trust. Among them: the collapse of the Sasse syndicate at Lloyd's of London and the scandal that blindsided A&A after its 1981 acquisition of Alexander Howden Group P.L.C.

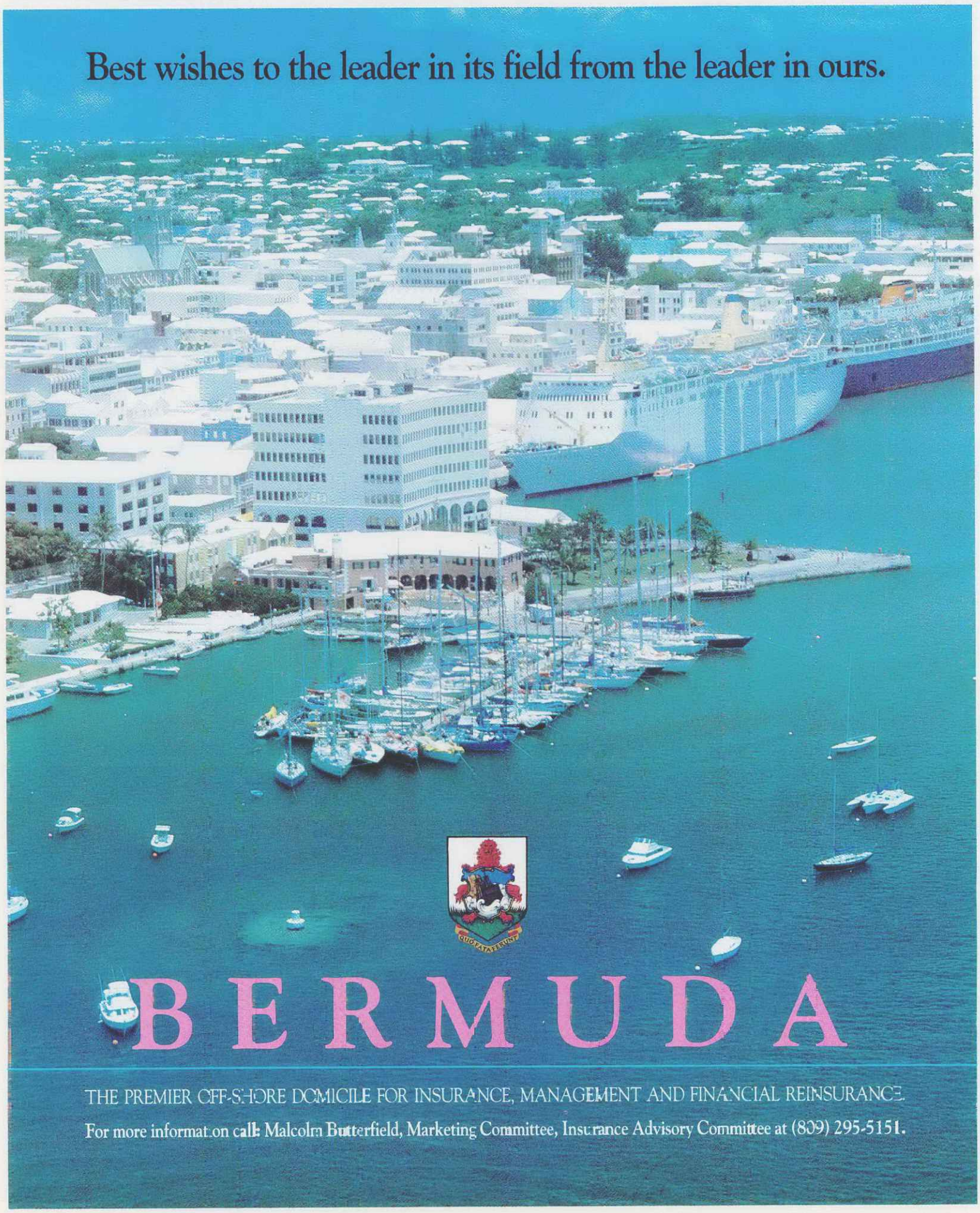
As their roles and relationships with clients and underwriters have evolved, brokers have struggled to weather other storms that were only small clouds on the horizon a quarter century ago.

One of these is third-party liability claims. In the late 1960s, there were only faint traces of the flood of asbestos, pollution, products and other long-tail liability losses that would follow.

Billions of dollars of third-party liabilities have profoundly altered the industry. They changed the way insurers write and price coverage, bankrupted some insurers and spurred alternatives to traditional insurance, including captives and policyholder-owned facilities like ACE Insurance Co. Ltd. and X.L. Insurance Co. Ltd.

Long-tail liabilities also created

Continued on next page



Continued from previous page
a new burden for brokers. This business still had to be serviced long after the books would ordinarily have been closed.

"In the days when the scope of the service or the range of these services all took place during the policy period, it wasn't much of a consideration," recalled Robert Clements, president of Marsh & McLennan in New York.

"But with the majority of the business being long-tail in nature, that is no longer the situation, and it's made it critically important for brokers and their clients to have an understanding of what the scope of the obligation is," Mr. Clements said. "It has led us, and I think others as well, to look for ways to spell it out through a separate service agreement."

It was a lesson brokers learned the hard way. "Twenty-five years ago, in our naivete, we did not know how to price (liability-related services). We just folded it in, and we got murdered," Mr. Gallagher agreed. "It cost us a lot."

Long-tail claims also contributed to reinsurer and insurer insolvencies on a scale that would have been hard to imagine in the 1960s.

The last decade has seen the disintegration of the H.S. Weavers (Underwriting) Agencies Ltd. line slip, the multibillion-dollar failures of Mission Insurance Co. and Transit Casualty Co., and several other collapses registering in the hundreds of millions of dollars.

These events have focused the minds of brokers and risk managers on security like never before.

A&A, for example, had several security committees 25 years ago, but the function "was nowhere near as highly visible as it is now," Mr. Bogardus observed.

Another result of the mid-1980s spate of insurer failures has been the push in Congress by Rep. John D. Dingell, D-Mich., to have a new federal agency take over insurance regulation.

That's not a new idea: *Business Insurance* in 1968 published an article by a New York-area risk manager lambasting sluggish and expensive state regulation and calling for a federal takeover.

Misgivings about the concept have changed little in 25 years: Many fear that the federal government would prove a poor regulator, or that congressional action will result in a cumbersome dual federal/state system.

"You're afraid of the camel getting its nose under the tent," Mr. Bogardus conceded. "The (federal) government's record on efficient operation is not great."

Although the 1968 article blamed agent and broker trade groups for fighting federal intervention, the attitude of many large brokers has changed.

Several brokers, A&A included, now back federal solvency regulation of commercial insurers and have joined with insurance companies and risk managers to lobby for the concept.

Confronted by these and other dilemmas, what direction will the brokerage business take?

Most expect continued growth in consulting rather than insurance placement services as reliance on traditional insurance declines.

For example, exploding health care and workers compensation costs have become risk managers' most recent headache and alternative risk financing strategies will play a key role in both areas, Mr. Gallagher noted.

The need for specialists in these and other areas will also continue to support many smaller "boutique" or "niche" consulting firms.

"There's a constant creation of new specialties and new skills," Mr. Quern observed.

Entrepreneurs who come up with ideas are often able to perfect them more quickly than could their counterparts in large organizations, he said. The most successful of these entrepreneurs may then find themselves and their innovations absorbed by the largest brokerages, which can put them to wide use.

Many observers expect the consolidation trend to continue.

"The number of smaller agents dwindles every year. They can't provide the services for anything but very small business," Willis Corroon's Mr. Miller said. "A company will outgrow its local agent very often and need services that are provided by the majors.

"More of the business will go to the majors," he predicted.

Some, however, see limitations to this trend.

Even with computers, large brokers often have trouble handling small commercial risks profitably on a fixed-commission basis, Mr. Bogardus observed. Large brokers must ask themselves if they can really provide a worthwhile service to these clients, he said.

"In some cases, I think the answer is we can not," he said. "I just feel that business is going to be abandoned by larger brokers to agents and direct writers."

Large brokers may also find that they've opened too many U.S. offices and begin cutting back.

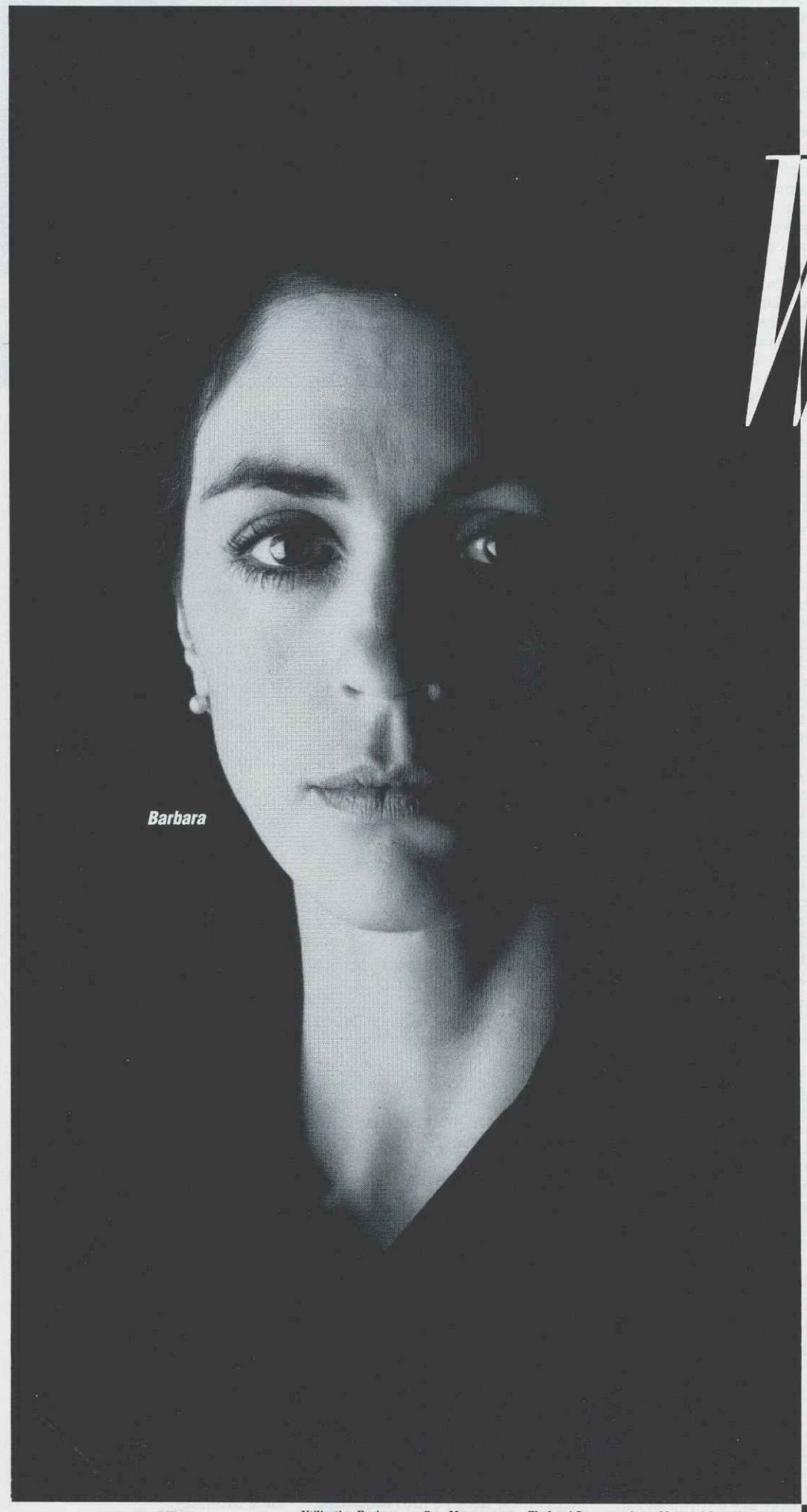
"Brokers have gone into all kinds of small towns where there is not that much growth potential," Mr. Bogardus said, predicting that smaller offices will either be closed or sold to local firms.

Whichever direction the brokerage industry takes, one thing is certain: The risks brokers must handle in most cases will only get larger and more complex with each passing year.

"If your view is that we're on our way back to the caves, then I think your view would be that insurance is going to get simpler," Mr. Clements said.

However, the United States is "the world leader in complications," and that spells a complicated future for brokers and risk managers alike, he said. BI

Douglas McLeod was BI's New York bureau chief for eight years until he was promoted to senior editor in January 1992.



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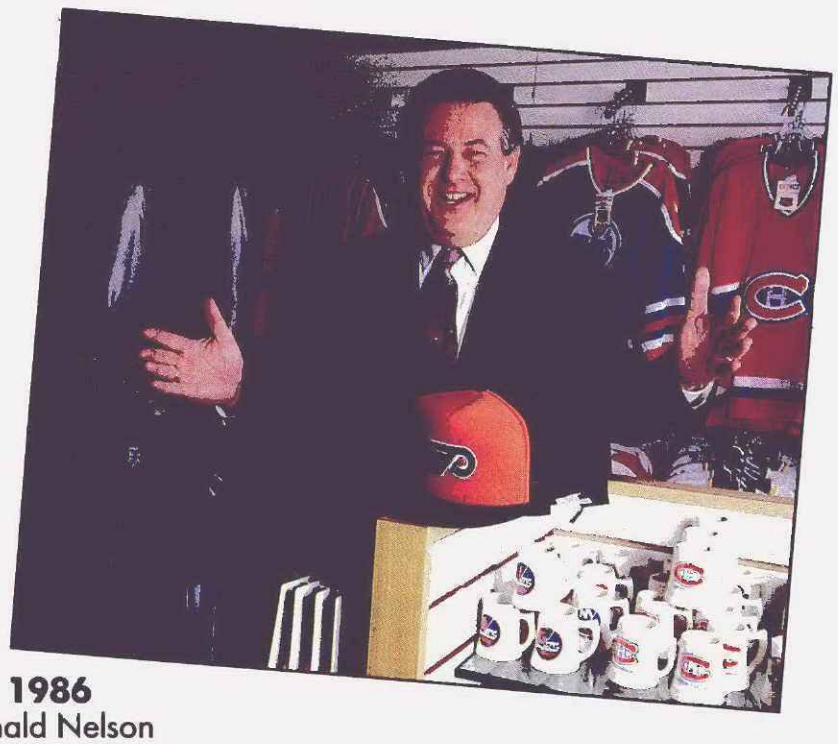
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Risk Managers of the Year



1986
Donald Nelson



1980
Thomas V. Hallett



1990
Stephen M. Wilder

By Sara Marley

Effective communicators make good risk managers, winners of the *Business Insurance* Risk Manager of the Year Award agree.

Broad education and experience in disparate areas of insurance and business are also important, as is the foresight to predict future liabilities that might arise from a company's business strategy.

A risk manager's job is to convince upper management "to get religion as far as risk management is concerned," said Eckart Russell, now a senior vp of Johnson & Higgins in Montreal. When he was named Risk Manager of the Year in 1982, Mr. Russell was risk and insurance manager at Alcan Aluminium Ltd. in Montreal.

"A necessary skill in a successful risk manager is selling his ideas and concepts up the line to the management within the corporation and down to the people who work for him at the plant level," according to Thomas V. Hallett, honored in 1980 as risk manager of General Motors Corp. in Detroit. Mr. Hallett is now director of business development strategies for Alexander & Alexander Services Inc. in New York.

Effective communication must be "not necessarily in insurance or risk management jargon, but in language management can understand," said Stephen M. Wilder, assistant treasurer-risk management at The Walt Disney Co. in Burbank, Calif., and 1990 Risk Manager of the Year.

While most business communication today is oral, writing skills are still valuable to risk managers, said William L. Mather, director-risk management of The Gillette Co. in Boston and the 1988 Risk Manager of the Year.

"Being in a worldwide organization, I don't always have the opportunity to talk to people directly and with the frequency I would like," Mr. Mather said.

Although more than two-thirds of its business is outside the United States, Gillette conducts all its business in English. And many foreign workers are more comfortable with written communication, Mr. Mather said.

Tone can be critical to communicating effectively.

"It's the professional demise of a risk manager to be known as a naysayer," warned Arnold L. Davenport, vp-risk management of the Marriott Corp. in Bethesda, Md., and the 1991 Risk Manager of the Year. "You have to take a positive approach and say, 'How can we minimize the risk to make it acceptable?' Some risks can't be avoided. You have to know how to manage them."

Risk managers also need the "personality to be able to convince people: tact, political savvy and people skills," said Richard M. Inserra, named Risk Manager of the Year in 1984 when he was director of insurance and risk management at American Can Co. Mr. Inserra, who has since worked as a risk management consultant, is now assistant treasurer for Union Carbide Corp. in Danbury, Conn.

A broad education in insurance as well as finance, law, taxation, engineering and general business aids the risk manager, Mr. Inserra said.

"I grew up in the insurance industry," pointed out Millicent W. Workman, the 1992 Risk Manager of the Year. She worked as both a broker and an underwriter before she took her current job, director of risk management at Belz Enterprises in Memphis, Tenn.

"Today, a risk manager must have a working knowledge of loss prevention and claims, particularly cost management functions," Mr. Davenport noted.

Many risk managers, however, still come up through a company's hierarchy rather than from the insurance industry.

"I don't think it's particularly important for a risk manager to have a strong technical background in any one area," Mr. Mather said. "I always felt half my ability to do the job was due to the fact that I know the company. The other half was that I know and understand the aspects of risk management."

Experience and education alone are not enough, Mr. Hallett added: "You can be well-educated and still not be a good risk manager. You have to add a measure of horse sense and street smarts."

Common sense and curiosity are attributes the Risk Managers of the Year see in themselves and their colleagues.

"You have to be kind of nosy," according to Mr. Mather. "There is a lot of information you need that doesn't get readily sent to you or jump off an established report."

Innovation led many Risk Managers of the Year—including Jeffrey W. Pettegrew, the 1989 honoree—to self-insure their or-

Continued on next page



1992
Millicent W. Workman

1981
Duane E. Allen



Continued from previous page
ganizations' exposures.

"Rise above traditional approaches. Be a leader in your organization," advises Mr. Pettegrew, who was honored as the risk manager and chief administrative officer of Contra Costa County Municipal Risk Management Insurance Authority in Walnut Creek, Calif. He now is director of risk management for Western Temporary Services in Walnut Creek.

But with the advice came a warning: "Document your achievements and use them as a tool to command credibility."

John A. O'Connell, who won the award in 1983, formed a captive insurance company for non-profit Holy Cross Shared Services Inc. of Notre Dame, Ind., in the 1970s.

Recognizing the "rapidly developing technology and the legalistic approach developing in our society, we had to do more than just respond to the insurance programs in the field," Mr. O'Connell said.

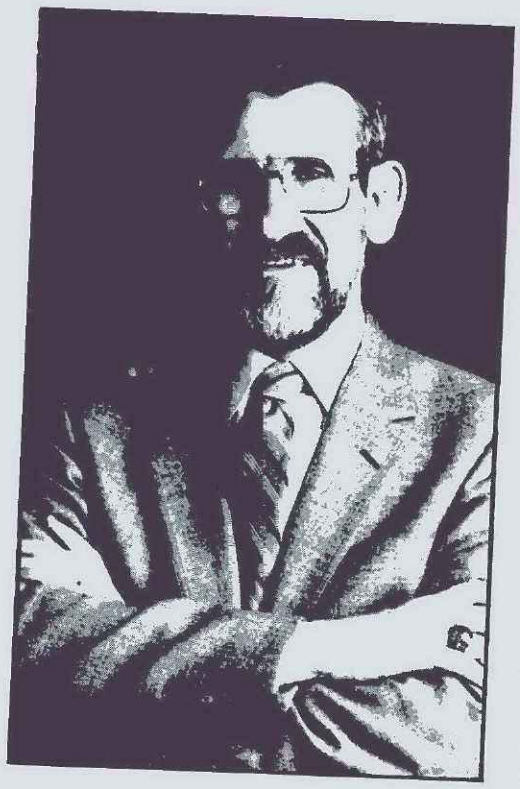
Today, the Congregation of the Sisters of the Holy Cross purchases only excess and umbrella coverage in a risk management program that protects operations, employees and property at schools, hospitals and convents around the country.

"It's easy to cover risks that you know exist. What's difficult in developing an insurance program is trying to determine what risks there will be in the future," he said. "You have to protect yourself tomorrow from things that did not exist today."

Mr. O'Connell, who has retired as president of Holy Cross Shared Services, Havican Insurance Co. in Colorado and Havican Vermont Insurance Co., suggests risk managers follow court decisions that may affect their organizations.



1987
Edith F. Lichota



1983
John A. O'Connell

"Risk managers can get too focused on their own account," Ms. Workman agreed. "They don't see what's going in the rest of the insurance world. You can't operate in a vacuum."

Following broader insurance issues helps Ms. Workman achieve her goal of having "rates fluctuate as little as possible over time."

"Good risk managers are always aware that the market is going to tighten," observed Mr. Inserra. "Twenty or 30 years ago, they just let the market happen. Now they are much more proactive.

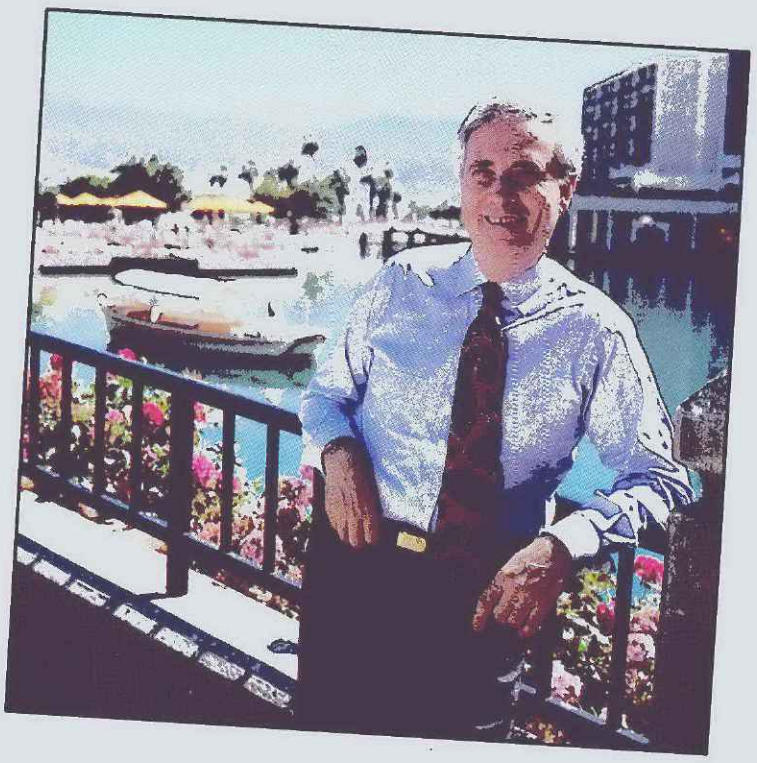
"I take a very analytical approach to risk management," he continued. As an advocate of "fine-tuning," he noted: "Organizations change, so (risk management) programs have to change."

"A good risk manager is a combination of administrator and manager," said Edith F. Lichota, who won the award in 1987 when she was a senior vp at Irving Trust Co.

"A good risk manager has the capability to deal with multiple levels of detail and keep it all in order. But he can also manage those details," said Ms. Lichota, who is now president of consulting firm Lichota & Associates in Norwalk, Conn.



1978
Howard T. Weber



1991
Arnold L. Davenport

Ms. Lichota is also vp-administration for the Bankers Insurance Co. Ltd. of Bermuda, which she helped create while at Irving Trust.

Being a successful risk manager takes education, interest in the company and the support of top management, said Duane E. Allen, 1981 Risk Manager of the Year. "It's tough to do an effective job if you don't have one of the three."

Honored for his accomplishments as assistant treasurer of Hanna Mining Co. in Cleveland, Mr. Allen is now president of consulting firm Applied Risk Insurance Services Inc. in Rancho Santa Margarita, Calif.

Good risk managers also "get the most out of outside resources," like brokers and consultants and "treat those people like part of the team," Disney's Mr. Wilder said.

In dealing with brokers and insurance companies, however, risk managers must remember that insurers "are a profit-making organization. They are trying to put together a program that is a win-win situation for both parties," said Donald Nelson, who won the award in 1986 when he was director of risk management for ARA Services Inc. in Philadelphia. Currently, he is Eastern regional vp for Alexander & Alexander Services Inc.



