

**401(k) sponsors react to fund scandals / 3**

**Csiszar outlines NAIC agenda for 2004 / 4**



# Business Insurance

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\$4

## Captive plan could lower barrier to benefits funding

By **JERRY GEISEL**

**WASHINGTON**—A major Swedish company's bid to use a branch of its Ireland-based captive to fund the benefit risks of its U.S. employees could further lower the barriers to captive benefit funding arrangements.

Svenska Cellulosa Aktiebolaget—a paper, packaging and consumer products company better

known as SCA—wants to use the recently formed U.S. Virgin Islands branch of its 13-year-old captive to fund U.S. benefits-related risks. The captive, SCA Re, would reinsure life insurance, accidental death and dismemberment, and long-term disability policies written by Aetna Inc. for SCA's U.S. employees.

While several employers in recent years have won Labor Department approval to fund em-

ployee benefits through their captives, SCA's application could be a test case for whether the department will further broaden its flexibility in its consideration of such arrangements.

In 1999, the department relaxed a stringent test that had limited captive benefit funding to employers whose captives took on a big chunk of outside business. But in exchange for easing that

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### Late News



PHOTO: GETTY

**Wal-Mart has faced litigation over its COLI policies.**

#### Wal-Mart settles suit over COLI policies

Wal-Mart Stores Inc. has settled a lawsuit that charged the employer's corporate-owned life insurance policies violated Texas law. In the 1990s Wal-Mart purchased life insurance policies on its employees and made itself the beneficiary to obtain certain tax benefits, a suit by the families of deceased Wal-Mart workers charged. Last week, the 5th U.S. Circuit Court of Appeals upheld a federal district court ruling that Wal-Mart's COLI policy violated Texas law because the employer lacked a sufficient financial interest in the lives of its rank-and-file employees. Terms of the settlement were not disclosed.

#### 9th Circuit bars worker's religious bias claim

A Hewlett-Packard Co. employee who was fired for displaying Bible passages condemning homosexuality cannot bring a religious discrimination claim against his employer, the 9th U.S. Circuit Court of Appeals ruled. "It is evident that he was discharged not because of his religious beliefs but because he violated the company's harassment policy by attempting to generate a hostile and intolerant work environment and because he was insubordinate," the court ruled. The employee had posted in his cubicle several passages from the Bible in response to company posters promoting diversity in the workplace.

#### PacifiCare says strike could hurt growth

PacifiCare Health Systems Inc. announced last week that an ongoing strike by Southern California grocery workers could cause it to fall short of its targeted membership growth for 2004 and impact earnings. PacifiCare is among three major health insurers

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### Alliance, NAI to speak with single voice

Merger expected to bring greater lobbying clout

By **MARK A. HOFMANN**

**WASHINGTON**—The merger of two major property/casualty insurer trade groups should mean more lobbying clout for the industry in Washington and the statehouses, say risk managers and other insurer trade organizations.

Even groups that don't agree with the entire agenda of the new Property Casualty Insurers Assn. of America—which came into being last week with the combination of the Alliance of American Insurers and the National Assn. of Independent Insurers—say the merger makes sense on several levels.

"Both have enormously respected and effective government affairs shops, and I think almost all of us in the industry welcome these developments," said Joel Wood, senior vp-government affairs with the Council of Insurance Agents & Brokers.

"Unlike the life insurer industry, which has one trade association, the property casualty/industry has had four—running the spectrum from the National Assn. of Mutual Insurance Cos. to the American Insurance Assn. That's not always a bad thing, and I

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## Services go to bat for employers, workers Advocacy firms help cure benefit troubles

By **SALLY ROBERTS**

As employers continue to shift some of the rising health care cost burden onto employees, more are beginning to ease the pain by offering health advocacy services as an employee benefit.

Staffed with medical, claims and health administration experts, advocacy service providers not only help employees navigate the health care system by answering and resolving various health plan questions and health-related needs, but they also go to bat for employees when

claims and billing problems arise.

This not only frees up employees from the often time-consuming and frustrating process of trying to resolve health care plan related problems and issues while at work, but also frees up corporate benefits departments to focus more on strategic benefit issues.