1982
Eckart Russell

Many of the Risk Managers of the Year believe that risk management has become more accepted by the business world in the past 25 years. Others think it still has some way to go.

In more than 40 years in risk management, "the biggest change I've seen is corporate management's acceptance of the risk management function as a very necessary tool to enhance profitability," said Harold C. Lang, who won the award in 1985.

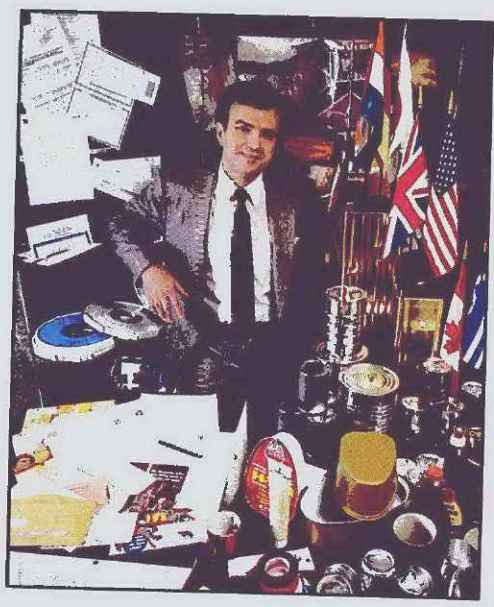
At the time, Mr. Lang was director of insurance and risk management at Leaseway Transportation Corp. Today, he holds the same title at Kohler Co. in Kohler, Wis.

"Risk managers have gotten greater visibility within organizations in the past 10 years," Mr. Nelson said. "They get more important as time goes on. Risk is a significant controllable expense that hasn't been given appropriate attention before now."

A risk manager has to "make a place for himself or herself on the management team," Ms. Lichota said.

However, a dichotomy is developing be-

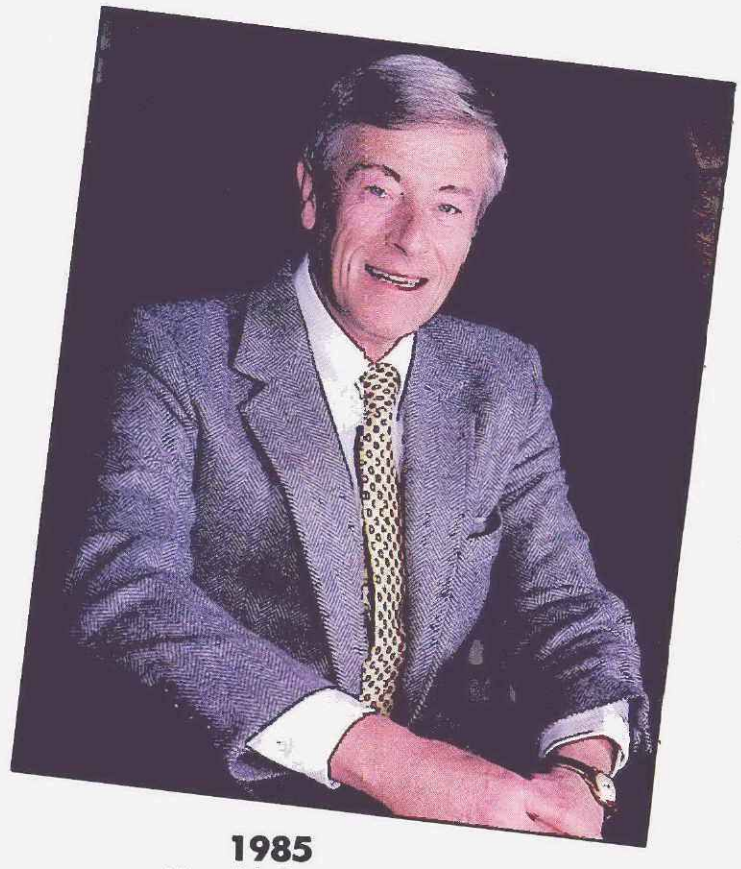
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1984
Richard M. Inserra



1988
William L. Mather



1985
Harold C. Lang

Continued from previous page
tween those risk managers whose companies view them as vital and "those whose responsibility is underrecognized by their employers," she continued. "The profession itself needs to do a better job communicating more broadly the advantages it can bring to employers that recognize what they do."

Some Risk Managers of the Year have moved on to become brokers or consultants. But they haven't forgotten their roots.

"I'm thinking as a risk manager, even though I'm a broker now," Mr. Nelson said. "I'm close enough to my risk management experience to add an extra dimension. I bring that to the table."

For Mr. Russell, a promotion from risk management at his former company would have meant a move into pure financial management, which he likened to "a doctor becoming a 100-meter dasher."

"I was not willing to give up 20 years of building experience, know-how, reputation, relationships and friendships in the world of risk management and insurance."

Instead, corporations should recognize that risk management can be applied outside of insurance to areas like foreign exchange risk, interest risk and balance sheet management, Mr. Russell said.

Mr. Hallett was risk manager at one of the world's largest corporation, General Motors.

"I felt I had done everything I could do on the risk management side that was really exciting," he said. "I wanted to do more with what I had learned. I wanted to educate the broker of the needs of the professional risk manager."

Other Risk Managers of the Year have found new challenges within risk management.

Mr. Pettegrew's current company provides temporary workers in 2,300 different fields. "You learn a little about all types of risk management. We do everything from Santa Claus to nuclear waste."

"I'm a career risk manager," Mr. Lang said. "This is not a stepping stone. It's the function in corporate management that excites me the most. No two days are alike. I brag about the fact that I'm a risk manager. I contribute to the bottom line."

After 22 years as a risk manager and weathering "a couple of cycles," Mr. Mather said the risk management discipline is better understood and more widely applied.

"People don't draw a blank anymore when you say you're a risk manager," he said. "There are better trained and more experienced risk managers today than there were 20 years ago. The profession has come along quite well." BI

Sara Marley, who joined BI last December, has written several stories about risk managers and the risk management profession.

Business Insurance created the Risk Manager of the Year Award in 1977, on its 10th anniversary, to recognize outstanding achievements in the field. Four years later, the Risk Management Honor Roll was created to single out outstanding risk managers in a variety of employment categories.

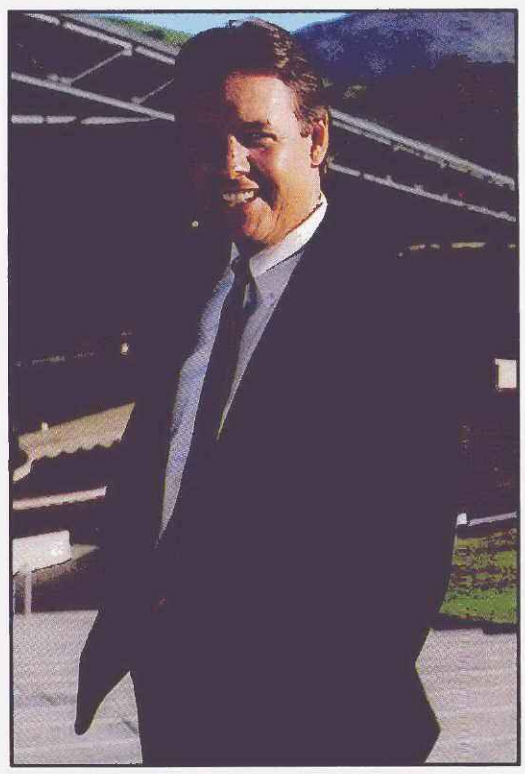
The first Risk Manager of the Year was Howard T. Weber, director of insurance at Minnesota Mining & Manufacturing Co. Mr. Weber died in 1988.

The Risk Manager of the Year and Honor Roll members are selected by 10 independent judges, who judge each candidate according to how well he or she:

- Established and implemented an effective risk management program within the organization.
- Tackled and solved one or more major problems for his or her organization.
- Innovatively applies the diverse tools of risk management and insurance.
- Creatively and effectively uses the insurance markets to structure an insurance program that serves the organization's needs.
- Established a workable intelligence system inside and outside the organization, culminating in a flow of information about events and activities that affect the organization's risk management and insurance.
- Skillfully performs the functions of management in the overall organization and within the risk management/insurance department.
- Achieves the most effective program at the optimum cost over the long term.
- Developed technical expertise in any or all of the broad categories included within risk management, leading to a better managerial grasp of the operations aspects of the job.
- Exhibits an attitude and performs activities fostering the advancement of the risk management profession.
- Develops in his or her career.

Nominations still are being sought for the 1993 Risk Manager of the Year and Risk Management Honor Roll. The deadline for submitting nominations is Nov. 19.

To request a nomination form, contact Karen Brown, *Business Insurance*, 740 N. Rush St., Chicago, Ill. 60611-2590; 312-649-5319.

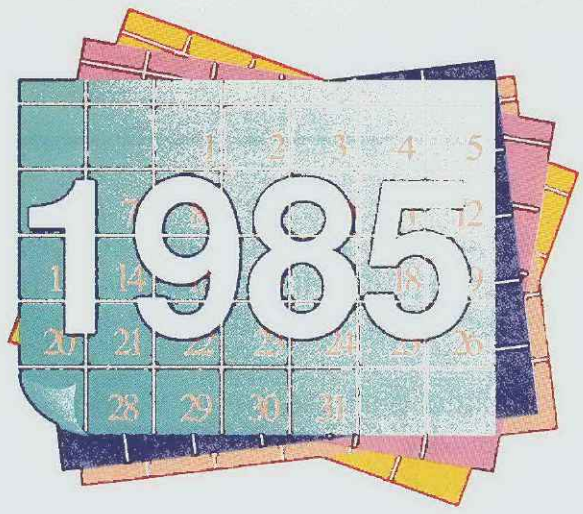


1989
Jeffrey W. Pettegrew

1979
Edward L. Erickson



Looking Back



The New York Insurance Department has seized **Ideal Mutual Insurance Co.**

The department says Ideal Mutual was $155 million short of meeting its liabilities as of Dec. 31, 1983. The insurer, however, says it has $12 million in policyholder surplus after meeting liabilities of $148.9 million, and adds that an actuarial report certifies that its loss reserves are adequate (*BI*, Jan. 14, 1985).

* * *

The already reeling **environmental impairment liability insurance** market took another severe blow with the announcement by Shand, Morahan & Co. Inc. that it no longer will write EIL coverage.

Shand, Morahan decided to stop writing the coverage altogether just one month after it announced that a lack of reinsurance would force it to cut back the EIL limits it could offer (*BI*, Jan. 28, 1985).

* * *

Manville Corp.'s recent $111.8 million settlement with three excess insurers brings the asbestos producer's available coverage for asbestos bodily injury claims to $426 million (*BI*, Feb. 11, 1985).

* * *

Salaried workers are now likely to be able to contribute to a **401(k) salary reduction plan**, according to a survey by Hewitt Associates.

The survey of 250 major U.S. employers showed that nearly three-quarters of the defined contribution plans offered to salaried employees in 1984 had a 401(k) feature, up from less than half in 1983 (*BI*, Feb. 11, 1985).

* * *

The Internal Revenue Service has changed its mind over the shifting of excess assets from defined benefit to **defined contribution pension plans**.

The IRS notified Buck Consultants that it is withdrawing its previous letter that sanctioned the transfer of assets if an employer received an actuarial statement that the assets in the defined benefit plan exceeded what would be required to pay accrued benefits if the plan is terminated (*BI*, March 4, 1985).

* * *

A state court judge has issued the final order apportioning insurance coverage in the 1981 skywalk collapse at the **Hyatt Regency Hotel in Kansas City**, but at least one insurer is planning to appeal the order.

The judge ruled that excess liability insurers for Hyatt Corp., which operates the hotel, must pay two-thirds of all the losses incurred by Hyatt and by Hallmark Cards Inc. and its subsidiary Crown Center Redevelopment Corp., which own the hotel. Hallmark's excess insurers must pay the remaining one-third of losses in the disaster, which killed 114 people and injured at least 200 others (*BI*, March 11, 1985).

* * *

Under a recent agreement between **Bethlehem Steel Corp.** and its retirees, health insurance premiums paid by non-union workers who retired from the steelmaker before April 1984 are capped for life, but retirees are responsible for co-payments and deductibles (*BI*, March 18, 1985).

* * *

Sedgwick Group P.L.C., the largest Lloyd's of London broker, and **Fred S. James & Co. Inc.**, the fifth-largest U.S. broker, are joining forces.

The acquisition will give Sedgwick the U.S. presence it has long sought and give James, currently a subsidiary of San Francisco-based Transamerica Corp., the vast overseas network it lacks (*BI*, April 8, 1985).

* * *

MGM Grand Hotels is claiming victory in the $75.9 million settlement of litigation over the $170 million in **back-dated liability insurance** covering the 1980 fire at the MGM Grand Hotel in Las Vegas.

MGM notes that the settlement amount exceeds the $75 million MGM paid to fire victims under a 1983 agreement, though it does not cover all of MGM's costs from the fire litigation (*BI*, April 8, 1985).

* * *

If Wheeling-Pittsburgh Steel Corp. terminates its severely underfunded pension plans, it could slap the **Pension Benefit Guaranty Corp.** with the largest claim in its 10-year history.

Wheeling-Pittsburgh claims could hit $200 million to $300 million in unfunded liabilities, much higher than the PBGC's previous record claim of $63.3 million, and it could be the precursor of more big plan terminations in the nation's struggling smokestack industries (*BI*, April 29, 1985).

* * *

At least $204 million in damage claims have been filed against Jewel Food Stores after more than **10,000 confirmed cases of salmonella poisoning** were linked to milk processed at a Jewel plant in Melrose Park, Ill.

Ninety-two lawsuits have been filed in the salmonella outbreak, which was cited as the primary cause of death in two cases and a contributing factor in two others by health officials in Illinois, where most of the cases occurred. Jewel is

Continued on next page

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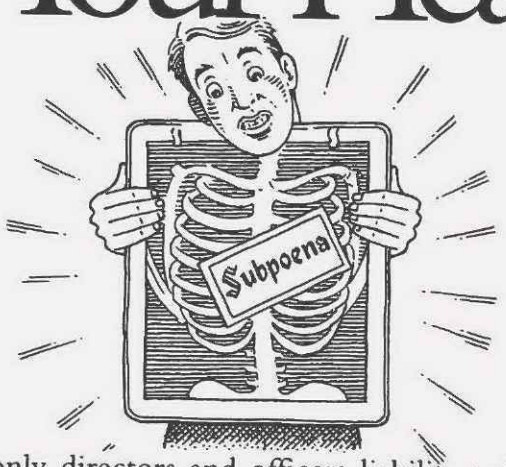
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Executive Risk Management Associates

Aetna

Continued from previous page
covered under the liability insurance program of American Stores Co., which bought Jewel last year (*BI,* April 29, 1985).

* * *

American Financial Group's bailout of **Mission Insurance Group Inc.** has caused the midterm cancellation of thousands of policies issued by American Financial Group subsidiary Transport Indemnity Co.

Because its assets are being used to shore up Mission, Transport Indemnity has been forced to cancel thousands of excess property and casualty policies (*BI,* May 6, 1985).

* * *

The Supreme Court has ruled that **states can require employers to offer certain benefits** under group health insurance plans.

The ruling is expected to raise employers' benefit costs, and to boost self-insurance, because the court said self-insured plans cannot be required to offer specific benefits (*BI,* June 10, 1985).

* * *

United Airlines plans to recover $962 million in **surplus pension assets**, the largest asset reversion ever.

The proposed pension asset reversion also is unique because it involves plans covering union workers in addition to salaried employees (*BI,* June 17, 1985).

* * *

The New York Insurance Department is seeking a court order to liquidate **Union Indemnity Insurance Co.**, a subsidiary of broker Frank B. Hall & Co. Inc. The department says the insurer was insolvent by $138 million at year-end 1984.

The liquidation petition follows two department examinations that found Union Indemnity substantially understated loss and expense reserves and liabilities for unauthorized reinsurance in 1983 and 1984 (*BI,* June 17, 1985).

* * *

Retail brokers say July 1 insurance renewals are even more difficult than Jan. 1 renewals, which many at the time said were the most difficult ever.

And the worst is not over: Brokers predict that the **commercial insurance market will continue to contract** into 1986 (*BI,* July 15, 1985).

* * *

A legislative package moving toward enactment would cause major benefit changes and added expense for U.S. employers.

The most significant proposal would deny employers their **tax deduction for health care expenditures** if they did not cover employees' spouses and dependents after an employee dies, separates from his or her spouse or divorces (*BI,* July 29, 1985).

* * *

The European Community has adopted a directive on product liability that requires member countries to impose **strict liability standards on manufacturers** and distributors. But, it allows the member nations to decide individually whether their product liability laws will allow the state-of-the-art defense or caps on liability awards (*BI,* Aug. 5, 1985).

* * *

Employees at the new **Saturn Corp.** auto plant to be opened in 1989 will have health coverage only through managed care facilities rather than traditional fee-for-service coverage.

The 6,000 United Auto Workers members to be employed at Saturn, a unit of General Motors Corp., will have health coverage only through health maintenance organizations or preferred provider organizations (*BI,* Aug. 19, 1985).

* * *

A hybrid pension plan, called a **cash balance pension plan**, is expected to grow.

The plan, introduced by BankAmerica Corp., replaces the traditional defined benefit pension plan and establishes a cash balance account for each employee when he or she becomes a member of the plan.

Then, each month thereafter, additional benefit credits are added to the account based on the employee's pay and years of service, and the account earns interest at a predetermined rate (*BI,* Aug. 26, 1985).

* * *

Employee benefits lobbying groups are headed to Capitol Hill to persuade Congress to reject the Reagan administration's renewed **attempt to kill 401(k) plans.**

Leading the fight are the Assn. of Private Pension & Welfare Plans, the Employers Council on Flexible Compensation and the ERISA Industry Committee.

The administration—for the second time in 10 months—is recommending that 401(k) plans no longer be allowed (*BI,* Sept. 9, 1985).

* * *

Lloyd's of London underwriters are planning to introduce their own **claims-made excess liability policy form**, a move that could send the London market into chaos.

Lloyd's underwriters have said they will not accept the claims-made form recently unveiled by H.S. Weavers (Underwriting) Agencies Ltd. Instead, Lloyd's plans to develop its own claims-made form and have it ready to use at Jan. 1 renewals (*BI,* Sept. 23, 1985).

* * *

The worldwide insurance and reinsurance market is careening toward the **worst capacity crunch in history**.

Corporations can expect limits available in 1986 to be drastically less than in 1985. And, what insurance is available will be much more expensive (*BI,* Sept. 23, 1985).

* * *

The Supreme Court will decide the constitutionality of the 1980 federal law that allows multiemployer pension plans to demand huge payments from companies that leave underfunded plans.

The justices will review whether the **Multiemployer Pension Plan Amendments Act** represents an unfair seizure of a company's property (*BI,* Oct. 21, 1985).

* * *

A federal judge has ruled that retirees have a contractual right to **promised post-retirement benefits**.

The judge ruled that employers cannot unilaterally change those benefits after retirement, even if company benefits literature expressly states that the employer has the right to alter or terminate plans (*BI,* Oct. 28, 1985).

* * *

State guaranty funds are levying record charges against property/casualty insurers to cover policyholders' claims in the wake of a rash of insurer insolvencies.

California and Florida alone are assessing insurers licensed in their states $85 million, which was the amount assessed by all guaranty funds put together in 1981, the previous record year. And 1985 assessments in Maryland, Georgia and Illinois bring the total 1985 assessments in just those five states to $118.5 million (*BI,* Dec. 9, 1985).

* * *

ACE Insurance Co. Ltd. is issuing policies after having raised about $260 million in capital from more than 20 corporate sponsors and non-sponsor policyholders.

ACE was incorporated earlier this year in the Cayman Islands (*BI,* Dec. 23, 1985).

BI

A Conversation With:

Douglas Barlow

Seldom in the short course of risk management history has one accomplished so much in so little time.

Douglas Barlow was a risk manager for only 13 years, less time than it takes some lawsuits to wend their way through the U.S. courts. But he was in on what was the profession's ground floor.

When Mr. Barlow was named risk manager at Canadian manufacturer Massey-Ferguson Ltd. in 1959, the term "risk management" had been around for only a few years. By the time he retired in 1972, the field was on its way to becoming an independent discipline.

A small part of the credit probably goes to Mr. Barlow. He was one of the first champions of captives. He created the first truly global insurance and risk management program for all classes of risk. And he first defined the "cost of risk" and declared the objective of minimizing that figure.

Two years ago, when Mr. Barlow became the first and only risk manager inducted into the Insurance Hall of Fame, the encomiums were legion. He is, they said, a futurist, a Renaissance man, one of the giants of the field.

Copy Editor Timothy Stanton recently spoke with Mr. Barlow in his cramped Toronto study, piled high with old volumes, thick sheaves of biographical notes, and Caribbean and African art.

* * * *

What are the most significant ways that risk management—the job or the people—has changed since you started in 1959?

There are now a greater number or proportion of very able executive types. The job itself has gained recognition as a distinct function with a definable objective; it gained in respect and status inside and outside the organizations served; it came to be better paid; and it began to draw beginners who had studied for it.

In 1975, three or four years after you were its president, the American Society of Insurance Management changed its name to the Risk & Insurance Management Society. Was that important?

The change was important in the sense that it was necessary—necessary to avoid the handicapped misrepresentation that the object of the society was the management of insurance rather than *risks*.

As risk managers took on more duties, where did that leave the insurance brokers?

Let's say they cooperated—they worked in happy concert. Between a good risk manager who has initiative and knowledge and the contact man from a good firm of brokers, there can exist something in the nature of a competition of ideas that is very fruitful. They serve as a check upon each other.

You came to your very first risk management job with a broad and impressive background—a law and business professor, a lawyer at a brokerage. Is a grounding like that useful today? Or are corporations better off hiring specialists with advanced degrees in risk management?

Well, my type of case is extremely rare. If I were a CEO, I would prefer the graduate of a good course in risk management, knowing that once he's in the job, he would have all the skills of the broker available to him and that he would learn very quickly.

If you were, in fact, a CEO, what qualities would you look for in a risk manager?

He'd have to be able to get along with people and get action from them without appearing to put pressure on them.

Sounds like you're looking for a politician.

Oh yes. I've also found that a sense of humor was very useful in getting things done in foreign countries and even on this continent.

Let's say a bright 23-year-old MBA student at McGill University, your alma mater, came to you for career advice. Would you recommend risk management to her now?

The job is generally underpaid. Very few graduates with an MBA are seeking to enter this field; it just doesn't happen.

But take someone who, like so many young people, goes to the university and finds that the arts course is the easy way to get a degree, hopefully with a fair mix of mathematics.

'The Superfund law has even changed the meaning of ownership. . . Now we're deprived of the right to misuse.'

Those people can reasonably look to risk management for an interesting future. When practical coursework—like the A.R.M.—is laid on top of a measure of intellectual discipline at a university, you have good material.

What, in your mind, have been the greatest shortcomings or failures of risk management over the years?

I don't know how to answer a question like that. It is like trying to change the past.

I sometimes feel that the symbiosis that exists, more or less, in insurance between insurers and enterprise would have been healthier for both had risk managers, insurance brokers and underwriters all been marinated in the history of insurance.

What do you mean?

I wonder if it would have reduced the range of the hard/soft market swings and in some degree the destructive epidemic of litigation.

Your choice of terms reminds me that risk managers not infrequently exhibit an underlying hostility to lawyers. Having been on both sides of the fence, do you share that antipathy?

One shouldn't generalize as much as that. Oh no. I criticize the ambulance chasers. There is an epidemic of litigation in the United States, not elsewhere.

How do the people in law, or business more generally, compare with those in risk management?

I think the brokers got the cream of the crop. Insurance companies were second and the risk managers, they were kind of low on the totem pole. But that improved definitely, noticeably in my time.

Better caliber people?

Better caliber? I hate words like that. With more and higher education. Whether that made them better or not is another question.

Not long ago, we quoted an old risk management hand as saying that insurance company people tend to be a very staid, uncreative lot and that the creative types in risk management have to kick them in the pants once in a while.

I would agree.

What attracts creative people to the work?

What has been attractive is the opening for expansion and progress. Secondly, there was all the variety of risks in a changing world.

Every change in business and politics brings new risks and exacerbates or aggravates old ones. The great example is the legal responsibility of directors of corporations.

Up until 30 years ago, a directorate was mainly a job of honor. You had a better chance of getting into it if you were one of the old boys.

If you played golf well.

Yes. And if your father had. The pay was small, really. But so were the responsibilities, and there were many perks. The law changed that, with an appreciable percentage of directors resigning recently.

A thing like (expanding liability for directors) incidentally presents to a risk manager of initiative a significant opportunity to bring himself to the attention of the chairman of the board by pointing out the dangers and what should be done about them.

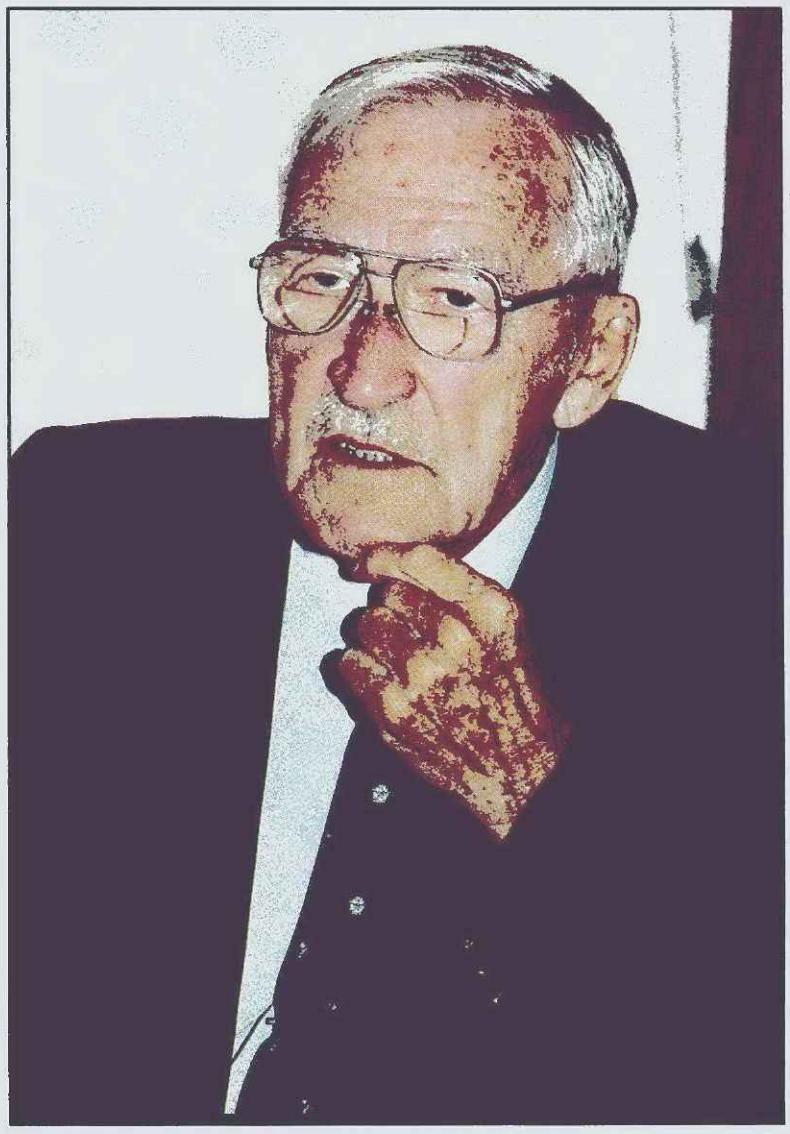


Photo by Jim Fish

One thing you were noted for is being an early champion of captives. You created two for Massey-Ferguson, the first in 1965. At that time, did you have any idea captives would take off like they did?

Yes! It was so obvious!

How much of the early captive movement was a tax dodge?

Quite a lot. Of course, the IRS became sensitive to the slipping away of dollars, and contemporary with that was another aspect.

The captive was a direct and sensitive path to reinsurance, because at the time the credit for a good fire record—big enough, scattered enough so that it had meaning—was inadequate.

It doesn't take a genius to realize that captives flock to tax havens, but why go once the tax advantages were removed?

It's not entirely because they were tax havens.

Regulatory havens as well?

Exactly. They are free of regulation. Most of them—not all of them.

You are well-known as something of a futurist, always concerned with the next problem and looking five moves deep into the game. Here's one for you: Who is going to pay in the years ahead to clean up our pollution?

I think it's going to be mainly from taxes. And secondly, I think quite a lot of it is going to be left on—as quietly as possible.

As I pointed out to a lecturer on the subject of CERCLA, the Superfund law has even changed the meaning of ownership. If you own a piece of property, you cannot divest yourself of the liabilities attached to it by selling it. That's extremely important.

Ownership is one of the fundamental ideas of our society. The right to use, dispose of, misuse: That's ownership, the classical meaning of ownership. Now we are deprived of the right to misuse.

On the topic of pollution, I would think that the single word that insurance companies must regret most is 'comprehensive' in the CGL policy.

What you are raising here is the very issue of the social and economic role of insurance. It has got to be to take the unknown risks, the unforeseeable risks. That's a big order. Insurers do it, though. They've got to have a margin of premium for the unknown.

And the risk manager who uses competition, particularly on renewals, to force a price that is essentially inadequate for the risk is not serving insurance or society. BI

A Conversation With:

John Garamendi

Where else but in the home of Hollywood would voters select as their first elected insurance regulator an Errol Flynn-like swashbuckler who fearlessly fences with insurers and gets nary a scratch?

"Nothing makes me happier than to fight with an insurance company," says California Insurance Commissioner John Garamendi. "If I wake up and haven't had a fight with one of them by 8 a.m., I consider it a bad day."

To critics, he's too much the showman, using excessive rhetoric.

But the intrepid Mr. Garamendi truly believes that he is fulfilling the wishes of the voters who elected him. Indeed, Proposition 103, the voter-sponsored ballot initiative that created his job, arose from a statewide consumer revolt over escalating auto insurance prices.

During his first two years in office, the Northern California rancher and former state senator has successfully transformed the Insurance Department into a consumer protection agency, much to the industry's dismay.

As a result, Mr. Garamendi is fast becoming a legend not unlike the silver-screen heroes for which this state is famous.

"This industry is going to end up in a fight with me—hopefully by 8 o'clock in the morning—until it learns to obey the law," he warns.

Mr. Garamendi discussed insurance regulation with Los Angeles Bureau Chief Joanne Wojcik.

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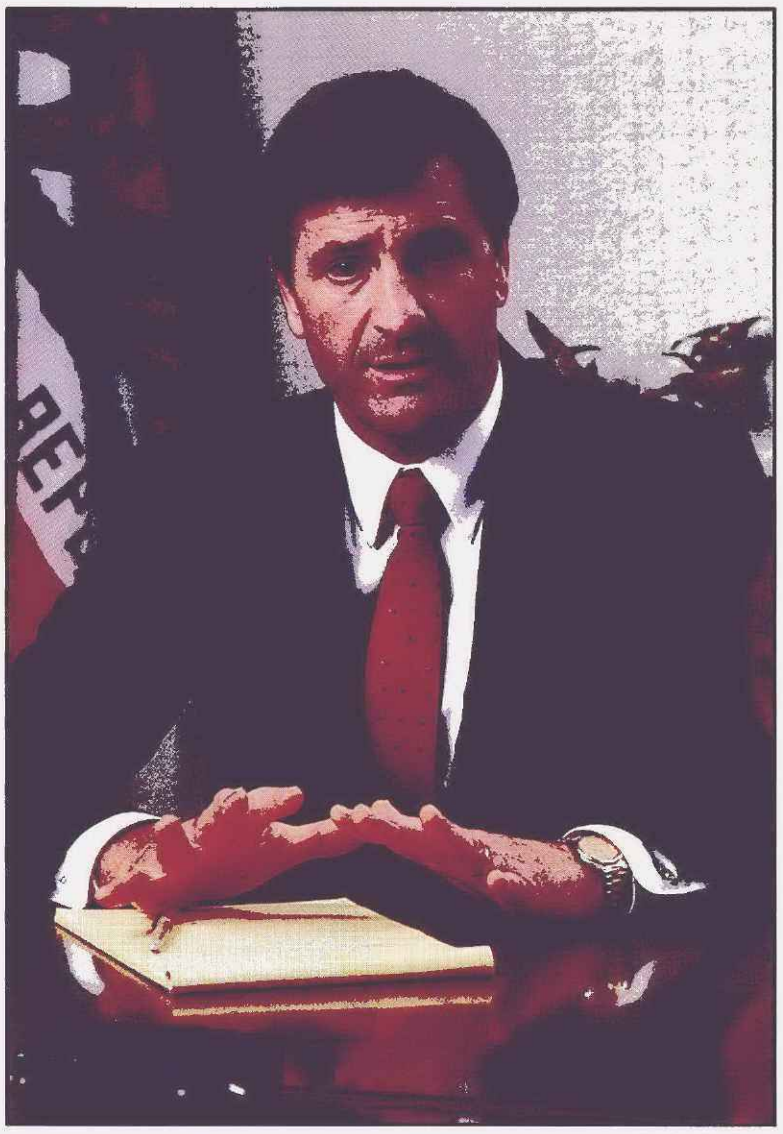


Photo by Tim Petros

How would you assess your first two years as the first elected insurance commissioner of the nation's most populous state?

We came into office to change the way things were done in insurance regulation. We did not want this office to be here for the benefit of the insurance companies. I believe the laws are designed to protect consumers and that this office's responsibility is to protect consumers. We wanted to turn this thing 180 degrees.

It has been a real aggressive, active change period. And I think we're rapidly changing the attitude, the orientation and the purpose of the Department of Insurance. In so doing, we have dramatically altered the attitude of the industry about what government regulators are going to be doing, both here and in other places. We've made this into a consumer protection agency.

There's no doubt in the insurance industry's mind what we are about and what we intend to do. We intend to hold them accountable and protect the consumer.

What has been your greatest success and, conversely, your biggest failure or disappointment since taking office?

We have devised a comprehensive change in the way in which health care is delivered—health care in the work comp arena, in auto and in health—one that has been said by The New York Times and others to be a model for the nation. This is the most substantive and complete reform of workers compensation proposed by anybody. It's a whole lot more than what's traditionally known as 24-hour care.

(The Legislature earlier this year passed a bill to establish a commission to design and implement a universal health insurance system as proposed by Mr. Garamendi. But, the measure was vetoed by Gov. Pete Wilson.)

But we haven't yet stomped out fraud in California. It's still going on even though we've increased the activities of the department.

And we still hope to achieve a legislative victory for a true low-cost auto insurance policy and reform of the auto insurance system. We're up against some very powerful interest groups. We hope to win that fight, if not this year, then next year.

Work comp also remains a very serious problem.

You weren't the first regulator to promote 24-hour care. But since you took up the cause, it's getting more attention. In fact, the NAIC's workers compensation task force, of which you are a member, is looking for a pilot 24-hour project to study. Do you see 24-hour care as the trend?

What we have done is taken the 24-hour concept, which is the merger of health care and workers compensation, added auto insurance to that and then figured out a way to make it universal and to pay for it.

The problem that the 24-hour concepts previously had is that they simply merged workers compensation and health and did not provide for the continuity of health care throughout the life of the individual. That won't work. So what we've done is to provide the 24-hour concept in a universal health coverage and a method of paying for it that is equitable and fair and reduces the cost of the system.

Is the NAIC task force following the legislation's progress?

The NAIC task force is definitely following this. And they're also looking at other experiments. They're looking at models that test whether you can combine workers compensation and health insurance without having the universal system that's ongoing.

As our concept picks up more momentum, it may become another one of the models. And if we change the president, I think we're going to see more states given power to establish models and maybe even some funding mechanisms at the federal level.

Until a few years ago, the public didn't seem to care about insurance regulation. Now, stories about California—and you in particular—are on the front page of The Wall Street Journal. Can you explain this phenomenon?

Insurance is a direct pocketbook issue for business and for individuals, and the costs are increasing to the point where people are very aware. Auto insurance, health insurance, workers compensation, homeowners insurance are all significant expenditures in the family budget—in some cases the second- or third-biggest expenditure.

On the other side, the public is aware they're not getting paid. The insurance industry's first commandment appears to be being obeyed, which is 'pay as little as late as possible.' And so the consumers who have a claim are getting stuck; they're getting mad.

The result is that this is moving to the forefront of political agendas as people complain to their legislators, 'We're mad we're not getting paid.'

In addition, in Los Angeles, the uninsured population is perhaps as much as 40% of the drivers, and 40% of the population doesn't have health insurance. It is a serious problem. It's only natural that it become a political issue.

How would you compare your approach as a commissioner with that of other regulators? Is it difficult to balance consumer advocacy with regulation?

Many of my predecessors used this job to protect the industry and to do the will of the industry. We reject that notion. Consumer advocacy, consumer protection, is the task of regulation.

If you go through all of the laws and all of the past regulations that have been written about insurance, they are there for the protection of the consumer.

For example, the Unfair Claims Practices Act is not there for the industry. It's there to force the industry to pay claims in a fair and prompt manner. And the solvency laws are not there for the protection of the industry. They're there for the protection of the consumer.

I don't think there's a page in the California Insurance Code that is designed for the benefit of the insurance industry.

I am the insurance industry's policeman. I have no interest in being its lover. My role is to regulate and police the industry and to protect the consumer.

Do you think other regulators view regulation as you do?

I hope so. I know many do. I don't know all of them, and I don't know all that's on their soul, but from what I see when I meet with them, when I talk with them, when they call me, they see it the same way. They may have a different idea of how to get there, but I think they see it the same way.

Is there any indication that your aggressive, high-profile approach to insurance regulation has begun to influence regulators in other states?

Each state is different. Each state has its own unique circumstances. It's not my task to influence what other states do, but to work with them to achieve our goals in California. To accomplish that, we reach out to other states as we are with the L.A. riot situation and say, 'We've got this problem in California. We see underinsurance; we see unlicensed companies operating in our state; we see redlining, non-payment of claims and so forth. Do you have the same problem? If so, let's work together.'

We've found an enormous synergy coming out of that. When I raised the question last spring at the meeting of the NAIC, about 10 other regulators came up and said, 'I want to work with you on that because I think we've got that problem in our state.' And we're doing that.

A dozen states elect their insurance commissioners. Do you think the attention that regulators like you have brought to insurance issues is likely to prompt other states to begin electing their commissioners?

I don't know. But I do believe we are proving here in California that an elected commissioner can be an effective regulator.

I believe I have changed this department's orientation, and it's well on the way to becoming an effective consumer protection agency. It was not that before.

And I'd like to believe that if I were appointed to this job, that I would do the same thing.

Should regulators take a different approach to regulating commercial lines than personal lines since commercial buyers are more sophisticated?

Yes, there is a difference.

Commodity insurance, which is a standard policy sold both to individuals and to business, needs a heavier amount of regulation and oversight because the purchasers generally have little information and are not in the position to negotiate price.

On the other hand, there is a type of policy that is a negotiated policy, which we call commercial. That policy requires far less regulation. The buyer is usually sophisticated and has a staff of lawyers and accountants or actuaries. The amount of premium is so large that it warrants both a special contract as well as the special attention of the buyer and the seller.

We structure our efforts along those lines. Specifically, we have structured our prior approval regulations under Proposition 103 taking into account that differential.

Our rate regulations, had the governor approved them, would have provided a heavy standard of review on price increases for both the personal and business commodities insurance policies. For commercial lines, we had a low level of review and did not envision significant rate regulation. We saw that as a negotiated agreement between the parties.

Now, the other side of the coin is financial solvency. In that case, it makes no difference whether it's personal or commercial. We look with a very heavy magnifying glass at the finances of the company, regardless of whether they are writing personal or commercial lines.

I guess maybe half—40%—of our effort here is on financial auditing.

Do you think there should be federal solvency regulation?

It will not work to split solvency regulation from rate regulation. The regulator on either side has to be aware of the other side. And to allow one governmental entity to regulate solvency and another to regulate rates won't work.

If the federal government regulated solvency and the states regulated prices, the industry would be in big trouble in a big hurry.

The solvency effort at the federal level should only be to set certain standards or to deal with

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companies not regulated at the state level: for example, unlicensed companies located offshore, some of the reinsurance that is international in scope and international insurance that states are unable to get a handle on.

The NAIC is attempting to do that through its model solvency regulation and certification of departments.

Do you think the insurance industry should keep its antitrust exemptions under the McCarran-Ferguson Act?

Since Proposition 103, California has operated without antitrust loopholes, and the insurance industry has been subject to antitrust laws. Now that's been 3½ years and there's been no great problem.

I believe the McCarran-Ferguson loophole to the antitrust laws should be repealed and the insurance industry should be forced to compete.

How would you assess the effectiveness of state regulation? For example, how could an insurer, like Executive Life, have been allowed to accumulate enough junk bonds to constitute two-thirds of its assets?

Insurance regulation was unable to keep up with the rapidly changing society and economy in the go-go 1980s.

First, regulators did not understand the risks that debt financing would create both in the general economy and in the insurance industry. Secondly, so many new products were generated in the 1980s that, operating together with the new investment vehicles like junk bonds, an enormous risk was created. The situation was made worse by the Reagan philosophy that was adopted throughout the country that regulation was evil and that government was bad.

'I am the insurance industry's policeman. I have no interest in being their lover. My role is to regulate and police.'

We delivered a big fat report to the Dingell committee that shows the Department of Insurance had information that indicated trouble. But instead of stepping forward to manage that problem, they stood back, as was the instruction of the president of the United States: 'Deregulate—don't get in the way of American business.' And they didn't. The department, federal regulators, state regulators just stood back.

Ronald Reagan set the tone in America, and in setting that tone, he created the opportunity for the collapse of Executive Life. It all flowed from the deregulation theory.

But because of the very aggressive intervention that we did in California, we were able to instill confidence in the life insurance industry. Had we not acted aggressively in the case of First Capital and Executive Life, the life insurance industry may have collapsed like the savings and loan industry.

With the upturn in the junk bond market, would it have been better, in hindsight, not to have taken over Executive Life? Wouldn't things have worked themselves out?

Executive Life was insolvent, badly insolvent. The regulations, the laws, required me to take action. The upturn in the junk bond market did not create sufficient value in those bonds. Executive Life did not own the average portfolio—whatever that is. It owned a very special portfolio that was $3 billion under water. There's no way that an upturn in junk bond ratios would have done anything to make this company solvent.

Looking back at Proposition 103, do you think it's a good idea to regulate by initiative?

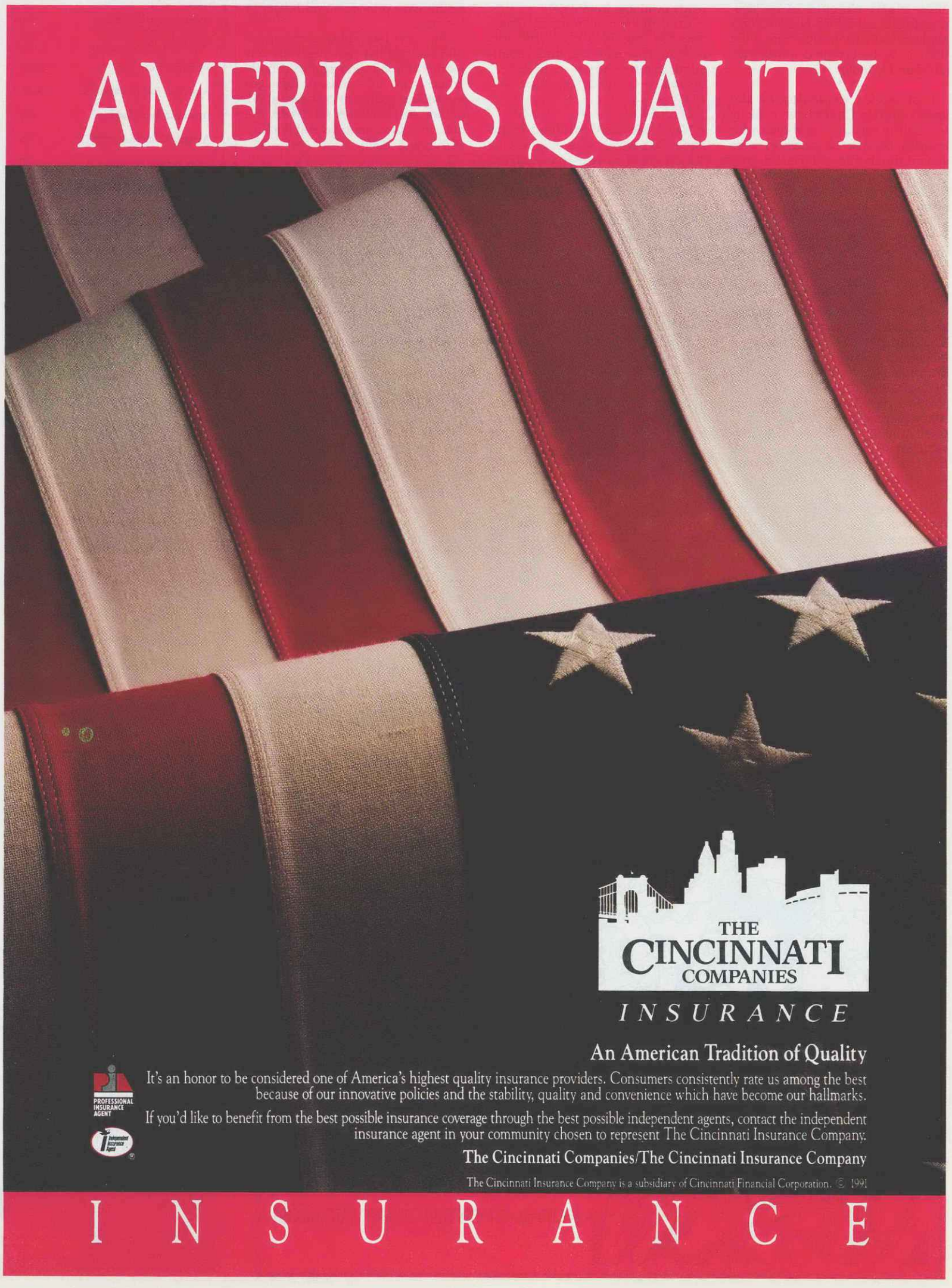
103 is not perfect. There are things in 103 that could have been written differently. But then again, no law is perfect, and over time all laws need to change and modifications need to be made. That's why 103 was modified about 20 times between 1988 and today. Change is the genius of the American system.

But while 103 was not perfect, it was necessary in changing the attitude of the industry.

What would you say is the biggest problem facing the insurance industry today?

It listens to its lawyers, not to its consumer relations people. The industry sells a consumer product, whether it's a consumer as huge as General Motors or as small as Mrs. Jones on any street in any town. The industry just doesn't understand that. It treats it as though it is a legal issue. And often it is a legal issue, but it always is a consumer product, and consumer satisfaction somehow is lost on a good part of this industry.

And they wonder why they are being battered in the press, why I get angry with the industry, why consumers vote for laws such as Proposition 103, why regulators and legislators are not listening to them. The reason is they're not listening to their consumers. BI



Workers Comp Woes

Employers face an uphill battle to mend ailing workers comp system

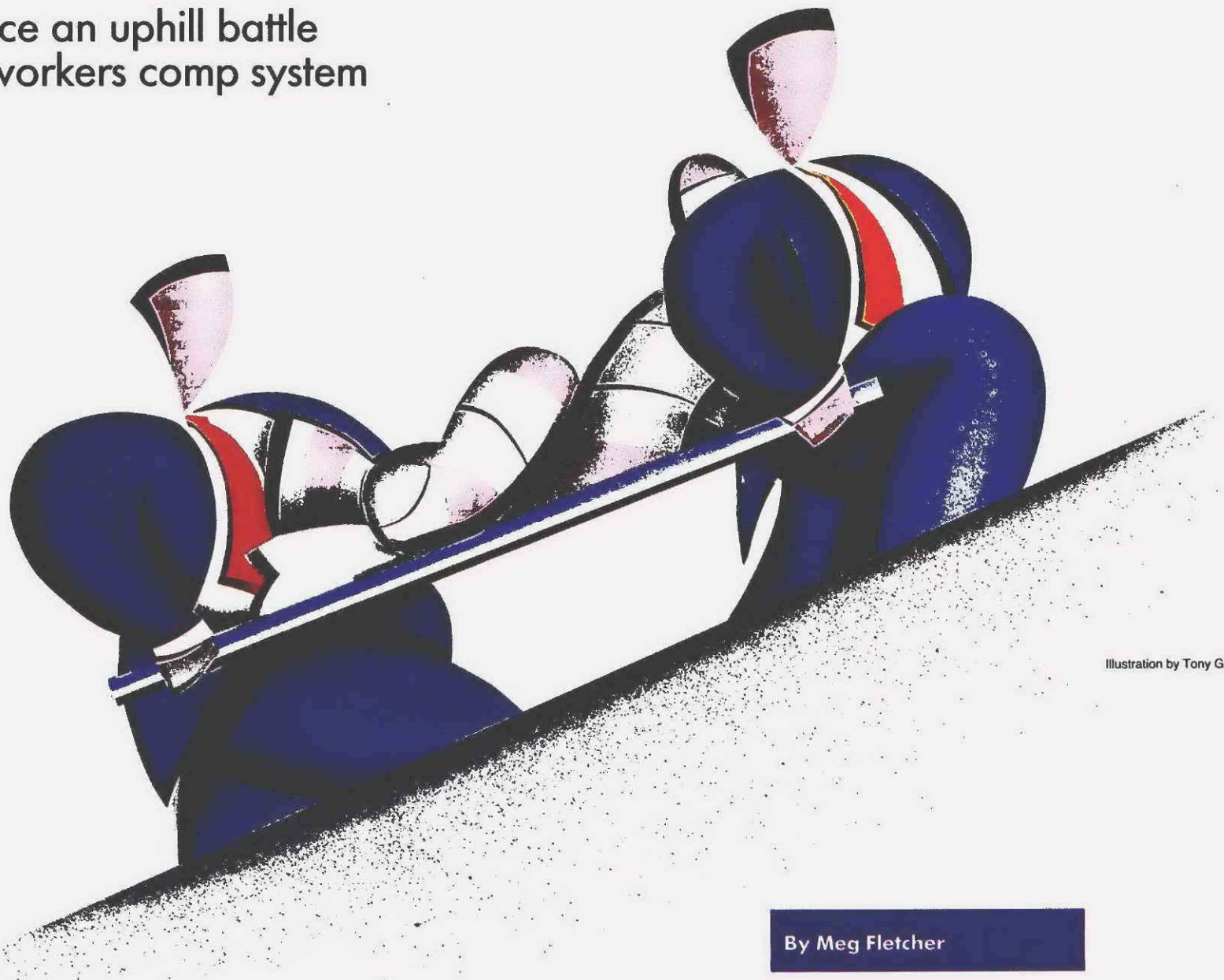


Illustration by Tony Griff

By Meg Fletcher

U.S. employers are paying more than $60 billion a year for a workers compensation system that's in worse shape than many of the injured workers it serves.

Costs now are rising at the rate of $7 billion per year, about 2½ times faster than the total $2.8 billion increase in overall workers compensation costs between 1960 and 1970.

Workers comp costs now average about 2.3% of payroll for insured and self-insured employers, more than double the 1% common 25 years ago.

The huge cost increases are caused by many problems, including rising medical and wage-loss benefit costs, a broader definition of compensable claims, a boom in workers comp-related litigation and inequities in benefit distribution.

But all of these problems should not overshadow the fact that the workers compensation system is based on a sound concept that has effectively compensated millions of workers with minor occupational injuries. In addition, some point out that benefit levels now adequately compensate more injured workers than 25 years ago.

"Fundamentally and conceptually, workers compensation is a system that had enormous and compelling balance associated with it," said Gary Countryman, chairman and chief executive officer of Liberty Mutual Insurance Co. in Boston, the nation's largest workers comp insurer.

The state-based workers compensation system in the United States—which began 81 years ago in Wisconsin—combined elements of tort law and European social insurance programs into a unique, no-fault system, noted Arthur Larson, a professor at Duke University Law School in Durham, N.C., and author of a prominent book on workers comp.

The so-called exclusive remedy doctrine essentially meant a worker injured on the job—regardless of fault—would receive prompt medical benefits and a modest level of income benefits. In exchange, the worker and his dependents relinquished their common-law right to sue the employer for any workplace injury covered by the system. The employer was to consider workers comp costs as part of the cost of production and include it in the price of its products.

Since its inception, the program has functioned fairly well for about 80% to 90% of all injured workers, emphasizes Edward Welch, an associate professor at Michigan State University in East Lansing and secretary of the Labor/Management Discussion Group on Workers Compensation (*BI*, Sept. 28).

"Conceptually, it is sound," Mr. Countryman said. "What's wrong with it is that we've got lousy execution."

While insurers are complaining now, 25 years ago it was workers who were hurting.

State workers comp programs then covered fewer workers and often paid meager benefits, leaving some injured workers with sub-poverty-level income.

But states began to improve their laws and benefits, spurred by labor representatives' attempts to improve the plight of injured workers through federal standards for state-based workers comp systems or even federal administration of the program.

A 1972 report by the National Commission on State Workmen's Compensation Laws, established as part of the Occupational Safety and Health Act of 1970, reinforced the value of state-based workers comp programs—as long as benefits were significantly improved. States largely complied, prompted by the explicit threat of federal standards.

Of course, the system was much different then. Claims generally stemmed from "typical" industrial injuries and illnesses, as opposed to cumulative trauma disorders or stress. Workers received medical care for those ailments under traditional fee-for-service arrangements. And there was less litigation.

From a financing standpoint, the system operated on a "pass-through" basis.

"Most employers filed a claim and dumped it in the lap of the insurer and didn't worry about it," said Lucille Gallagher, vp-risk management for Monfort Inc. in Greeley, Colo.

"There was a much different regulatory environment in which costs were rising at a much slower rate and there was a much more routine pass-through of those cost in terms of higher insurance rates," concurred Liberty Mutual's Mr. Countryman.

Workers compensation insurance "wasn't very expensive and it didn't make much difference if you had a delivery system that wasn't very efficient," said John F. Burton Jr., director of the Institute of Labor and Management Relations at Rutgers University in New Brunswick, N.J.

However, large companies that have self-insured their workers compensation exposures for years "continued to refine and improve their claims operations. . .incurring lower costs through constant monitoring of medical claims and policies of returning injured employees to work," said Douglas Stevenson, executive director of the National Council of Self-Insurers in Chicago.

In time and by necessity, these cost-cutting techniques spread to smaller companies and those insurers that had not already adopted them, he said.

"What has changed most fundamentally" in the past 25 years "is the pace of cost increases," said Mr. Countryman.

Preliminary data for 1991 indicate that the workers compensation system cost U.S. employers $62 billion, up $7 billion—or 12.5%—from an estimated $56 billion in 1990, according to conservative estimates Mr. Burton developed from Social Security Administration statistics.

In comparison, "from 1960 to 1970, the annual costs of workers comp increased relatively 'modestly'—from $2.1 billion to $4.9 billion," Mr. Burton said in a recent issue of his "Workers Compensation Monitor."

"Then occurred a decade of rapid growth in costs that quadrupled the annual expenditure on the program, culminating in the 1980 figure of $22.3 billion," he said.

The 1980s began with a relatively moderate increase in workers comp costs: total costs rose only 12.1% between 1980 and 1984 to $25.1 billion. But, the increases became sharper—totaling between $4 billion to $5 billion annually—between 1984 and 1989, he said.

"Rising medical costs were the key cost-driver," said William Hager, president of the National Council on Compensation Insurance in Boca Raton, Fla.

"In workers compensation, expenditures on medical care grew by nearly 400% from 1975 through 1985," said Richard A. Victor, executive director of the Workers Compensation Research Institute in Cambridge, Mass.

Medical costs now generally account for at least 40% of all workers compensation costs, but can reach 50% or 55% in some states.

Contributing to this trend is the fact that the workers compensation system has been slower than the group health care industry in adopting medical cost containment programs. Because of this, medical providers shift expenses no longer reimbursed by group health care plans to workers comp programs, which exacerbates the rise in medical costs.

The fundamental agreement that underlies workers compensation makes it difficult for employers to implement cost control strategies, like limits on employees' choice of physicians, even though such an approach "is now the best way to go to obtain quality care that is cost-effective, according to Ms. Gallagher.

In its desire to preserve that fundamental agreement, labor is "adamantly" opposed to medical care copayments and deductibles, now common in group health care plans, though labor does accept appropriate utilization review procedures, said James Ellenberger, assistant director for the AFL-CIO's Department of Occupational Safety and Health in Washington.

Also contributing to rising medical costs is the increased litigiousness of the system, which causes additional medical services to be performed to substantiate lawsuits, Mr. Victor said.

While much of the focus has been on increasing medical costs, the drive to increase wage-loss benefits in the 1970s also has bloated workers comp costs.

In addition, workers compensation is tapped as a supplemental unemployment insurance program by some employees: An employee who faces a layoff will file a workers comp claim to ensure a source of income.

And, though wage-loss benefits have increased, they have not been increased equitably.

The WCRI is concerned with

Continued on next page

Continued from previous page
how benefits for temporary disability and additional payments for any residual permanent impairments are distributed.

For example, some workers with temporary disabilities—depending on their tax brackets—receive more than 100% of their lost pretax earnings, while others receive less than 80%.

This occurs when states do not consider the effect of tax-free workers comp benefits on an employee's income.

In addition, some states overcompensate employees with minor injuries and undercompensate those with major injuries.

Adding to cost pressures is the expanding definition of compensable injuries.

Just as claims involving backs and heart disease have always posed problems for the system, so do claims—like carpal tunnel syndrome and stress—stemming from growing service-sector jobs, Mr. Burton said.

In addition, there has been increasing coverage of occupational diseases in addition to traumatic accidents.

However, despite the overall growth of such claims, many states still impose inappropriate claims filing deadlines given the delay between exposure to a toxic substance in the workplace and manifestation of an ailment, he said.

Despite efforts to define exactly what types of injuries and illnesses are compensable, workers comp litigation continues to grow and boost system costs.

"In many cases workers want more than the system is set up to provide," said Charles O. Davis, executive director of the National Conference of Insurance Legislators in Brookfield, Wis.

"I think we have a lot of litigation for a number of reasons," Mr. Welch said. Workers compensation deals with issues that are "very nebulous," such as how much an injured worker's back hurts. "We'll never eliminate disputes, but we want to reduce them."

States have made gains in reducing litigation by promoting informal dispute resolution or using independent medical examiners. But overall, the complexity of workers comp laws and rising awards have attracted lawyers—and litigiousness—to the system.

In addition, Mr. Welch noted, employers and insurers sometimes do not pay the benefits a worker deserves, or an employee must sue to get any response from his or her employer.

Still, the concept that workers comp is an employee's exclusive remedy ". . .has held up rather well in the past 25 years, despite mounting attacks by opponents of workers comp," said Eric Oxfeld, assistant general counsel of the American Insurance Assn. in Washington.

Interest in the causes of escalating workers compensation costs rose as insurers' financial results deteriorated.

From 1967 to 1984, workers comp generally was a profitable line of business for insurers as the market operated on a seven-year underwriting cycle, Mr. Hager said.

In the mid-1980s, there was a fundamental change that saw dramatic increases in workers comp insurers' combined ratios, which ballooned to 123% in 1991, he said. Insurers lost 10 cents on every workers compensation premium dollar after investment income in 1991, the NCCI reports.

In short, workers comp business plunged into the red in 1984 and has yet to resurface.

Insurers' efforts to get the message across to buyers was "muted" because regulators approved only a portion of the rate increases insurers sought, Mr. Countryman said.

While indemnity costs rose 11.2% and medical costs rose 12.8% in 1991, workers comp premiums increased by only 7.4%, the NCCI says.

Insurers' unwillingness to sell workers comp at a loss has fostered the growth of residual markets, which now write 25% of all workers comp premiums.

In Maine, for example, insurers have fled the state. Now, more than 90% of Maine premiums are written by the residual market.

Insurance regulators responded with increasing scrutiny of insurer rate filings and operations, trying to eliminate what they considered to be excessive profits and inefficient administrative procedures.

In some states, legislators have established competitive state funds in hopes that a government-sponsored facility can hold down costs that private insurers have been unable to control.

Employers explored different alternatives.

Employers increasingly are turning to self-insurance; 30% of all employees now are covered by self-insured workers comp plans, compared with 20% in 1980, said Mr. Stevenson of the National Council of Self-Insurers.

Self-insured workers comp programs produced the equivalent of $19.4 billion in premiums last year, up 27.4% from $15.3 billion in 1990, according to a study by Johnson & Higgins and IMR Corp.

However, employers' exodus to self-insured plans has led some states to demand higher levels of security or the establishment of self-insurance guaranty funds to ensure that workers will continue to receive benefits should their employer go out of business.

More than 25 states have established such guaranty funds since Michigan instituted the first in 1972, Mr. Stevenson said.

In Texas, the largest state that allows employers to opt out of the workers comp system, about 40% of all employers have left the system and its protections against tort lawsuits.

Substantive reforms recently passed in a few states, including Texas and Oregon, are offering a weak ray of hope that the problems plaguing the workers comp system can be resolved, Mr. Hager said.

Also encouraging are signs that risk managers increasingly are focusing on loss control to prevent claims in the first place.

Over the past 25 years, employer costs have been increasingly allocated to individual production units, which makes lower-level managers more aware of workers compensation problems and more willing to prevent accidents.

"Now, the employer is much more involved in the process of preventing injuries and managing the case," Ms. Gallagher of Monfort Inc. said. BI

Associate Editor Meg Fletcher joined BI in 1984 and has covered state regulatory and workers compensation issues since 1987.

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BI–WC

A Conversation With:

John F. Burton Jr.

John F. Burton Jr. has been called the "keeper of the flame" for an enlightened workers compensation system.

Twenty years ago, he was chairman of the federal National Commission on State Workmen's Compensation Laws. In its landmark 1972 report, the commission concluded that states generally offered "inadequate and inequitable" protection to workers, but states—not the federal government—should continue to regulate workers compensation.

Since then, Professor Burton has been discussing and evaluating efforts to improve workers compensation systems, in addition to his teaching and research.

He is now director of the Center for Labor and Management at Rutgers University in New Brunswick, N.J., and edits a newsletter, John Burton's Workers Compensation Monitor.

He also has taught at Cornell University, the University of Chicago and Yale University. He holds a doctorate in economics from the University of Michigan.

After a recent workers compensation symposium, Associate Editor Meg Fletcher caught up with Mr. Burton over breakfast and on a brief airline flight.

* * * *



Photo by David Lubarsky

What are the most significant problems facing workers compensation today?

Defining the proper scope of the program is certainly an increasingly challenging problem, because there is no easy solution.

The issues emerging in a lot of cases today—like carpal tunnel syndrome and stress claims—are really testing the ability of the system to draw the line for compensability. This problem has become worse in recent decades, and I suspect is going to continue to get more complicated.

The program as originated had a pretty straightforward task—dealing with injuries that mostly resulted from traumatic events. You could pretty well tell whether or not the injury was work-related.

However, origins of some types of disorders—like back disorders or lung disorders—have always been hard to determine.

Would back injuries be an example?

Back problems are often caused by a mixture of hereditary predisposition to back problems and the aging process. Then there can be things at the workplace—like trauma or strain that develops over a period of years.

Since backs have long been a problem of the workers comp system, we've worked out some legal rules to decide which backs 'get in' and which backs are 'out.' But I don't think those legal rules are defensible in a lot of cases on the basis of scientific knowledge.

Deciding which cumulative trauma disorders 'get in' and which do not is a tough issue, too, because drawing a line between work-related and non-work-related is inherently very difficult.

I don't think there are right answers on this thing. I just think that the system is being tested in terms of its ability to deal with these conditions with mixed etiology, and it's causing tremendous strain to the system and leading to litigation and delays.

How does the problem of defining the scope of a workers compensation system affect medical care?

Questions are increasingly being raised about whether medical care —and even income benefits—ought to be provided on a different basis for a compensable injury because the need for medical care arose from the workplace.

The issue is being discussed because of a variety of health care-related proposals to control costs, like 24-hour coverage experiments.

In terms of other health-related initiatives, I think people will wait and see what happens for a few years, unless the level of frustration gets so high that some states or the federal government do something on their own.

What would be the ideal wage-loss benefit level for workers compensation?

Getting a benefit system that is adequate but not excessive is a real challenge for the overall system.

The national commission was looking at programs that in almost every state were inadequate and sometimes below the poverty level of income. We've had a lot of progress on that in most states.

However, there is a problem in some states of non-taxable workers compensation benefits replacing a very substantial portion of a worker's lost take-home pay, sometimes 100%, resulting in benefits being too high.

The national commission recommended that benefits be 80% of spendable income. We should be moving to schemes that don't have such disincentives to return to work built into them.

On the other hand, several states still have inadequate benefits.

Just how well is the workers compensation system now delivering benefits to injured workers?

The delivery system in many states is simply not up to the task. By delivery system, I mean everyone it takes to get the benefits out to the workers, including insurers, self-insurers, lawyers, doctors and the state agency officials.

If anything, it has become worse in some jurisdictions because as benefits have gone up, more lawyers have been attracted to the system because it is a more lucrative place to make a living now.

In many cases, those lawyers should be there, but not to the extent that they are in some states like California, where legal system costs are $1.5 billion per year just to pay physicians and lawyers—not for treatment or testimony.

But we are beginning to move on that challenge as states like Texas and California in the last few years have passed legislation to try to improve the delivery system.

The key to that is you have to have adequate resources for state workers compensation agencies. They have to have decent data systems, good personnel and a mission that makes them something other than a quasi-court.

They've got to view their role as monitoring and providing assistance to workers, employers and carriers to try to reduce the need for litigation. That's the challenge we really have for the system for the next decade: Trying to figure a way to get better delivery systems.

How have states responded to the national commission's 1972 report?

We've made enormous progress in the area of benefit levels.

As of 1972, the benefit maximums were exceedingly low and perhaps only one state complied with the national commission's recommendation that benefits be at least 100% of the state's average weekly wage. The majority of states had maximums below the poverty level.

Now, we have more than 30 jurisdictions complying with that recommendation.

Other popular recommendations include requiring most employers in most states to provide workers compensation protection and removing limits on the right to medical and physical rehabilitation benefits.

States have also made progress in protecting workers from occupational disease claims, but probably half of them have limits on diseases that they don't have on injuries. But states haven't done much to increase workers comp protection for farm workers or household and casual workers.

Are there still large discrepancies among states?

A dozen or so states still have workers compensation benefits and coverage far below what the national commission recommended, states like Arkansas, Mississippi and Indiana.

We have a system with gross inequities among states and, while not denying the general progress, the fact that we still have those states is of great concern to me.

Overall though, it's fair to say that, compared with 20 years ago, we now have a much stronger workers compensation program in terms of coverage and benefit levels.

Many states made substantial improvements in the 1970s. It's gratifying that we have not slipped backwards in the 1980s, in terms of compliance. It is particularly impressive in light of the fact that given the last 20 years, the unemployment insurance program has experienced very bad slippage.

Are federal standards needed to get states to adopt more of the recommendations?

The continuing number of low benefit states makes me think that the case for federal standards is still compelling.

Given the fact that after 20 years we still have those, I despair of voluntary action even with the encouragement of groups like the National Conference of State Legislatures.

However, the concept of federal standards as the national commission recommended would not displace states from running the program. It would simply say that if you've got a state program, this is simply a floor below which you can't go in terms of coverage or benefit levels.

At the time the national commission made its report, states were threatened with federal standards if they did not comply. However, the prospects of federal standards being developed solely for workers comp are quite slim in the near future.

How might federal standards be achieved?

What might happen are indirect routes. One could be the movement toward some solution to the health care crisis. It is not inconceivable that we will have a mix of federal and state health care programs for workers, and it is possible it might sweep in the health care for workers comp.

The other possibility may stem from the product liability reform movement since a lot of those lawsuits affect what happens at the workplace.

The Bush administration has proposed federal standards, and we need to think about the implications of those standards for workers comp.

But, I do not think there is much prospect for a federally administered workers comp program.

Why not?

First, it would require a massive dislocation of state employees and, politically, I don't think that is going to happen.

Second, the reputation of some of the federally administrated programs—deservedly or undeservedly—is pretty poor. As a result, I think Congress is skeptical—if not cynical—about the prospect of turning over the administration of the state programs to federal employees.

That is why, in part, the national commission said to leave the administration to the states but superimpose on it some standards.

What can an individual employer do to reduce workers compensation costs?

Research suggests that within a given state like Michigan—which has average costs and average benefits—there is wide variation in the cost of workers compensation programs among similar employers. The variation depends upon employers' strategy about improving safety rules and involving employees.

One thing that has become increasingly evident from research in recent years is that individual employers have a great deal of ability to reduce their costs and improve their safety and health records and get employees back to work. BI

Looking Back



Only $1 million in liability insurance is known to be available to cover damage awards from a New Year's Eve fire at a hotel in San Juan, Puerto Rico, that killed 96 people and injured as many as 125 others.

The $1 million primary policy for the **San Juan Dupont Plaza hotel** was written by an American International Group Inc. unit (*BI*, Jan. 12, 1987).

* * *

MEDMARC Ltd., is the first captive insurance company to come ashore as a **risk retention group** under the recently expanded Risk Retention Act.

MEDMARC, an 8-year-old Bermuda-based group-owned captive, is now domiciled in Vermont and will provide up to $5 million in product liability coverage to medical equipment manufacturers (*BI*, Feb. 2, 1987).

* * *

A California court is giving permission to the California Insurance Department to liquidate **Mission Insurance Co.** and four of its subsidiaries. The liquidation order ends more than a year of frenzied efforts to keep Mission alive.

The Mission insolvency currently totals $520 million and may be the largest insurance company insolvency in history (*BI*, March 2, 1987).

* * *

New York Insurance Department Superintendent James P. Corcoran is suing Frank B. Hall & Co. and auditor Touche Ross & Co. for $140 million, charging they are responsible for the insolvency of **Union Indemnity Insurance Co.** of New York, a former Hall unit.

The suit accuses Hall of "neglecting and abusing" Union Indemnity, which was ordered liquidated by a New York court in 1985, and accuses Touche Ross of knowingly approving false financial statements for Union Indemnity (*BI*, March 16, 1987).

* * *

For the first time in three years, increased competition among world aviation underwriters is forcing **airline hull and liability insurance rates** to fall and capacity to rise.

London brokers and underwriters predict that the 20% to 30% hull and liability rate reductions many airlines obtained during April 1 renewals may mark the beginning of a downward spiral into a soft market (*BI*, April 20, 1987).

* * *

Legislation being drafted by Rep. Rod Chandler, R-Wash., would give employers a new tax-effective way to fund their **retiree health care liabilities**.

The legislation would allow an employer to make annual tax-deductible contributions of $2,000 per employee to a special retiree health care trust. The funds would accumulate tax-free interest.

Business groups say their members would welcome a tax-attractive vehicle to fund the tens of billions of dollars in promised but unfunded retiree health benefits (*BI*, May 4, 1987).

* * *

The wave of **tort reform legislation** enacted by many states in 1986 will have only a slight effect on liability claim indemnity costs, but a trio of stronger reforms could, according to a new study.

The Insurance Services Office study says the complete elimination of joint and several liability, substantial relaxation of the collateral source rule and a $250,000 cap on non-economic damage awards could reduce indemnity payments in 24 studied states by between 48% and 83%, depending on the state (*BI*, May 11, 1987).

* * *

Sir Peter Green, a former chairman of Lloyd's, was censured by a Lloyd's disciplinary committee and fined about $55,000 for "discreditable conduct" while he was an underwriter.

Sir Peter was found grossly negligent for failing to improve the terms of one of his syndicates' reinsurance policies between 1978 and 1982 (*BI*, May 11, 1987).

* * *

Pillsbury Co. is creating a new **flexible benefit plan for retirees** to give the company a greater ability to control costs, while providing retirees more benefit flexibility.

Retirees will receive credits, based on length of service with the company, to be used to purchase medical, dental and life insurance coverage.

The Pillsbury program is thought to be the first retiree flexible benefit plan (*BI*, May 18, 1987).

* * *

Sen. Edward Kennedy, D-Mass., is introducing legislation to **require all employers to offer health insurance coverage** to their workers.

The latest Kennedy proposal, though, is less onerous than his earlier measures. An employer, for example, would be allowed to alter individual benefit provisions, like offering a higher medical deductible, if it paid a higher percentage of the premium.

Sen. Kennedy estimates that the legislation would increase employers' health care costs by $25 billion annually (*BI*, May 25, 1987).

* * *

Insurers say they will fight legislation introduced by Sen. Howard Metzenbaum, D-Ohio, that would gut the **McCarran-Ferguson Act**.

Among other things, the legislation would bar the Insurance Services Office from analyzing claims information and publishing advisory rates (*BI*, June 8, 1987).

* * *

In one of the largest suits of its kind, Westinghouse Electric Corp. is suing all of its property and liability insurers since 1948 for the defense and indemnification of **pollution claims** against the company.

The suits seek coverage for the cost of cleaning up 74 separate hazardous waste sites nationwide and for responding to hundreds of bodily injury claims filed by Westinghouse customers claiming they were exposed to toxic substances contained in the company's products (*BI*, June 15, 1987).

* * *

The **competitive property/casualty insurance market** is accelerating. Brokers report that property rates are falling at least 25%, while rates for most types of liability insurance are dropping 10% to 15% (*BI*, July 13, 1987).

* * *

Police in Britain and France have arrested five **former officials of Alexander Howden Group P.L.C.** on various charges of fraud or theft.

The officials, including flamboyant former Lloyd's underwriter Ian R. Posgate, were arrested in connection with the siphoning of "millions of pounds" from Howden and its subsidiaries prior to 1982 (*BI*, July 20, 1987).

* * *

All employers must inform workers of the potential dangers of any hazardous substances used in the workplace starting next spring.

The Occupational Safety and Health Administration's newly expanded **hazard communications standard** will cover 32 million workers in 3.5 million locations when it becomes fully effective (*BI*, Aug. 24, 1987).

* * *

The use of **case management when treating people with AIDS** can cut medical expenses to a fraction of the costs incurred by employers relying on unmanaged hospital care (*BI*, Sept. 7, 1987).

* * *

The Pension Benefit Guaranty Corp. is returning three previously terminated pension plans, which have more than $2 billion in unfunded liabilities, to **LTV Corp.**

The PBGC took its action, after Dallas-based LTV, which earlier said it couldn't afford to contribute to its pension plans, set up a new low-cost pension program (*BI*, Sept. 28, 1987).

* * *

Insurers issuing policies to **purchasing groups** organized under the federal Risk Retention Act are subject to state regulation, a federal judge says.

U.S. District Court Judge John F. Keenan says the law does not supersede state regulation of rates and forms of purchasing group policies (*BI*, Oct. 5, 1987).

* * *

A trial begins today in the largest **insurance coverage dispute over pollution claims**. Shell Oil Co. is seeking coverage to pay potentially billions of dollars in cleanup costs for pollution at the Rocky Mountain Arsenal near Denver and McColl Air Force Base in Fullerton, Calif.

The litigation involves more than 250 of Shell's insurers dating back to the 1940s (*BI*, Oct. 12, 1987).

* * *

The House Ways and Means Committee has passed legislation that could curb the appeal of **flexible benefit plans** and blunt the plans' edge in controlling health care costs.

Under the measure, a $500 cap would be placed on the amount of pretax contributions employees could make to the plans, virtually wiping out the ability of employees to make sufficient pretax contributions to cover dependent care expenses (*BI*, Oct. 19, 1987).

* * *

The **stock market crash** is unlikely to cause the commercial property/casualty insurance market to tighten, even though the crash reduced insurers' surplus by about 10%.

The record one-day 508-point drop in the Dow Jones 30 Industrials may restrain competition somewhat, but many experts believe lower rates are inevitable because the industry enjoys a glut of capital (*BI*, Oct. 26, 1987).

* * *

Florida Insurance Department officials and representatives of the Miami-based **Insurance Exchange of the Americas** will meet to determine whether the exchange can be revived or allowed to die.

The exchange has been closed since huge reinsurance losses were discovered in February (*BI*, Nov. 2, 1987).

* * *

The House of Representatives has approved legislation scaling back penalties for **employers that violate COBRA**.

Under the new penalty structure, no fines would be applied for violations that are inadvertent and are corrected within 30 days. In other situations, the penalty would be $100 for each day an employer failed to extend coverage to a beneficiary (*BI*, Nov. 2, 1987).

* * *

Employers with retiree health plans may not reap any immediate savings even if Congress passes legislation to **expand the Medicare program to cover more catastrophic expenses.**

A "maintenance of effort" provision tucked into the legislation just before it passed the Senate would require employers that cut back retiree health care programs to eliminate benefits that duplicate Medicare coverage to pass those savings on to retirees for a one-year period (*BI*, Nov. 16, 1987).

* * *

The **New York Insurance Exchange** is closing its doors to new and renewal business following membership approval of an underwriting suspension.

Syndicates stopped binding business Nov. 23 and agreed not to issue policies with effective dates subsequent to Dec. 31 (*BI*, Nov. 30, 1987).

* * *

The St. Paul Cos. Inc. has bid $495 million to buy the outstanding shares of **Minet Holdings P.L.C.** St. Paul submitted its bid after Lloyd's of London dropped its ban on insurance companies holding more than 26% of a Lloyd's broker.

St. Paul would become the first U.S. insurer to own 100% of a Lloyd's broker (*BI*, Dec. 14, 1987).

* * *

Congress is unlikely to reduce **COBRA's huge tax penalties** this year. Benefit experts say all technical provisions, including a provision that would set a $100 a day penalty limit on COBRA violations, will be stripped from a pending budget reconciliation bill.

That means employers can expect no relief until next year—at the earliest—from COBRA's current penalties: loss of the tax deduction for health care expenses (*BI*, Dec. 14, 1987).

* * *

Congress has approved legislation that will for the first time require employers with defined benefit pension plans to pay **premiums to the Pension Benefit Guaranty Corp.** on the basis of the funding levels of their plans.

The old flat-rate $8.50 annual per-participant premium will be replaced with a variable rate structure. Premiums will range from $16 for well-funded plans to up to $50 for the most severely underfunded plans (*BI*, Dec. 28, 1987). BI

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A Conversation With:

E.J. Leverett

Twenty-seven years ago, E.J. Leverett sold his insurance agency and headed to the University of Georgia to build an undergraduate and graduate program in risk management and insurance.

Today, the program he developed is regarded as among the best in the nation.

In August, after more than a quarter century of heading the department and teaching, Mr. Leverett retired.

During that time, he wrote seven insurance-related books, including one risk management textbook and several insurance agency operation and sales management books; 112 industry-related journal articles; 12 industry-related monographs; and five chapters for various agency operations books by other authors. He also has lectured at 13 universities across the nation about the industry.

Included in Mr. Leverett's numerous honors are two awards for being an outstanding teacher—one from the university and the other from his department.

Even though he is retired from teaching, he heads a consulting firm, Leverett & Associates. And, he plans on remaining active at the University of Georgia, helping the department to recruit students. He also plans to assist students with their careers in risk management.

Mr. Leverett talked with Staff Reporter Sally Roberts at his home office in Bogart, Ga., about risk management and insurance education and his career.

* * * *

How did you become interested in risk management?

After college, I didn't really know what to do, so I went to a professor and I asked him, 'How do you decide what you want to do?' And he said, 'What would you do if you didn't have to work to make a living?' So I set down my priorities and he said, 'Now you find the closest thing to that as you can, and still make a living.'

Well, it turned out to be the insurance business. My parents thought I was crazy. Then after 13 years out in the industry, I decided deep down what I really wanted to do was teach. So for the past 27 years I've been able to interact the academic world with the business world.

What were your priorities that led you into insurance?

I sat down and said, 'Well, I know I want to sell. I want to help people. I want to be active in my community. I want to be active in my church. And I don't want to travel.'

It's interesting how those things have changed. Of course, I travel a great deal now. But other than the traveling part, those priorities are still pretty important.

What did you stress in the risk management courses you taught?

My concept of risk management is perhaps a little different, although not all that different.

I describe it as something of a revelation that happened to me. I was on the patio shelling some English peas one day, and I looked at that English pea and I said, 'My heavens, that's risk management.'

So my concept is five peas in a pod for risk management. The pod of the pea is designed to protect the peas, and the five peas include people, property and profits. The risk manager's job is to protect all three.

Now, the additions are the next two: Palatability, because if a program isn't palatable to top management—I don't care how good it is—it isn't going to work. And the fifth pea, which is perhaps more important than any of the others, is political. We operate in a political environment. I'm not talking about the national political scene—I'm talking about the internal political things that go on in an organization. You've got to learn how to swim with the sharks without getting eaten alive.

So I try to teach them those things you don't normally find in a textbook: namely, how to survive in a corporate organization. Maybe you could call this personal risk management, but nonetheless it is real risk management.

In what areas of study should students of risk management concentrate, besides a curriculum's core risk management and insurance courses?

Students should definitely know accounting, finance, business law, economics and marketing.

What kind of students major in risk management and insurance? What qualities does it take to enter this field?

I would have to say that the people skills are very, very important, because you are going to have to be dealing with people in other departments all the time.

I also frequently tell students that I don't care what your job title is, don't deceive yourself that you're not a salesperson; you are. The only thing that is different is the product you're selling. In risk management, you're selling ideas.

To compete though, students have got to have technical ability, people skills and be able to interact in legal situations. It's really so broadly based that there isn't any bit of knowledge that can't be helpful. The more they can acquire from all different disciplines, the better off they will be.

How well are risk management programs drawing female students, and how has that changed over the past 25 years?

The insurance industry has always recognized women as players. For as long as I've been at UGA, I've never seen less than 15% women in the program. Today, a good 30% to 40% are women.

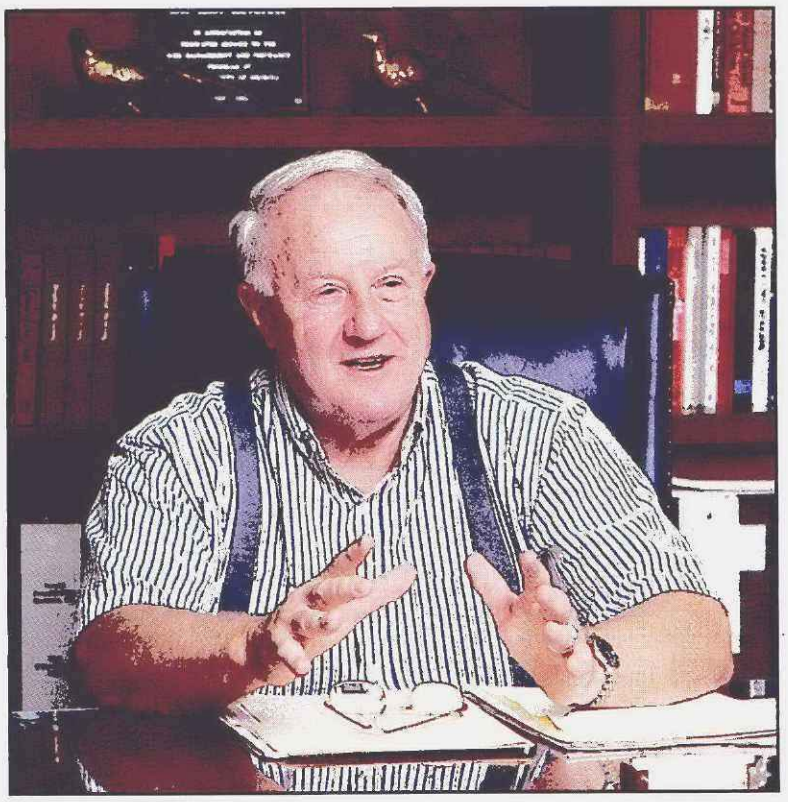


Photo by Dan McClure

Should risk managers and insurance agents be required to have a degree in risk management and insurance?

A lot of people would say you can get into this industry without having a degree in risk management and insurance—and you can.

But these students have a leg up and don't have to start completely from scratch like someone totally out of the field.

> It was a revelation. . . I looked at that English pea and I said, 'My heavens, that's risk management.'

However, I don't think it is necessary to have the degree. I think it is very helpful, and you'll be miles ahead of someone else starting out without it.

The University of Georgia has one of the largest risk management and insurance programs in the nation. How did you build the program?

One of things everybody says is, 'Who ever goes to college to major in risk management and insurance?' Well, nobody does. That's not quite true now, but at that particular point in time they weren't real sure that this was even a valid major.

So students had to be recruited. We went into classes that we could get into, namely our elective principles course, and told students why they ought to major in risk management and insurance.

What did you tell them?

We would tell them the sequence that we had and how that would lead to employment opportunities.

After all, when you are going to college, presumably you are there to get out and be productive and enter the business world in some fashion. So basically we said to them, 'Hey, there is opportunity in this business, and if you prepare yourself correctly, we will see to it that you get exposed to those opportunities.'

I very candidly make a commitment to them right there. I say, 'Now, or 10 years from now, I'm going to help you in the job market,' and I do that. I spend an awful lot of my time in the job placement area for students and former students.

What makes the University of Georgia's program in risk and insurance one of the best?

I think one of the crucial things that enabled us to build a program to its current size is that we really care about those students. That's not something you find in most academic communities.

We have a group of instructors that is very student-oriented and a curriculum that is very practical-oriented.

In fact, our curriculum is so broad that really it's a curriculum that helps you in decision-making. And you can take it and move to any area that you want because we are all—regardless of what your title is—managing risk.

One of the differences between our students and some others is that they will come out of here understanding what the commercial general liability policy is all about.

They will understand risk, too, and understand risk financing—but the nitty-gritty part of where the rubber meets the road, they're going to understand that, too, because risk managers don't hire people right out of college to go to Bermuda to manage their captive. They hire them to do things they don't want to do, like analyzing insurance contracts.

So you're going to have to be able to do the nitty-gritty part of the job, and we prepare them to do that.

What are the advantages of having a degree in risk management and insurance?

One of the advantages when people hire someone from the University of Georgia is that they are not just hiring someone with a degree. They're hiring someone who is committed to an industry. That's very important, because a lot of people might go into the industry looking for a job. Our students are looking for careers.

Also, there is probably no other job in a company other than the chief operating officer that has to cut across as many different lines of operations as does a risk manager. So when our people come out of here, they're going to have an understanding of accounting, management, finance, loss control, personnel and employee benefits. It's a very broad-based education, including a healthy dose of liberal arts.

What do you see happening with risk management and insurance degrees at other universities?

Fortunately for UGA but unfortunately for the industry, other institutions do not see this as a discipline they want to involve themselves in. I think that is shortsighted, but then I'm not the administrator of those institutions. In fact, risk management and insurance programs at other institutions are under fire. I would say there are more being put to death than being created.

Unless your administrator sees this vision and is willing to commit some resources to it, it's probably going to die on the vine.

Now, the industry can certainly step forward and do something about it—through financial help, by offering jobs and by being adjunct lecturers. But the support should be going to institutions that are committed to this as an industry.

Now that you are retired from teaching, how are you still involved in the field of risk management and insurance?

Even though I'm retired, I'm not really retired. My consulting practice still goes on, and it will continue to go on as long as my clients are kind enough to hire me.

I will also still go back and tell people why they ought to major in risk management and insurance. I'll still actively help them find jobs, and I'll still be active in the department.

What do you see in the future for risk management as a career field and as a degree option?

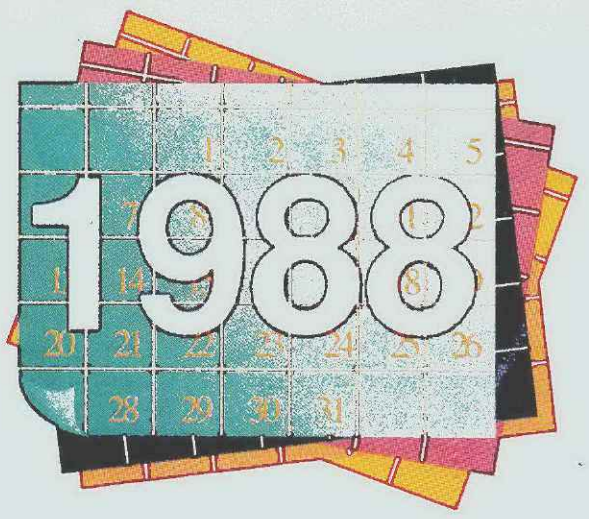
I think it's endless.

Risk management is a discipline that can take you wherever you want to go, and if you do the job well, you can rise up in the ranks. I think the future is really bright for risk management.

As for risk management and insurance as a degree option, many programs are being introduced at universities, but at the same time, the same amount are being dissolved.

Without a constituency out in the industry, the programs could fall by the wayside. BI

Looking Back



Some 59% of employers with more than 10,000 workers say at least one of their employees has AIDS.

The Alexander & Alexander Consulting Group survey found that 10.1% of employers nationwide have at least one employee with **Acquired Immune Deficiency Syndrome**. Large employers were more likely to have employees with AIDS than smaller firms (*BI*, Feb. 8, 1988).

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As many as 50% of employers with **401(k) plans** have had to cut back on salary deferrals to the plans by higher-paid employees in order for the plans to pass the tough non-discrimination tests laid down by the Tax Reform Act of 1986.

In addition, employers say they are adding loan provisions to boost participation by lower-paid employees (*BI*, Feb. 15).

* * *

Allied-Signal Inc. is launching a unique nationwide plan that guarantees to hold down the rate of health care cost increases for the Morristown, N.J., conglomerate.

Under the program, plan administrator CIGNA Corp. will absorb health care cost increases over each of the next three years if they exceed stipulated levels.

In turn, Allied-Signal will offer a new national managed health care network through CIGNA. Employees will be able to obtain services outside the network, but will pay a much greater share of the costs (*BI*, Feb. 22, 1988).

* * *

There is no across-the-board increase in **product liability suits**, the General Accounting Office says.

In a new report, the GAO says much of the 272% increase in product liability suits filed in federal courts between 1976 and 1986 is attributable to one product: asbestos. In addition, litigation was fueled by suits involving the Dalkon Shield and Bendectin, an anti-morning sickness drug (*BI*, March 14, 1988).

* * *

European reinsurers are proposing a new clearinghouse to gather and process claims information for reinsurers around the world.

The clearinghouse—the **International Reinsurance Advisory Service**—initially would concentrate on gathering information on major U.S. asbestos losses, but ultimately could process information for other types of claims (*BI*, March 21, 1988).

* * *

Insurers, reinsurers and other industry officials conspired to manipulate the U.S. commercial liability insurance market, seven state attorneys general charged in **antitrust litigation**.

As a result of the conspiracy, the Insurance Services Offices Inc. was forced to rewrite its new commercial general liability insurance policy forms to exclude all coverage for pollution and include a retroactive date in the claims-made CGL policy, the suit says.

The suit names four primary U.S. insurers, ISO, the Reinsurance Assn. of America, six U.S. reinsurers, eight Lloyd's of London managing agencies, six British reinsurers companies and three reinsurance brokers (*BI*, March 28, 1988).

* * *

J.C. Penney's health care plan, under which an employee only can obtain coverage for a spouse who earns less then the employee is legal, a federal appeals court says.

The 6th U.S. Circuit Court of Appeals said the plan **did not discriminate against women** because Penney had a "legitimate business reason" for offering the plan.

Benefit experts note that as the number of two-wage earner families increase, more employers may try to limit coverage for an employee's spouse (*BI*, April 11, 1988).

* * *

Employers and insurers are forming a new coalition to lobby Congress to delay and simplify **Section 89**, the section of the tax code that sets new non-discrimination tests for welfare plans.

But the newly organized Section 89 coalition says without any guidance from the Internal Revenue Service it will be impossible for employers to comply with the law (*BI*, April 18, 1988).

* * *

Massachusetts Gov. Michael Dukakis has signed legislation establishing an innovative **"play or pay"** approach to expanding health care coverage in the Bay State.

Under the law, scheduled to go into effect in 1992, employers with at least six employees would be hit with a new $1,680 tax per employee to fund health care for the uninsured. The tax can be offset for each dollar it spends on health care (*BI*, May 2, 1988).

* * *

California's Proposition 51, which protects defendants in multiple-party suits from paying more than their share of responsibility for **non-economic damages**, does not apply retroactively, the state Supreme Court has ruled.

The Supreme Court ruled that applying Proposition 51 retroactively would be unfair to litigants in cases stemming from causes of action prior to the initiative's June 4, 1986 effective date (*BI*, May 2, 1988).

* * *

State insurance regulators can require an insurer writing coverage for Iowa members of a **purchasing group** domiciled in another state to be admitted or authorized in Iowa, a federal court has ruled.

The ruling—involving Frontier Insurance Co., which is licensed in New York and the District of Columbia and writes coverage for six Washington-based purchasing groups—is a blow to purchasing group supporters. They have argued that only one state—the state where the purchasing group is domiciled—can regulate the insurer (*BI*, May 9, 1988).

* * *

Competition continues to heat up in the commercial property/casualty insurance market.

Buyers renewing their coverages this spring are seeing **rates fall by between 10% and 40%**, while also receiving better terms and conditions. Unlike the soft market of the late 1970s and early '80s, competition now is being driven by insurers rather than reinsurers (*BI*, May 16, 1988).

* * *

Employers are paying out far more in **COBRA claims** than they are taking in premiums from COBRA beneficiaries.

Some employers responding to a *BI* survey say they are paying $2 in COBRA claims for each dollar of premium paid by former workers and spouses who purchase coverage under the Consolidated Omnibus Budget Reconciliation Act of 1985 (*BI*, May 16, 1988).

* * *

Asbestos producers and insurers are disbanding the **Asbestos Claims Facility**, which has handled more than 20,000 claims.

Defection of seven of the largest asbestos producer members made it impossible for the remaining members to continue. The facility, formed under the Wellington Agreement, was intended to resolve asbestos claims more quickly and for lower legal costs than proceeding through the court system (*BI*, May 30, 1988).

* * *

A landmark **expansion of the federal Medicare program** will prevent employers from reaping any immediate savings when they eliminate benefits that duplicate the soon-to-be expanded Medicare program.

Over the next two years, employers will have to pass on cost savings they achieve when they eliminate hospital and physician benefits that duplicate the expanded Medicare Part A and Part B programs (*BI*, May 30, 1988).

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Employers will have to spend more than $900 million annually to comply with new rules issued by the Occupational Safety and Health Administration.

The new OSHA rules will **reduce worker exposure to about 400 widely used hazardous substances**. Issuing rules on a comprehensive basis is a change in direction for OSHA, which had been issuing exposure rules on a substance-by-substance basis (*BI*, June 13, 1988).

* * *

A House subcommittee has approved legislation that would gut the McCarran-Ferguson Act to strip insurers' current **limited exemption from federal antitrust law**.

The bill, sponsored by Rep. Jack Brooks, D-Texas, and passed by the House Monopolies and Commercial Law Subcommittee, would, among other things, make publication of recommended rates and sharing of data subject to federal antitrust law (*BI*, June 20, 1988).

* * *

The explosion of the **Piper Alpha oil platform** in the North Sea could produce a $1 billion loss, the largest man-made disaster in history. Some 164 people were either killed or missing.

The 12-year-old platform, which was operated by Occidental Petroleum Corp., was insured for $790 million, while liability losses could exceed $100 million (*BI*, July 11, 1988).

* * *

Circle K Corp. is suspending a controversial policy of **excluding health care coverage for lifestyle-related claims**, such as AIDS.

Circle K, the nation's second largest operator of convenience stores, had said it was adopting the policy to control rising health care costs in its self-insured plan. But the plan aroused a firestorm of anger from gay rights and AIDS organization (*BI*, Aug. 15, 1988).

* * *

Landmark legislation intended to improve the competitiveness of **health maintenance organizations** is nearing congressional approval.

The legislation, expected to receive final approval this year, would allow employers and federally qualified HMOs to negotiate rates based on an employer's past and projected experience. (*BI*, Aug. 22, 1988).

* * *

Employers' financial statements will take an even bigger hit under a revision to an accounting standard for recognizing **retiree health care liabilities** now being hammered out by the Financial Accounting Standards Board.

Under the revision agreed to by FASB, employers would have to accrue as an expense against earnings retiree health care liabilities from the date an employee is hired until the date an employee is eligible for retirement health care benefits. FASB had earlier tentatively concluded that employers could expense these liabilities until the date of employees' expected retirement (*BI*, Oct. 17, 1988).

* * *

In the waning moments of the session, Congress has approved legislation that will **reduce COBRA penalties** and hike the federal excise tax on reversions from overfunded pension plans.

Under the technical corrections legislation, COBRA penalties generally will be capped at $100 per COBRA beneficiary, while the excise tax on reversions that employer capture from the termination of overfunded pension programs will be lifted to 15% from 10% (*BI*, Oct. 31, 1988).

* * *

California voters have approved **Proposition 103,** a landmark initiative that will require insurers to roll back for one year almost all property/casualty rates to a level 20% lower than November 1987 rates.

Some insurers contend that mandated rate reductions could threaten their solvency while risk managers worry that some insurers may abandon the California market (*BI*, Nov. 14, 1988).

* * *

The Internal Revenue Service is tightening the screws on employers that want to take tax deductions for **premiums paid to insurance subsidiaries**.

Under Revenue Ruling 88-72, a parent corporation cannot take a tax deduction for premiums paid to a wholly-owned insurance subsidiary regardless of how much unrelated business it writes (*BI*, Nov. 28, 1988).

* * *

The **explosion of a Pan American World Airways jumbo jet** in the Scottish town of Lockerbie could produce one of the biggest aviation losses ever.

Underwriters are reserving $250 million to $300 million to cover claims arising from the crash of the Boeing 747, which killed all 243 passengers and 15 crew members and about 15 people on the ground (*BI*, Dec. 26, 1988). BI

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A Conversation With:

Robert E. Vagley

As president of the American Insurance Assn., Robert E. Vagley has earned a reputation as an industry maverick by opening dialogue with consumer groups, organized labor and environmentalists.

Mr. Vagley also broke with insurance tradition by attempting to work out a compromise reform of the McCarran-Ferguson Act with Rep. Jack Brooks, D-Texas. Although that effort has faltered, the AIA has had better luck in another break with tradition: It is now working with Rep. John Dingell, D-Mich., on a proposed dual federal/state system of solvency regulation.

Before joining the AIA in 1986, he was a partner in the Washington law firm Preston, Thorgrimson, Ellis & Holman, where he specialized in insurance-related issues like federal black lung compensation and hazardous waste legislation and was a lobbyist. He also was a House committee staffer.

Mr. Vagley recently discussed with Associate Editor Mark A. Hofmann several pressing issues facing property/casualty insurers.

* * * *

How influential is the property/casualty industry on Capitol Hill compared with 25 or even 10 years ago?

I can give you a 10-year perspective. It has grown substantially, and it continues to grow.

Early on, there was an understandable focus on state issues, with some inattention given to Washington because the industry was largely regulated on the state level.

That's changed. Even though we're not per se regulated in Washington, there are no fewer than 12 or 13 federal agencies that have some substantial impact on the business of insurance.

Clearly, there are a plethora of agencies and laws that are clearly applicable to the property/casualty industry. So that really commands the industry's attention.

I think AIA recognized that back in the mid-'80s, when it determined to move its headquarters from New York, really to facilitate proximity to the Capitol and our ability to lobby effectively here. That may explain in part why they recruited me: because my background was as a federal lobbyist.

Are insurers and risk managers increasing their visibility on the Hill and with the regulators? If so, how are they doing it?

Yes they are, and I think they're doing it the old-fashioned way—by working at the day-to-day communications that are indispensable in establishing a group or an industry's credibility or trust on Capitol Hill.

In terms of influencing public policy, I think that risk managers within the industry present the greatest area of untapped potential.

They are no less a community of consumers than are consumer representatives who are internationally known. They can be enormously effective. They bring a high level of trust and credibility to the political process, and I think they could be invaluable in working and assisting on critical matters.

Do insurers really have the clout that consumer activists say they have?

No, not nearly.

I think the consumer advocates know that we don't have the clout that is attributed to us. They ascribe that immense influence to us to suit their tactical needs and not on any sense of reality.

I think we have a considerable influence—as we should. We are an important industry; we are an industry that's indispensable to the country's fabric and its society. When I speak of the industry, I'm really talking about the broader industry—the agents, the brokers, the companies, the risk managers, the community.

What are the biggest issues now for the property/casualty insurance industry?

There are four or five that I would list among the biggest.

I think the Superfund issue is a colossal issue for the property/casualty industry. There are potentially billions of dollars at risk in the Superfund program. It presents an enormous challenge for us to try, with other segments of the American public, to reform this egregious law, which is long on promises but very short on performance.

The issue of insurance regulation or solvency regulation is a critical issue. We have tried and have been somewhat successful in broadening the debate to include rational insurance regulation. I think there is an opportunity out there to rationalize insurance regulation and actually, in the process, to measurably improve the solvency of insurance companies. It was an area that was frankly neglected until John Dingell came along and called attention to it.

The issue of taxation is a critical issue for us. Even though tax increases aren't popular, they could be popular against commercial entities.

Like others in the business community, insurers are always targets for those kinds of revenue measures. In our judgment, insurance companies already are paying more than their fair share of taxes, so I see kind of an unrelenting need to be attentive to the threat of additional taxation at the federal and state levels over the next few years.

The McCarran-Ferguson Act is certainly an important issue. And, for us, the objective is to get this issue behind us in a way that does not disable the industry and, in fact, allows the industry to remain viable and prosper. It has been a very contentious issue within the industry, and one that remains unresolved.

A fifth issue is the need to get serious about the Earthquake Project (which would create a federal reinsurance program).

Some of us have really taken steps to undergird the industry's presence and effectiveness on that project. As we were reminded recently with Hurricane Andrew, natural calamities occur with no predictability and the scientists tell us the so-called "Big One" is out there in terms of an earthquake. It's just a question of when and where.

The sixth one is an area in which we find ourselves increasingly involved. That is leveraging American public policy to expand business opportunities for domestic companies abroad. The converse is to engage the public policy process in a way to resist or to defeat any attempts to disadvantage foreign insurance companies doing business in the United States.

Do you think a federal role in insurance regulation is inevitable?

I do. I think that those who enchant themselves by thinking there is no federal role in regulation really need to examine reality.

As I mentioned earlier, the federal government already is very pervasively involved in the business of insurance in the securities area and the tax area and a host of other areas that are very consequential.

It is simply unrealistic to talk about federal involvement in the business of insurance as though it is a new idea or a new issue. It has been with us for years, and I think everybody with any degree of sophistication understands that.

In terms of federal involvement in insurance regulation and in solvency regulation, the reason I believe it is inevitable is that even those who currently regulate in those areas—state regulators—concede there are some areas where a federal role is appropriate, whether it is in respect to regulating alien reinsurers, or criminal fraud. Clearly, there are some areas in which the National Assn. of Insurance Commissioners has conceded that federal regulation is appropriate.

I think the door has been opened, even by the state regulatory community, for federal regulation, and the question is what will be the ultimate scope of that. I see that evolving over a period of years.

Looking back over your tenure as head of AIA, and even further back, what have been the key events and issues that have shaped Washington's view of the industry since the late 1960s? Are property/casualty insurers still suffering from the fallout from the market contraction of the mid-1980s?

In terms of shaping attitudes for ill and for good, I think there have been troublesome attitudes that have been shaped by a number of events that probably started with the cost and availability concerns of the mid-'80s and, all of a sudden, the presence of the industry on the front page of national publications.

That was really seared by the passage of Proposition 103. That was really built on that same theme and really emitted a series of waves and vibrations and calamities from which we are still recovering.

Some other issues that have contributed to negatively shaping the view of the industry in Washington have been failures of some companies that triggered the Dingell investigation, though I think that will lead to a good conclusion.

Certainly it created in the minds of some policymakers a belief that the industry was not viable, that the industry would fail as the savings and loan and banking industries have failed. But, certainly nothing could be further from the truth.

On the positive side, I do think we are viewed very positively in Washington, much more positively than we are viewed in several states. Really, the community of insurance interests that are in Washington now have worked very hard in developing relationships with Congress and the administration and effectively communicating and establishing relationships with interest groups whether they be consumers, labor, environmentalists or civil rights groups. That more than offsets the negative impressions that have been created by the other experiences I mentioned.

Do you think relations with consumers and consumer activists have improved?

Absolutely. I think the AIA's relationship with the consumer community is exceedingly good. We have put a lot of sweat equity into building that trust and building those relationships. I think it has paid enormous dividends.

I think some of the evidence is the creation of joint entities such as the Advocates for Auto & Highway Safety, of which we're very proud and which has been very successful (see story, page 92).

The Coalition for Consumer Health & Safety is another example. I can tell you we are working with the consumer community again in the interest of building a fraud coalition not unlike the Advocates to combat fraud.

Do you think that the controversy over building codes that has erupted in Florida in the wake of Hurricane Andrew might be another opportunity for insurers to join with consumers to push for stronger building codes?

I do. There are some tragic events that do some good by forcing people to look at things.

Even Proposition 103, which I regard as the principal calamity that I have witnessed in my years at the AIA, really led to some things that ultimately will prove to be beneficial. It was a heck of a price to pay, I might add. But it really galvanized the attention of insurance executives to the need to be attentive to the concerns and needs of their customers, whether they be in the personal lines sector or the commercial lines sector.

I think it really underscored the importance of ending what until then had been virtually a war against the consumer movement.

I think it was mindless of some of the industry to view consumers as though they were the enemy. They are in fact our customers. As we saw that developing, we tried valiantly to arrest that drift and to deal more effectively with the consumer movement. That finally came to pass, but unfortunately not until after Proposition 103. BI

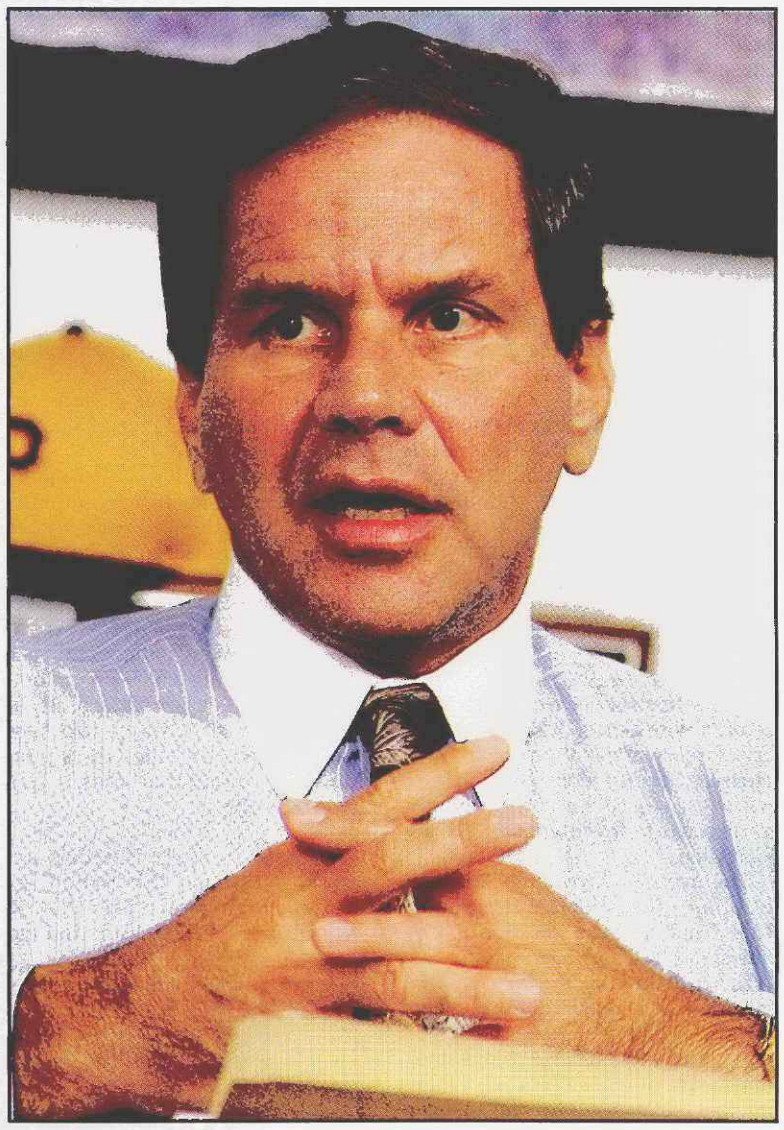


Photo by David E. Hittle

Earth, Wind and Fire

Ill wind blows through industry as catastrophes expected to worsen

By Gavin Souter

The best-laid plans of risk managers and insurers can't always prevent the grief and pain of disasters.

And, unfortunately, the signs point to more and bigger catastrophes in the future.

Natural catastrophes are increasing both in frequency and severity. This is partly due to historic weather cycles, but factors like global warming may also play a role, insurers say.

Man-made disasters are becoming more devastating as industrialization becomes more complex and the value of manufacturing plants increases.

Changes in the insurance industry also contribute to greater insured losses. A broadening of coverage terms has widened insurers' exposures, as has a greater willingness to settle claims, some contend.

One of the most immediate and devastating threats, though, is believed to be from earthquakes in Japan and the United States, particularly in areas like the Pacific Northwest and the Midwest where the risk has not been given the attention it deserves.

Twenty-five years ago, the insurance industry still was reeling from claims produced by Hurricane Betsy in 1965. Since then, many disasters have battered risk managers and insurers but, in terms of the size of losses, the going has been toughest in the past decade.

According to Munich Reinsurance Co., insured losses from natural disasters were eight times larger in the 10-year period ending in 1991 than during the 1960s—even after allowing for inflation. And insured damages from natural disasters have increased markedly in the late 1980s and early 1990s.

The total cost of natural catastrophes and other large losses to insurers worldwide leaped from less than $3 billion in 1986 to a record $17 billion in 1990, according to Swiss Reinsurance Co.

Insured damages dipped to about $14 billion in 1991, Swiss Re reports. But 1992 losses are likely to set another record, boosted by the largest single loss ever to hit the market, Hurricane Andrew, which is expected to produce around $12 billion in insured damages.

One reason that insured catastrophe losses have grown so dramatically is that individuals and businesses have bought wider insurance coverage over the past 25 years, said Alfred Bloch, manager of catastrophe and reinsurance research for Swiss Re in Zurich.

"In terms of dollar amounts, catastrophe losses have increased dramatically over the past 10 years and that is partly because insurers have started to broaden their coverage of catastrophic perils," he said.

For example, Japanese insurers did not normally cover storm losses until 1981, Mr. Bloch observed.

"Now they give full coverage for storm losses, and that has increased losses by 20 times," he said.

Insurers worldwide paid losses totaling $5.2 billion as a result of Typhoon Mireille, which battered Japan in September 1991.

But insurers cannot turn the clock back 25 years and withdraw the broader coverage they have written because competition is too intense and the heightened expectations of consumers will not change, pointed out Juergen Zech, chairman of Cologne Reinsurance Co. in Cologne, Germany.

Insured losses also are increasing due the greater willingness of insurers to pay claims, he said.

"Insureds are becoming more demanding and making more claims than they used to, and insurers are becoming less strict in their settlement of claims," Mr. Zech said.

This is not due to the generosity of "consumer friendly insurers" alone, he stressed. "Insurers are not equipped to investigate. . .the volume of claims that they incur after storms like the European windstorms in January 1990."

Experts warn, however, that severe storms are on the rise.

An increase in the number of insurance claims coincides with a return to more turbulent weather patterns, according to Swiss Re's Mr. Bloch.

There were greater incidences of typhoons in Japan in the 1950s and 1960s than there were in the 1970s and early 1980s, he noted.

Now, in the 1990s, the world could be returning to those earlier weather patterns, Mr. Bloch said, observing the increase in typhoons.

The world also is entering a warmer period, he said.

As a result of this phenomenon, "I think what we can expect, but can't prove, is more flooding due to more inland rain and rising seas," Mr. Bloch said.

The warmer weather also is exposing a broader area of the world to severe weather like hurricanes, he said.

For example, the chances of major hurricanes hitting the Northeastern United States is growing as the average global temperature rises, Mr. Bloch said.

Until now, a storm of the severity of Hurricane Andrew was expected to only hit New York City once every 100 years, but as the world temperature rises, so does the expected frequency, Mr. Bloch said.

Changing weather patterns will lead to greater frequency of catastrophic losses, agreed Andrew Dlugolecki, chief manager of operations at General Accident Fire & Life Assurance Corp. P.L.C. in Perth, Scotland.

"If you look at the temperature trend in the United Kingdom, for example, you can see that there has been warming over the past 32 years. And looking at records going back 300 years, we can see that there is a tendency for warmer weather to be associated with higher frequency in storms," he said.

Since 1960, the number of major windstorms has increased markedly, Mr. Dlugolecki said.

Munich Re's research, for example, shows that the average number of major windstorms a year was 0.8 in the 1960s; 1.3 in the 1970s; 2.9 in the 1980s; and 4.0 in 1990 and 1991 alone. The German reinsurer generally defines a major storm as one that causes more than $100 million in insured damages, or that kills more than 10,000 people.

Although the weather may be warmer, it is too early to say whether it is due to natural fluctuations in temperature patterns or whether it is caused by the so-called greenhouse effect, Mr. Dlugolecki said.

There is undoubtedly some fallout from the greenhouse effect due to increased emissions of carbon dioxide and other gases in the atmosphere, said James Rasmussen, director in the world weather watch department of the World Meteorological Organization in Geneva, Switzerland. But, he added, it is still too early to say whether we are experiencing more storms as a result of this.

The natural greenhouse effect traps long-wave solar radiation in the atmosphere and warms the earth's surface, Mr. Rasmussen explained. The radiation is re-radiated downward and upward by clouds and greenhouse gases like carbon dioxide, chlorofluorocarbons, methane and nitrous oxide.

The increase in greenhouse gases due to human activities will lead to a warmer world climate, he said.

Currently, computer models suggest that the global mean temperature will rise by 1 degree Celsius (1.8 degrees Fahrenheit) by 2025 and by 3 degrees Celsius (5.4 degrees Fahrenheit) by the end of the next century, Mr. Rasmussen said.

But computer models cannot predict whether the rise in temperature will result in more or even more severe storms, he said.

"We can say that there will be longer periods of drought in some areas and, due to increased precipitation, some areas of the world will be wetter, but we can't say that this will lead to more severe storms," Mr. Rasmussen said.

However, in insurance terms, severe weather is causing more losses, whatever its causes, said Mr. Zech of Cologne Re.

"We are experiencing a large natural catastrophe loss almost every year due to the increased concentration of risk," he said.

The concentration of risk is also blamed for increasing insured losses from man-made disasters. Production processes are increasingly interdependent, and the centralization of production in larger facilities puts higher values at risk.

The way corporations conduct their business has led to greater severity of man-made catastrophes, said Wolfgang Friedel, vp and manager at Arkwright Mutual Insurance Co. in Shelton, Conn.

Industrial plants are becoming larger to achieve greater efficiencies, he noted. For example, a company that 25 years ago maintained two separate plants is now able, through improved technology, to complete all of the processes at a single large plant, he said. But, the concentration of insured values at one site leads to a larger potential for disaster.

Also, competitive and economic pressures have driven companies to cut their expenses, Mr. Friedel said.

"Companies are being forced to cut their expenses to the bone, so they make staff cuts and the first people to be let go are often plant maintenance people and they are the people you need to prevent disasters happening in the first place," he said.

Pressure to produce profits also leads senior managements to make commercial decisions without considering the risk management implications, Mr. Friedel said.

Although a natural catastrophe will likely have a bigger impact in terms of total insured damage to a region, man-made disasters are a greater concern to corporate risk managers, he said.

A major man-made disaster like the 1989 explosion of the Phillips Petroleum Co. plant in Pasadena, Texas, or the 1984 leak of poison gas from a Union Carbide plant in Bhopal, India, will have a more severe impact on a single company in terms of insured losses and reduced stock values than a natural catastrophe ever will, Mr. Friedel said.

Looking ahead, though, one of the greatest exposures facing risk managers and insurers is an increased risk of large earthquakes in Japan and the United States, experts say.

"We are definitely in a rising part of the seismic cycle," said Charles Scawthorne at EQE International in San Francisco, which specializes in earthquake loss prevention.

For example, a large California earthquake is anticipated every 150 to 200 years, he said. The last major earthquake was in 1906; however, that massive quake was the culmination of increased seismic activity that began in the 1830s, he said.

In Northern California, there have been earthquakes of increasing severity in 1981, 1983, 1984, 1987 and 1989, Mr. Scawthorne said.

A major earthquake is also due soon in Japan, he said.

"An earthquake of the size of the 1923 Tokyo earthquake has a return period of 75 to 100 years, so we are due for a large catastrophic earthquake in Tokyo soon," Mr. Scawthorne said.

A major earthquake is also waiting to happen in the Pacific Northwest, Mr. Scawthorne said.

Seismic studies show that every 300 years there is a major earthquake in the region between Oregon and British Columbia. There has not been a major earthquake in the area since it was settled in the early 1800s, he said.

When the big Pacific Northwest quake does come, it will be of the magnitude of the Chilean earthquake in 1960. That was the largest earthquake of this century and registered 9.6 on the Richter scale.

The Midwest also is susceptible to considerable earthquake damage, said Melvyn Musson, vp at Johnson & Higgins in St. Louis.

"The New Madrid fault in the Midwest is potentially more damaging than the San Andreas fault in California. If we had a major quake in the Midwest, it would affect six states and we do not have the planning in place to deal with that."

Quakes in the Midwest have a recurring cycle of about 100 years; the last major earthquake in the area occurred in the 1890s, Mr. Musson noted.

"If a major earthquake hits the Midwest, you are looking at a total economic loss in excess of $50 billion—and insurance against earthquake damage is easy to obtain in the Midwest," he said. BI

Gavin Souter, an associate editor in BI's London bureau, has tracked disaster claims since joining the staff in 1991.

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A Conversation With:

Diana J. Scott

Diana J. Scott, formerly a project manager for the Financial Accounting Standards Board, headed the development of the accounting rule that will require most employers to recognize retiree health care liabilities as they are accrued rather than as they are paid.

During the five years Ms. Scott worked at Norwalk, Conn.-based FASB, her primary responsibility was the research and development of Financial Accounting Standard 106: "Employers' Accounting for Postretirement Benefits Other Than Pensions." The seven-member FASB board approved the rule in December 1990.

FAS 106 requires employers to accrue as an expense against earnings retiree health care liabilities from the date an employee is hired until the employee is first eligible for the benefits. Previously, employers only reported as an expense item on their income statements their pay-as-you-go costs for retiree health benefits. FAS 106 also requires employers to either fully recognize their accumulated retiree health care liabilities in the first year after the rule takes effect or to amortize them over up to 20 years.

As of late last year, employers faced a whopping $335 billion in retiree health care liabilities, including $203 billion in promised but unfunded benefits for active employees and $132 billion in liabilities for retirees, according to the U.S. General Accounting Office.

Ms. Scott now is a benefit consultant with Towers Perrin Co. in Chicago. She was interviewed by Associate Editor Deborah Shalowitz.

* * * *

What are some of the positive effects of FAS 106?

The most positive result is that it has gotten companies to focus on a cost that was probably not managed as well as it should be. And, from an investor's perspective, it will have a very positive result because it will more fairly present a company's financial position.

How is FAS 106 affecting employee benefit plans?

A lot of companies are finding that they made a promise that was much more expensive than they can really afford. FAS 106 is causing them to look at that promise and redesign the plan to bring it back to much more affordable levels—or less unaffordable levels.

Also, what we're finding now is that companies are much more focussed on assessing their retiree medical promise on a regular basis. Even now we're seeing that companies have made one pass on plan design and are finding that it's still more expensive than what they'd like to provide. So they're making a second pass.

Specifically, how is FAS 106 affecting plan design?

I'm seeing more cost sharing. Companies would like to make retiree medical benefits available but really can't afford to bear all the cost. I also think that by having costs shared with the retiree, the retiree takes on more responsibility and becomes a wiser user. That really has some benefits. But I do think that companies believe that going out and buying an individual policy is just not a workable solution for retirees.

How do you think plan design will continue to change in the next decade?

I think what might happen is there will be more alternatives provided. For example, companies might offer different levels of benefits that the retirees could purchase, with the retiree bearing the additional cost of a more generous plan. Also, companies are looking at the benefits available to the active employees and making those available to retirees with retirees making the commitment that they'll bear some or a most significant share of that cost.

The other thing I think is going to happen, at least I hope it happens, is that companies will focus on the retirement package as a whole. So they'll look not just at pensions in isolation and retiree medical plans in isolation, but they'll say, 'What is it that we want to provide as a retirement package and how do we achieve that objective?'

It seems that as a result of FAS 106, many companies are curtailing retiree health plans. Is this what FASB intended?

I would say it is an unfortunate result. I think that the FASB knew that there would be situations where companies would terminate plans or would cut back benefits. But you have to understand that the FASB's objective is to improve financial reporting. And, as part of its mission, it is precluded from making decisions on the basis of social ramifications. I think that the FASB at least made the effort to get to Washington to make sure that congressional administrative staff understood the issues, what the FASB was doing, why it was doing it and what the implications could be. It's really up to government to deal with the social implications.

If there had been no FAS 106, do you think that the kinds of changes in retiree health plan design that we're seeing would have occurred?

Yes, I think that they would have occurred. I think that it would have been a couple more years. What was extremely interesting to me was when I went to the FASB in 1986, we heard continually the project wasn't really going to have an impact, that companies could terminate their benefits any time they wanted to, that there really wasn't a promise here and so forth. Over the next five years, because of medical inflation, because of legal cases, because people were retiring earlier, the issue became much more significant.

Some employers think that FAS 106 is so onerous that the SEC or Congress will roll back the rule or at least delay the deadlines. What is the likelihood of this happening?

Slim to none. It won't happen. The SEC is supportive of the document. We went down and met with the SEC about three weeks before the document was issued. The SEC has given the FASB the authority to issue accounting standards, and they really can't go back on it.



Photo by Brooke Hummer

In fact, the FASB had been asked to reconsider the effective date earlier this year and it said it wasn't changing it.

Do you think the rule should be delayed?

No. I think if anything, we're seeing how important it really is. If the standard wasn't important, we wouldn't have such a reaction.

Do you see a day when employers can't afford retiree health plans because FAS 106 made them so aware of the cost?

I guess I can. I guess there are companies now that are saying they never realized this promise is as expensive as it is. It's one thing to be paying retiree medical benefits to a few people, but when you translate that to your whole employee population and the probability that individuals will get the benefits you say, you have no idea this was what you were promising.

I would say some companies will say they can't afford their plans, but I don't think it will be a very prevalent practice.

Why not?

Well, I think that companies will say, 'Maybe I can't afford to be as generous, but I still want to do something.' And there are tax advantages to providing medical benefits rather than pension benefits. From a funding perspective, the tax advantages aren't there, but from the retiree's perspective, retiree medical benefits are tax-free while pension benefits are taxable income. So it really is, from a retiree's perspective, preferable to get retiree medical benefits.

What more should employers do to better control the cost of these plans?

I'm working with a company now that's developing a financial reporting system for their employee benefits area to look at the costs that are being incurred on a quarterly basis and compare that with what they had expected costs to be. That way they can react rather quickly if costs are becoming excessive.

Also, I think that cost sharing with retirees is a prudent approach because it helps the retiree take responsibility and become a wiser user of medical benefits.

The one other thing that companies can do—and it doesn't really control costs, but it helps in the cost sharing—is to set up vehicles for employees to prefund retiree medical care so they can be setting aside money now while they have more money available.

What triggered the FASB to embark on the whole process of what eventually turned into FAS 106?

In 1979, the FASB was putting pensions on their agenda. They decided at that time they would look not just at pensions but at all postretirement benefits, which is kind of interesting because at that time retiree medical wasn't a big deal. That was true even as late as 1983 and 1984.

In 1984, the board decided that maybe post-retirement benefits, retiree medical in particular, were sufficiently different from pensions that they should be handled separately. So they decided to proceed with the pension standard and then, based on what developed with the pension standard, to build on that or use that as a starting point for post-retirement benefits.

What's unfortunate is that decision delayed for three or four years consideration of the post-retirement medical standard. And that was three years during which medical inflation was increasing and there were a lot of early retirement windows, so the obligation was mushrooming. When the board took up the project again in 1986, they were looking at a somewhat different animal.

Do you think any other rule has had a greater effect on benefit plans than FAS 106?

No, I really don't think so. I think, without question, that FAS 106 has had the most significant effect of any standard in the benefits area. I'm not saying that because I worked on it; I'm just saying that because of the magnitude of the dollars involved.

What exactly was your role in this?

As project manager of the FAS 106 project, I was responsible, with my staff, for identifying what the accounting issues were, how those issues could be dealt with, coming up with alternative approaches for the board to consider and setting up examples that would demonstrate how different accounting treatments would be reflected on companies' financial statements.

We did a lot of fact finding, generated a lot of ideas on alternatives to accounting treatments and then made sure that the standard that was developed was internally consistent. It was really my role to keep that process coordinated, for my staff and me to meet with the board to present issues and suggestions and to draft a document.

Has your perspective on the problems employers face implementing FAS 106 changed?

No, it really hasn't. We were lucky in that we had a fairly good rapport with the actuarial community, with the American Academy of Actuaries, so we knew through a lot of discussions with them what the benefits world was like. We knew from discussions with companies and from the field tests what to expect. So when I moved to the consulting side, I was not surprised by what I saw.

Would it be better for Medicare to be expanded and be the single source of retiree medical benefits?

This is my personal opinion—no. I don't think the government is a very efficient provider of medical benefits. I think that companies are much more used to managing costs. Look at the manufacturing process—you have to develop a product at a reasonable cost to sell at a price that people are willing to pay. Companies really can apply those same concepts in other areas, like in employee benefits. BI

Looking Back



The Internal Revenue Service is preparing a new rule that could require employers with **flexible spending accounts** to cover employee health care expenditures they never intended to pay.

Under the rule, employers would have to reimburse employees for health care expenses even if there was not enough money in the FSA to cover the expense. Employers would be out of luck if an employee quit before making new contributions to the FSA (*BI*, Jan. 30, 1989).

* * *

Employer health care costs leaped by more than twice as much in 1988 as the previous year.

According to a survey by A. Foster Higgins & Co. Inc., health care costs increased 18.6% in 1988, rising to an average of $2,354 per employee from $1,985 in 1987. Health care costs rose only 7.9% in 1987 and 7.7.% in 1986 (*BI*, Feb. 6, 1989).

* * *

A proposed **Financial Accounting Standards Board rule** would require employers to accrue as an expense against earnings retiree health care liabilities from the date an employee is hired until the employee is eligible for retiree health care coverage.

Benefit experts say the proposed rules—which are the last step before FASB issues a final rule—will result in employers scaling back their retiree health care plan obligations to reduce the impact on their financial statements (*BI*, Feb. 20, 1989).

* * *

AIDS-related claims on group health and accident policies rose 121.7% to $188 million in 1987 from $84.8 million a year earlier, the Health Insurance Assn. of America and the American Council of Life Insurance report. AIDS-related group life claims rose 66.9% to $132.5 million from $79.4 million during that period (*BI*, Feb. 27, 1989).

* * *

The head of American International Group Inc. is proposing a new **premium tax to finance hazardous waste cleanups**.

The proposal by Maurice R. Greenberg, AIG's president and CEO, calls for a 2% premium tax on commercial property/casualty policies and an equivalent assessment on self-insured companies. Insurers generally support the proposal; some risk managers say it isn't fair (*BI*, March 6, 1989).

* * *

Sears Roebuck & Co. is suing the IRS, saying that it does not owe tens of millions of dollars in back taxes relating to premiums Sears paid to three insurance subsidiaries. Sears says it should be allowed $44.7 million in deductions for premiums paid to subsidiaries that include Allstate Insurance Co. and Northbrook Excess & Surplus Insurance Co.

The IRS maintains that deductions can't be taken for premiums paid to wholly owned subsidiaries because there is no transfer of risk (*BI*, March 13, 1989).

* * *

Many benefit managers say they will continue to offer their employees coverage from **Maxicare Health Plans Inc.**, despite the bankruptcy filing by what had once been one of the nation's largest health maintenance organizations.

Employers say they will closely monitor service provided by Maxicare and hold special open enrollment periods if necessary (*BI*, March 27, 1989).

* * *

Exxon Corp. has at least $600 million of commercial insurance to pay for pollution cleanup and liability claims resulting from a massive oil spill in Alaska's ecologically rich Prince William Sound.

About 10.1 million gallons of crude oil spilled from the **Exxon Valdez** tanker after it hit a rocky reef (*BI*, April 3, 1989).

* * *

The Insurance Services Office Inc. next year will stop providing insurers with **fully developed advisory rates**. Only prospective loss costs will be provided.

As a result, insurers will have to analyze prospective loss cost information, determine their own prospective expense provisions and develop their own rates (*BI*, April 10, 1989).

* * *

Alexander & Alexander is questioning the ability of **H.S. Weavers (Underwriting) Agencies Ltd.** to pay future claims. A&A says it is unable to determine Walbrook Insurance Co. Ltd.'s potential to meet future obligations. Walbrook writes most of the Weavers line slip.

A&A, a major producer of business for Weavers, is instructing its brokers to obtain alternative quotes, leaving it to clients to decide if they want to buy coverage from Weavers (*BI*, April 24, 1989).

* * *

Most provisions of **Proposition 103** are constitutional, the California Supreme Court says.

The court upheld the 20% rollback of rates, but it also ruled that a provision that insurers could not obtain rollback relief unless they were "substantially threatened with insolvency" was unconstitutional (*BI*, May 8, 1989).

* * *

The Pension Benefit Guaranty Corp. cannot return to **LTV Corp.** three previously terminated pension plans and their $2 billion in unfunded liabilities, an appeals court says.

The 2nd U.S. Circuit Court of Appeals in New York dismissed the argument by the federal pension agency that the Employee Retirement Income Security Act of 1974 gives the agency the power to return previously terminated plans after a company, like LTV, sets up new pension plans (*BI*, May 22, 1989).

* * *

Frank B. Hall & Co. Inc. will pay $48 million to the New York Insurance Department to settle charges that it was responsible for the collapse of former subsidiary **Union Indemnity Insurance Co. of New York**.

The agreement, which calls for Hall to make an initial $19 million payment followed by installments over a 10-year period, settles a $140 million suit against Hall by New York insurance regulators (*BI*, June 5, 1989).

* * *

The National Assn. of Insurance Commissioners says that by pre-empting state regulatory authority, **the Risk Retention Act** is making it too easy for "unscrupulous" individuals to write coverage for risk purchasing groups without sufficient assets to protect policyholders when claims come in.

In a letter to the Department of Commerce, the NAIC also says some insurers are withdrawing from writing certain liability coverages on an individual basis, but then writing the business through purchasing groups to avoid state filing and rate regulation (*BI*, June 26, 1989).

* * *

While declining to rule on whether so-called **excessive punitive damage awards are unconstitutional**, the Supreme Court says it may want to look at the issue again.

All nine justices said they are concerned with the current system of unrestrained punitive damages and may want to consider the issue under the 14th amendment's due process clause (*BI*, July 3, 1989).

* * *

Some companies can deduct most of the premiums they pay to captive insurance companies, a federal appeals court says.

In the first victory for employers on the issue, the 6th U.S. Circuit Court of Appeals says **premiums paid by a company subsidiary to a captive are tax-deductible.** In the wake of the decision, involving Humana Inc., other employers may structure their captive programs so that premiums are paid by subsidiaries rather than the parent (*BI*, Aug. 7, 1989).

* * *

Insurance industry defendants in a **massive antitrust suit** won a big victory when a federal judge dismissed the 1988 suit by 19 state attorneys general.

U.S. District Judge William Schwarzer in San Francisco essentially ruled that the states failed to show that the defendants engaged in a boycott, which would be a violation of the McCarran-Ferguson Act. The states are expected to appeal (*BI*, Sept. 25, 1989).

* * *

Insured property damages from **Hurricane Hugo**, which ravaged North and South Carolina, Puerto Rico and the Virgin Islands, will be at least $4 billion, making it the costliest storm on record.

The brunt of the damages were in South Carolina, where insured losses are put at $2.55 billion. In the Charleston area alone, more than 300,000 buildings were damaged. The flood of claims, though, is not expected to douse property/casualty rate cutting (*BI*, Oct. 2, 1989).

* * *

An employer can prohibit fertile women from holding jobs that pose a significant risk to the health of their fetuses, a federal appeals court says.

The 7th U.S. Circuit Court of Appeals says the **"fetal protection policy"** of Johnson Controls Inc., a Milwaukee-based manufacturer of lead-filled batteries, did not unfairly discriminate against fertile female employees (*BI*, Oct. 16, 1989).

* * *

At least $1 billion in property damage claims are expected from a powerful **earthquake that shook the San Francisco-Oakland area**.

The powerful earthquake, which registered 7.1 on the Richter scale, resulted in the collapse of a mile-long section of the Nimitz Freeway in Oakland and deaths of several dozen motorists (*BI*, Oct. 30, 1989).

* * *

Section 89 is no more. The House and Senate voted last week to repeal the controversial part of the Internal Revenue Code that set massive and, according to employers, hopelessly complex non-discrimination rules for welfare plans.

Corporate lobbyists describe Section 89 as the biggest congressional folly ever in the employee benefit arena (*BI*, Nov. 13, 1989).

* * *

Responding to a torrent of complaints from the elderly, Congress has **killed the Medicare Catastrophic Coverage Act**.

The 1988 law was intended to give the elderly more protection from acute care catastrophic health care expenses. But middle- and upper-income retirees said the taxes imposed on them to fund the expanded benefits were too costly.

The repeal of the law, though, will prevent employers from reaping billions of dollars in savings they would have eventually recovered when they eliminated benefits that duplicated the expanded Medicare program (*BI*, Nov. 27, 1989).

* * *

Proposed **Financial Accounting Standards Board rules** on accounting for retiree health care liabilities could cut corporate earnings 10% to 30%, a survey of companies found (*BI*, Dec. 4, 1989).

* * *

Revisions to the landmark 1987 **continuous trigger ruling** by a California state judge could make it much harder for policyholders to tap numerous years of coverage to pay asbestos claims.

The revisions by Judge Ira A. Brown would not necessarily restrict the amount of coverage policyholders could tap. But the revisions would make it more difficult for policyholders to prove they were entitled to coverage (*BI*, Dec. 25, 1989). BI

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A Conversation With:

Patrick Peugeot

Patrick Peugeot is chairman and chief executive officer of SCOR S.A, the largest reinsurer in France and the eighth-largest in the world.

Mr. Peugeot began his career at the French state auditing office after receiving an engineering degree. In 1972, he was named chief executive of Hachette, a French communications and publishing company.

His first contact with the insurance industry came in 1974, when he was appointed senior vp of Assurances Generales de France Reassurances. In 1981, Jacques Delors, then French minister of finance, invited Mr. Peugeot to join his staff as technical adviser for banking and financial affairs.

In June 1983, Mr. Peugeot was appointed chairman of Caisse Centrale de Reassurance, the French government reinsurance agency, and that November took on the additional role of chairman and CEO of Societe Commerciale de Reassurance, in which CCR was a major shareholder.

Mr. Peugeot became chairman and CEO of holding company SCOR S.A. after the merger of SCOR and UAP Reassurances in November 1989.

Mr. Peugeot was interviewed in Paris earlier this month by Associate Editor Gavin Souter.

* * * *

What are the most important changes that have occurred over the past 25 years as far as reinsurers are concerned?

First, the emergence of new markets. Before, there was only London—then New York, Zurich, Munich and Paris emerged. They may not be at an exactly equal level of importance, but they are not that far from each other. You can underwrite many risks in any of these markets with good leaders and a large amount of capacity.

Second, the size of the risks we are being asked to cover has increased more quickly than any economic measure you can cite.

Has the increase in the size of risks been met with a similar increase in available capacity?

Over 25 years, yes. The market has provided the capacity—not always at the price that people want to pay—but, all in all, you cannot say that anyone was left without coverage, even if some have only half of what they would like.

We can see this from the run of catastrophes we have had in recent years. Capacity has grown to provide coverage. Twenty-five years ago, capacity contracted after Hurricane Betsy. But with Hurricane Hugo (in 1989), the European storms in 1990 and Hurricane Andrew, we have had the equivalent of three Betsys in four years, and there is still sufficient capacity in the market.

In what ways do you think that the reinsurance industry could have performed better?

If you look back, the main mistake was to underwrite liability business at too low a premium and not organize the claims management in such a way that we could control claims when they occurred rather than wait for a long discussion with lawyers and juries.

Obviously, U.S. insurers and foreign reinsurers were not prepared for the enormous problems they faced from asbestosis and pollution risks.

Reinsurers and insurers now are unwilling to offer coverage for gradual pollution. Do you think we will return to a situation where gradual pollution is a readily insurable risk?

The idea we have is that pollution—accidental as well as gradual—is a specific business and should be insured on its own merits. Obviously, it is easier to underwrite accidental rather than gradual pollution, but our policy at SCOR is that if we are able to audit the risk, check that no previous claims were made and there was no reason to fear any specific problems will arise, then you should be able to cover gradual pollution.

The reason for this is that in the past, most of the problems with gradual pollution coverage were related to lack of control of the risk. When a careful review was done of the claims, it was shown that there was already some pollution—and that is why so many claims have not been settled.

Would you say that would be true of other coverages? Have reinsurers had to tighten up the control over all of their risks?

I would say that due to the growth of facultative business and specialist underwriters, reinsurers are in a better position to control the risk before they underwrite it.

For example, since the late 1970s, satellite business has been underwritten mainly by engineers rather than traditional marine underwriters. And since then, it has been a much more stabilized market and the business has been more profitable for everybody.

How important is facultative business for insurers and reinsurers now?

Obviously, there is large facultative business in those countries where insurers don't want to write with much retention. The U.S. casualty market is the best example.

Another reason for the growth of facultative business is that at times when treaty commissions are not very high, the reinsurers have given higher commission to facultative business.

But I don't think that these are the only reasons when you look at the development of a large market in facultative business.

Since the early 1980s, SCOR has wanted to underwrite 50% facultative and 50% treaty. In the long run, we are close to this.

From our point of view, we prefer facultative business because we have better control of the risk when we write it risk-by-risk. And when we have better control, we can provide more capacity. That is why we can provide capacity up to $100 million for some risks, where on some treaty business we would provide much less than that.

How do reinsurers view the changes in accounting methods over the past 25 years?

In the United States, especially, they have improved. Disclosure of information is done much more fluently, which means that you have quarterly results and full information on reserves and accounts every quarter. Unfortunately, we will probably wait a long time before it is widespread in Europe.

From SCOR's point of view, we think that we should do it. It will be difficult, but I hope that I will not retire before SCOR is able to provide quarterly results—and that's only 10 years from now.

Also, reinsurers are now able to provide results of one underwriting year at the same time as insurers. That means that SCOR is giving to its shareholders 1991 results relating to the 1991 underwriting year in April 1992, the same time as the insurers. We've been doing that for eight years.

Would not providing accounts so quickly cause a problem for Lloyd's of London, which is a large reinsurance market?



Photo by Bruno Delessard

You said it—it's a problem for Lloyd's. But if you want to build confidence with names like we try to build confidence with shareholders, you have to provide them with information as quickly as possible. People need to know. It's not fair to shareholders not knowing what happened one year until two years afterwards.

I could see the difference in approach the first time I went to New York as CEO in late November 1983. Then we had just received information about the 1981 underwriting year results in France, 1980 results for London and we were able to have information about the third quarter for 1983 in the United States. And it's still the same except for France.

What do you think the prospects are for foreign reinsurance companies in the United States?

The U.S. market is roughly 50% of the world market so you can not imagine any important reinsurer in the world not being settled in the United States.

That's why over 35% of the members of the Reinsurance Assn. of America have foreign shareholders. And if you look at Hurricane Andrew, (based on a $10 billion loss) the foreign reinsurers' share will be around $4 billion.

So in the long term, foreign reinsurers are needed by the U.S. market and should not be hurt by such things like the federal excise tax, which really is not in accordance with the general view developed with GATT negotiations. Fortunately, it does not apply to countries where there is a taxation treaty; but as a matter of principle, it is not fair and is not in the interests of the U.S. market to impose such a tax on cessions to foreign reinsurers.

Most U.S. insurers want to spread their cover with as many reinsurers as possible with good solvency and, from that point of view, I think that they will be happy to have foreign reinsurers available if the reinsurers have an adequate solvency margin.

One of the problems that reinsurers are facing at the moment is the rise in catastrophe claims. Do reinsurers have a firmer hold on that than they did on liability business?

I think so. I think that now there are a lot of means available to control catastrophe exposures, even if they are not perfect.

For example, a European reinsurer provided the Japanese market, three years before Typhoon Mireille, with an estimate for the cost of a major typhoon in Japan. The figure it estimated was very close to the actual loss figure for Mireille.

Unfortunately, other factors sometimes distort the story. For example, in many countries insurance companies are not able to provide the necessary information on precise locations and values of the risks they write. Also you have specific markets, like the LMX market in London, which distort the picture. Even the best people were not able to control LMX.

Are rates for catastrophe business now at the correct level?

Almost. I would say today we are very close to the maximum rate that insurers can afford, say, 40% rate on line. You can say that we have adequate rates for most catastrophe risks. The problem is that the capacity is not always available.

The level of capital required to underwrite reinsurance business also has changed over the past 25 years. What kind of capital requirements will small reinsurers need in the future?

For short-term business, we will still be left with a very low level of capital needed, say $10 million. But as soon as you get to medium- and long-term risks, the insurer will want to be sure that the reinsurer will be there when the claims occur.

Obviously, this cannot happen with a low capital of $10 million. You need a minimum of $100 million, and you could could even say that you need capital of at least $500 million to underwrite long-tail risks.

So more and more you will have two markets. One with many reinsurers covering short-tail risks and one where you have only a few reinsurers, say 30, covering the longer-tail risks.

And for all risks, there are fewer reinsurers. Ten years ago, 100 reinsurers could be leaders on one type of business. Today, it's in the neighborhood of 50. This is true for any type of business.

What services will reinsurers have to offer to win business? Or can they be nothing more than providers of capital?

Obviously, those reinsurers who would like to be leaders need to have specialists such as engineers, actuaries and specialists in pollution. And, obviously, they need to be well-trained.

But for short-tail business, there can still be plenty of followers.

What about the future of the reinsurance broker. Does he or she have one?

I am sure brokers have a very good future. You will not have an adequate market without brokers beside underwriters.

In many cases the broker is able to first analyze the risk and know which underwriters he can show it to. Second, the broker is able to gather the capacity needed. Third, he is able to check the security of the reinsurers.

So he will need to be a specialist with good knowledge of the market and with analytical skills for reinsurers' investment and balance sheets.

What other changes do you see in the reinsurance industry?

Reinsurers have to be able to provide to investors an adequate return on investments. They have not done that in the past few years.

The main challenges for reinsurers are control and management of risks and capacity. This means that they need better information. That is why we need to develop information technology networks. BI

Looking Back



The liabilities of more than 100 **Mission Insurance Group reinsurers** sued for full payment on hundreds of millions of dollars in claims could be greatly reduced or eliminated under a recent court ruling.

The California Court of Appeals ruled that reinsurers may offset amounts they owe an insolvent insurer against amounts the insolvent company owes them (*BI*, Jan. 8, 1990).

* * *

The Washington Supreme Court has ruled that the **costs of a government-ordered pollution cleanup are insurable**.

The Jan. 4 ruling marks the first time a state supreme court has interpreted standard language in the comprehensive general liability policy that states the insurer "will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages" (*BI*, Jan. 15, 1990).

* * *

A windstorm that swept across northern Europe Jan. 25 could cost insurers more than the "once-in-a-lifetime" $3 billion windstorm that belted southeastern England and northern France in 1987.

About 100 people died as the storm—dubbed 90A—barreled through Belgium, Denmark, France, Germany, Luxembourg, the Netherlands and the United Kingdom (*BI*, Jan. 29, 1990).

* * *

A string of gargantuan insurer insolvencies in the 1980s points to **serious shortcomings in existing state regulation**, and changes to the current regulatory system—including possible federal involvement—should be considered, concludes a report by the House Oversight and Investigations Subcommittee.

"The parallels between the present situation in the insurance industry and the early stages of the savings and loan debacle are both obvious and deeply disturbing," said subcommittee Chairman Rep. John Dingell, D-Mich. (*BI*, Feb. 26, 1990).

* * *

Employers would be required to fund generous group health insurance plans or else pay a hefty new payroll tax under a recommendation by the **Pepper Commission**, a blue-ribbon panel studying the U.S. health care system (*BI*, March 5, 1990).

* * *

Allied-Signal Inc.'s trailblazing national managed health care program could save the industrial giant $200 million in health care costs over three years based on the program's results during its first 18 months.

Allied-Signal says the per-capita health care costs for the 43,000 employees enrolled in the program, which was initiated in 1988, is now about $2,450. That is 23% less than the $3,200 the company projected had the employees and their 70,000 dependents remained in a traditional indemnity plan (*BI*, March 19, 1990).

* * *

Walbrook Insurance Co. Ltd., which wrote 55% of the H.S. Weavers (Underwriting Agencies) Ltd. line slip, suspended underwriting after an actuarial report showed it may have to increase reserves to pay for unrecoverable reinsurance.

Walbrook is continuing to pay claims, but six affiliates—all owned by London United Investments P.L.C.—have suspended claims payments and may be insolvent (*BI*, April 2, 1990).

* * *

Despite pro-policyholder rulings by state supreme courts in Washington and North Carolina, the Maine Supreme Judicial Court says the **costs of government-ordered pollution cleanups are not covered "damages"** under comprehensive general liability insurance policies (*BI*, April 16, 1990).

* * *

A federal grand jury has indicted 14 California attorneys and four others on charges of **defrauding insurers of up to $50 million** through racketeering activity and mail fraud.

The suspects—allegedly part of a network known as the "Alliance"—are charged with conspiring to inflate legal bills by manipulating and prolonging litigation (*BI*, April 30, 1990).

* * *

Some large employers with good workers compensation loss experience may face higher premiums under **a revised formula for calculating an individual employer's experience rating** proposed by the National Council on Compensation Insurance.

The new formula also is likely to increase premiums for small employers with poor loss experience. However, it is expected to lower workers comp premiums for small employers with good loss experience and large employers with poor loss experience (*BI*, May 21, 1990).

* * *

The Internal Revenue Service has proposed **long-awaited pension non-discrimination rules**, which interpret the pension provisions of the Tax Reform Act of 1986.

The rules, detailed in more than 300 pages, cover areas like minimum participation requirements for pension plans, Social Security integration and non-discrimination tests relating to benefits and employer contributions (*BI*, May 21, 1990).

* * *

The **merger of Corroon & Black Corp. and Willis Faber P.L.C.** is expected to be a perfect fit that will create the truly global broker each had long sought to become. The combination will create the fourth-largest insurance broker in the world (*BI*, June 11, 1990).

* * *

The House Judiciary Committee's **approval of legislation that would amend the McCarran-Ferguson Act** could set the stage for the first congressional floor vote on overhauling the 45-year-old law.

The bill, introduced by Rep. Jack Brooks, D-Texas, would strip insurers of their key exemptions from federal antitrust law (*BI*, June 25, 1990).

* * *

A U.S. Supreme Court ruling forcing **LTV Corp. to reassume responsibility for three pension plans** with $2.3 billion of unfunded liabilities is a victory for the nation's pension system and the employers that finance it.

The decision reduces the potential that the federal Pension Benefit Guaranty Corp. will be hit with billions of dollars of new liabilities and will help the agency hold down the premiums it charges employers (*BI*, June 25, 1990).

* * *

New York state's highest court has agreed to hear arguments in insurers' attempt to reclaim at least $124 million that the Legislature appropriated from the state's **property/casualty guaranty fund**. Lower state courts had dismissed the insurers' case (*BI*, July 9, 1990).

* * *

American Telephone & Telegraph Co.'s new national managed care network is far and away the largest established by an employer.

Within a year, about 100,000 union employees and their dependents will have access to the network, which is administered and managed by three insurers: Empire Blue Cross & Blue Shield of New York, Travelers Corp. and Prudential Insurance Co. of America (*BI*, July 23, 1990).

* * *

Employers would have to **extend COBRA health care continuation coverage for up to 15 years**—at least five times longer than now required—under a proposal drafted by a member of the House Ways and Means Committee (*BI*, July 30).

The measure was included in the Women's Health Equity Act, introduced in the House in August (*BI*, Aug. 20, 1990).

* * *

State insurance regulators can require a **risk purchasing group insurer** that is domiciled in another state to be licensed in their states before the purchasing group can do business, the 11th U.S. Circuit Court of Appeals has ruled (*BI*, Aug. 13, 1990).

* * *

Two witnesses to a fatal accident in California may sue the companies involved in the incident for **emotional distress** even though the onlookers were not physically harmed and did not know the accident victim.

But, while the California Supreme Court let stand the novel ruling, it said the appellate court decision cannot be published, meaning it cannot be cited as legal precedent (*BI*, Sept. 10, 1990).

* * *

Employers for now can continue to "restructure" their 401(k) plans to make it easier to pass non-discrimination tests, but the Internal Revenue Service may ban the new technique.

Restructuring a 401(k) plan for testing purposes could mean the difference between passing and failing the non-discrimination tests, benefit experts say (*BI*, Sept. 17, 1990).

* * *

Unionized professors, librarians and other academic **professionals at Temple University walked off their jobs** earlier this month partially as a result of the university's attempt to require all employees to contribute $260 per year toward their health coverage (*BI*, Sept. 17, 1990).

* * *

The board of AmBase Corp. has approved **a definitive agreement to sell The Home Insurance Co.** to TVH Acquisition Corp. in a transaction valued at $970 million. TVH is a holding company owned by an investor group including Swedish insurer Trygg-Hansa Holding AB (*BI*, Oct. 8, 1990).

* * *

Legitimate concern about insurers' real estate portfolios and unreasonable investor panic are fueling **a dive in insurer stock prices**, analysts say.

A sharp downturn was sparked by the Oct. 5 announcement by Travelers Corp. that is was adding $650 million to real estate and mortgage loan reserves (*BI*, Oct. 15, 1990).

* * *

A report by **consumer organization Public Citizen** contends that five of the nation's 20 largest property/casualty insurers would be financially vulnerable and potentially at risk in a severe economic downturn.

Insurers call the report irresponsible and preposterous, and Public Citizen later admits it erred in saying two of the insurers would be vulnerable. But, it stood by the report's other findings despite intense criticism (*BI*, Oct. 22, 1990; Oct. 29, 1990).

* * *

A woman who contracted AIDS from her dentist is suing a dental preferred provider organization for its role in directing her to that now-deceased provider.

If Kimberly Bergalis' suit against CIGNA Dental Health Plan is successful, it could increase managed care organizations' liability (*BI*, Nov. 5, 1990).

* * *

MCA Inc. and at least one movie production company are insured for losses from **a fire at MCA's Universal Studios**. The fire, later determined to be arson, destroyed 20% of the sets on Universal's back lot.

The sets were used in several movies, including "To Kill a Mockingbird," "The Sting," "Back to the Future" and "Dick Tracy." Damage from the fire was estimated at $25 million (*BI*, Nov. 12, 1990).

* * *

Bloodstock insurers are facing their **largest-ever claim following the death of Alydar**, one of the most successful breeding stallions in thoroughbred history. Alydar may have been insured for more than $35 million (*BI*, Nov. 19, 1990). BI

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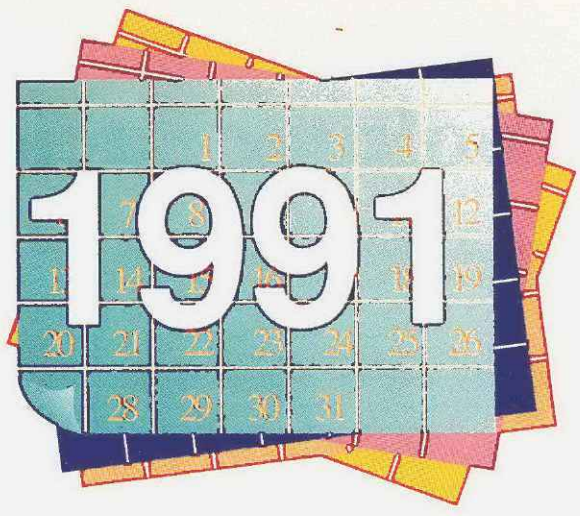
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Looking Back



Rep. Jack Brooks, D-Texas, has introduced legislation—identical to a measure that died during the last congressional session—to **overhaul the McCarran-Ferguson Act** and strip insurers of their key exemptions from federal antitrust law (*BI*, Jan. 7, 1991).

* * *

A day after taking office, new California Insurance Commissioner John Garamendi **froze rates for all lines of coverage** regulated by Proposition 103.

In addition, he unveiled a Proposition 103 implementation plan that essentially would nullify his predecessor's plan (*BI*, Jan. 14, 1991).

* * *

The **Persian Gulf War** is creating chaos for risk managers, insurers and brokers worldwide.

Because of the fighting, buyers and brokers are uncertain whether policies will cover terrorist acts prompted by the war; insurers have canceled terrorism coverage for energy-related risks so the coverage can be rewritten at a higher price; and aviation and marine war risk rates are rising (*BI*, Jan. 21, 1991).

* * *

Led by another year of more than 20% increases in medical indemnity plan costs, group health care costs now exceed an average of $3,000 per employee for the first time ever.

Total **health care costs soared 17.1%** in 1990 to $3,217 per employee on average from $2,748 in 1989, reports A. Foster Higgins & Co. Inc. (*BI*, Jan. 28, 1991).

* * *

Corporations that pay premiums to wholly owned captive insurance companies can deduct those premiums from their federal income taxes if the captives write "relatively large" amounts of third-party business, according to three recent rulings by the U.S. Tax Court (*BI*, Feb. 4, 1991).

* * *

The Bush administration for the first time is proposing **sweeping reforms of medical malpractice liability laws** to control health care costs.

The administration is preparing a package of medical malpractice tort reform proposals, like eliminating joint and several liability for non-economic damages, for adoption by states. States that fail to adopt the package by 1995 could lose about $800 million annually in federal funds (*BI*, Feb. 11, 1991).

* * *

TPF&C, the nation's second-largest employee benefit consulting firm, is laying off 10% of its U.S. workforce in the **first company-wide layoffs ever at a major benefit consultant**.

Other benefit consultants say the job cuts reflect a decline in demand for benefit consulting (*BI*, March 4, 1991).

* * *

The U.S. Supreme Court ruled 7-1 that the due process clause of the 14th Amendment does not mandate **restrictions on punitive damages awarded by juries**.

The court rejected the arguments of business organizations that had asked the court to limit punitive awards. Instead, the court concluded that trial judges must properly instruct jurors on the purpose of punitive damages and called for sufficient judicial review of punitive awards (*BI*, March 11, 1991).

* * *

Large employers in Oregon are supporting **a plan to widen access to Medicaid coverage while prioritizing and rationing medical care** that is available through the government program.

Withholding payment for certain high-risk, high-cost services will make more funds available to extend basic health care coverage to all of the state's uninsured, low-income individuals, state officials say. Employers believe the plan will help stop cost shifting by providers (*BI*, March 18, 1991).

* * *

A U.S. Supreme Court ruling that **employers may not prohibit all fertile women from holding jobs that pose a significant risk to the health of their unborn children** could increase liability and other costs for employers.

The ruling is a defeat for Johnson Controls Inc., which had enforced a policy to prohibit fertile women from working with lead, a known toxin (*BI*, March 25, 1991).

* * *

Concerned about the **declining value of Executive Life Insurance Co.'s extensive junk bond holdings**, California Insurance Commissioner John Garamendi has seized control of the Los Angeles insurer.

Of Executive Life's $10.1 billion in assets, about $6.4 billion is invested in junk bonds, Mr. Garamendi said (*BI*, April 15, 1991).

* * *

Democratic leaders in the Senate are expected to introduce **a sweeping new universal health care access proposal** this month. The so-called play-or-pay legislation would require employers to provide a minimum health care benefits package or pay a new pay-

Continued on next page

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Continued from previous page
roll tax to fund a public program for the uninsured (*BI*, June 3, 1991).

* * *

A three-judge panel of the 9th U.S. Circuit Court of Appeals has unanimously ruled to **reinstate the massive antitrust litigation** against 31 insurance industry defendants. The suit was dismissed in 1989 by U.S. District Judge William Schwarzer (*BI*, June 24, 1991).

* * *

Lloyd's of London's nearly $1 billion pretax loss for its 1988 year, by far **the largest deficit in Lloyd's 300-year history** and its first marketwide loss in 21 years, may be a taste of things to come.

Chairman David Coleridge says prospects for 1989 and 1990 are also gloomy because of low rates and severe catastrophe losses (*BI*, July 1, 1991).

* * *

The **rehabilitation order issued in New Jersey for Mutual Benefit Life Insurance Co.** demonstrates how quickly an apparently solvent company can be brought to its knees by policyholders worried about the security of their investments.

Regulators seized Mutual Benefit to avert its collapse after thousands of policyholders demanded to cash in their policies (*BI*, July 22, 1991).

* * *

Hurricane Bob, which lashed New England with 125-mph winds, caused $780 million of insured property damage, but brokers and insurers are relieved that the damage was not worse (*BI*, Sept. 2, 1991).

* * *

In a pre-emptive strike against disgruntled U.S. members who contend Lloyd's of London has violated U.S. securities laws, **the Corporation of Lloyd's is seeking injunctions against two members to prevent them from suing Lloyd's in U.S. courts.**

Members are threatening to sue Lloyd's in an effort to recover their investment. Lloyd's contends that all members sign agreements that any disputes will be heard in English courts (*BI*, Sept. 2, 1991).

* * *

Fraudulent or mismanaged multiple employer welfare arrangements have left more than 400,000 people stuck with more than $132 million in unpaid medical claims since 1988, the General Accounting Office reports.

Angry congressmen blamed MEWA problems on the ambiguity of whether regulatory responsibility lies with states or the federal government (*BI*, Sept. 23, 1991).

* * *

Legislation that would expose group health and life insurers to **punitive damage awards for improperly denying claims** is on its way to the House Education and Labor Committee.

The legislation would overturn a 1987 Supreme Court decision that exempts insurers' group claims handling practices from state tort penalties (*BI*, Sept. 30, 1991).

* * *

Insured damages from the **fire storm that roared through an affluent area of Oakland, Calif.,** could reach $1.2 million, according to insurance industry estimates.

Although the loss is another blow to the catastrophe reinsurance market, it is not expected to force up prices in the commercial property/casualty market (*BI*, Oct. 28, 1991).

* * *

Officials of a California county say a hold-harmless agreement will shield the county from liability in **the death of a woman who was struck by a giant umbrella** constructed on county land as part of a project by the artist Christo.

The 20-foot umbrellas, each weighing almost 500 pounds, were deployed along California's Tejon Pass (*BI*, Nov. 4, 1991).

* * *

Lloyd's of London members are resigning from the market at a record pace. Some 3,245 members have resigned from Lloyd's already this year, compared with 1,894 resignations at this time in 1990. There was a record 2,349 total resignations in 1990.

The resignations will cause capacity at Lloyd's to be cut by 10% for 1992, officials predict (*BI*, Nov. 11, 1991).

* * *

Hartford Group Inc. may pay 50% more for its catastrophe reinsurance next year, London underwriters say. Hartford is seeking $250 million excess of $50 million in catastrophe reinsurance for 1992, but some brokers and insurers say there may only be $150 million to $180 million in catastrophe capacity worldwide (*BI*, Nov. 18, 1991).

* * *

Typhoon Mireille, which tore through Japan Sept. 27 and 28 with gusts of up to 150 mph, caused $2.27 billion of insured damage, the Japan Fire & Marine Insurance Assn. estimates. And, claims are still coming in (*BI*, Dec. 2, 1991).

* * *

Employers with managed health care plans are breathing easier following a federal appellate court ruling that **penalizing health plan members for failing to have medical procedures precertified** does not violate public policy (*BI*, Dec. 16, 1991).

* * *

More Americans lacked health insurance in 1990 than at any time since Medicare and Medicaid were established in 1965, a new study shows. **Some 34.7 million Americans were without insurance in 1990**, up 1.3 million from 1989, according to U.S. Census data (*BI*, Dec. 23, 1991). BI

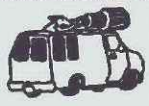
Stumped? Here are the answers to the quizzes on page 117.

Employee benefits: 1. b. Javits and Williams. **2.** b. Hewitt. Both Hansen and Meidinger were acquired by Mercer. **3.** a. $1. **4.** d. Gerald Ford. **5.** b. 1978. **6.** c. Expand women's pension rights. **7.** b. 1983. **8.** b. Flexible spending accounts. **9.** a. 501(c)(9) trust. **10.** d. BankAmerica. **11.** b. 1973. **12.** Claude Pepper. **13.** c. Public employers. **14.** c. David Ball. **15.** c. 1989. **16.** b. 550. **17.** b. When doctors order excessive tests to minimize malpractice risks. **18.** c. 1986. **19.** b. About $70,000. **20.** d. CIGNA guaranteed that Allied-Signal's health care costs would not rise more than a specified percentage over three years.

Risk management: 1. Alexander Howden Group executives Kenneth Grob, Ronald Comery, Alan Page and Jack Carpenter were accused of stealing millions of dollars. **2.** b. *Keene vs. INA*. **3.** c. 1975. **4.** a. Lewis-New York; Gunter-Florida; Bunner-California; Washburn-Illinois. **5.** None. **6.** c. Carnation. **7.** b. J. Robert Hunter. **8.** c. Oil Insurance Ltd. **9.** b. The Crump Cos. **10.** c. Frank B. Hall. **11.** b. 1969. **12.** b. Florida. **13.** c. Robin Jackson. **14.** d. Exxon-Erieview. **15.** INA Corp. and Connecticut General Corp. **16.** c. UNR Industries Inc. **17.** c. Thomas Hallett. **18.** b. 1987. **19.** d. Voter Revolt. **20.** b. Dean of Yale Law School.

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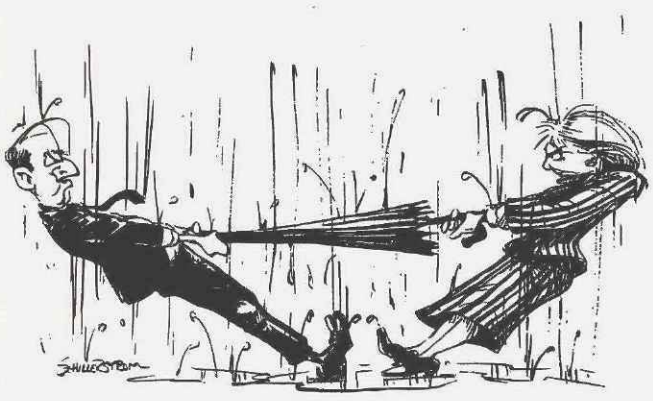
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A Laughing Matter

To conclude this special anniversary issue on a light note, *Business Insurance* asked readers to share some of the funny stories they have heard over the years.

Feel free to use them as needed—with due credit to our contributors, of course.



An insurance company is a place where they rent you an umbrella in fair weather and ask for it back when it begins to rain.

Jeffrey W. Pettegrew
Director of Risk Management and Insurance
Western Temporary Services
Walnut Creek, Calif.

Jesus was touring a hospital and asked the first patient he saw, "What's wrong with you my son?" The man replied, "I am crippled from a farming accident." Jesus touched the man, who got up and ran out of the hospital totally cured.

Jesus went over to the next bed and asked the woman, "What is wrong with you, my daughter?" The woman replied, "I lost my sight as a child." Jesus touched her, and suddenly she could see for the first time in many years.

Jesus approached the next patient, but before Jesus could open his mouth the man shouted: "Don't touch me, Jesus, I'm on workers comp!"

Michael Lee
Risk Management Assistant
City of Minneapolis

Two old friends, both prosperous businessmen who hadn't seen each other in a long time, happened to meet on a beach in Miami.

"What brings you here, Jack?" asked one of the men.

"Actually, Fred, a tragedy. My business burned to the ground, and I'm taking a vacation on part of the $250,000 insurance recovery."

"What a coincidence," responded Fred. "My business was destroyed by a flood, and I got almost a million in insurance."

After a moment of thought, Jack leaned to his friend and whispered: "Tell me, Fred—how do you start a flood?"



Mark Roberton
Risk Manager
Husky Oil
Calgary, Alberta

Insurance is the world's second oldest profession, but it is often confused with the first!

Edward G. Weiss
Director of Corporate Risk Management
First of America Bank Corp.
Clawson, Mich.

What is an actuary? Someone who wanted to go into accounting but didn't have the personality for it.

—Anon.

A risk manager dies and is told she has a choice between heaven and hell. She goes to heaven and hears harp music and sees people watching bluebirds and fields of flowers. When she gets to hell,



there's a big party with trays of liquor and food, a great band and people dancing. She chooses hell, but when she shows up the next day, all she sees is fire and brimstone.

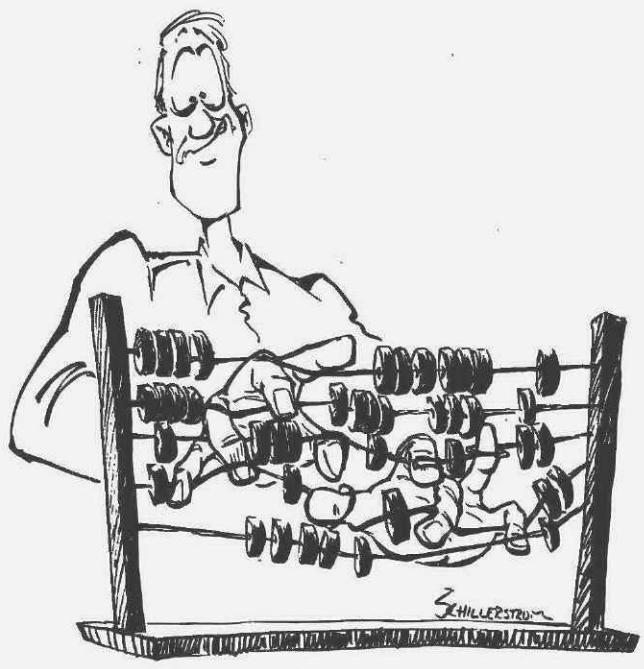
She asks what has happened and is told that yesterday she was a prospect; today she is a client.

Greg Myers
Vp
Becher & Carlson
Woodland Hills, Calif.

An underwriter is a person who knows a lot about a small number of things, who over time learns more and more about less and less until he knows everything about nothing.

A broker is a person who knows a little about a great number of things, who over time learns less and less about more and more until eventually he knows nothing about everything.

A risk manager is a person who wants a great deal



for very little, who over time gets more and more for less and less until finally he gets everything for nothing.

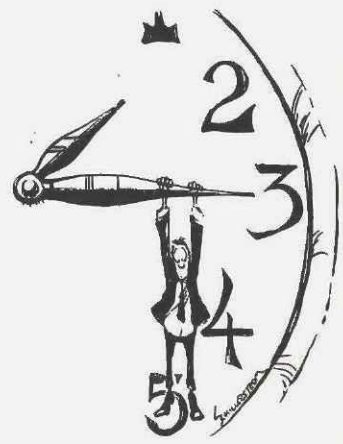
Diana P. Walker
Director of Risk Management
Thousand Trails/NACO
Bellevue, Wash.

A woman was looking for insurance on her $100,000 wooden leg. Lloyd's wanted a rate of $2.50 per $100. A specialty lumber insurer wanted $1 per $100. Finally, an HPR insurer quoted only 10 cents per $100 after rating the leg as a wooden structure with an overhead sprinkler.

W.M. Keller
Senior Vp
Jardine Insurance Brokers of Illinois
Chicago

The definition of a risk management consultant: One who not only asks for your watch to tell you the time, but once the project is over and paid for won't give you the time of day—unless it is a billable hour.

Robert Abraham
Principal Consultant
REA Associates
Wayzata, Minn.



An actuary was really proud of himself when he worked a jigsaw puzzle in six months. The box said "2 to 4 years."

Bob Huffman
Benefits Manager
Coast Benefits
Las Vegas

When you work as a team, one side shouldn't do all the talking.



Edgar Bergen & Charlie McCarthy courtesy of the Bergen Foundation.

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Webster wasn't kidding

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