Employers also say that by outsourcing health resolution issues they distance themselves from privacy rules contained in the Health Insurance Portability and Accountability Act. That results as

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### Spotlight Report

## PROPERTY/CASUALTY MARKET REPORT

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January 12, 2004

# Fortress Re partially settles fraud claims

**BURLINGTON, N.C.**—Managing general agent Fortress Re Inc. has paid three Japanese insurers \$265 million in what the insurers describe as a partial settlement of claims that Fortress defrauded them of hundreds of millions of dollars while managing an aviation reinsurance pool.

The three insurers, Aioi Insurance Co. Ltd., Sompo Japan Insurance Inc. and the insolvent Taisei Reinsurance Co. Ltd., are splitting the payment in proportion to their participation in the pool. Aioi received 48%, or \$127.2 million, while Sompo and Taisei each received 26%, or \$68.9 million.

The payment came during settlement talks that began in earnest last month, almost immediately after Sompo won a \$1.1 billion arbitration award against Fortress, according to Clifford H. Schoenberg, a lawyer representing Sompo with Cadwalader, Wickersham & Taft in New York.

An arbitration panel found that Fortress had committed fraud, concealing the pool's massive losses over several years while taking unjustified profit commissions and diverting premiums through an affiliated Bermuda-based reinsurer (*BI*, Jan. 5). The award comprised \$1 billion in compensatory damages and \$100 million in punitive damages to Sompo.

Aioi is separately scheduled to begin arbitration hearings against Fortress next month, and both Sompo and Aioi are pursuing civil

fraud litigation against Fortress principals and other defendants in North Carolina federal and state courts.

Fortress made the \$265 million payment unconditionally, and insurers view it as a down payment on an eventual final settlement of the two-year-old dispute. Talks are continuing, and Mr. Schoenberg said the insurers expect to find out this month—before the Aioi arbitration hearings begin—whether a final deal can be reached.

"We expect things to happen sooner rather than later," he said. Fortress representatives either could not be reached or declined to comment on the payment.

—By Douglas McLeod

# Mutual fund scandal prompts scrutiny of 401(k) practices

By JUDY GREENWALD

Plan sponsors are keeping a close eye on the unfolding mutual fund scandal because of its potential impact on their employees' 401(k) funds and concerns about their own fiduciary liability.

Most are still taking a cautious, wait-and-see approach, though some companies that do business with the numerous mutual fund companies caught up in the scandal—which includes those run by Boston-based Putnam Investments Inc., Denver-based Janus Capital Group Inc. and Menomonee Falls, Wis.-based Strong Mutual Funds—have removed these funds from among the investment options for their 401(k) plans.

Some plan sponsors are also introducing restrictions on the frequency of plan participants' trading, which is one of the factors drawing the scrutiny of regulators and attorneys.

Central to the scandal are the practices of market timing and late trading. The controversy, which began last year, has led to the investigation of many mutual funds com-

panies by numerous states, the U.S. Securities and Exchange Commission and Congress.

Market timing, which is not illegal per se, involves frequent, short-term trading done to take advantage of changes in stock market conditions, a practice that sometimes is in violation of a fund's prospectus. Frequent trades can increase trading costs and can be a drag on a fund's long-term performance.

Late trading, which is illegal, involves placing an order to buy or sell a fund share after normal market hours, or 4 p.m. EST. Late trading enables the trader to profit from market events that occur after 4 p.m. that are not reflected in the day's price. These trades generally involve international funds.

Putnam faces allegations that two of its former portfolio fund managers engaged in market timing practices, in violation of Putnam policies (*BI*, Nov. 10, 2003).

At Janus, the company said that it appears 10 institutional investors were given the opportunity to trade frequently, although there is no evidence of inappropriate trading in

the Janus funds by portfolio managers or senior management, nor has there been any evidence of late trades placed directly with the funds. The company said it is taking steps to protect against frequent trading in the future.

Strong Financial Corp., Strong Mutual's parent firm, said it is taking steps designed to prevent investors from engaging in frequent trading activity. It said former Strong Mutual Funds Chairman Richard S. Strong, who has resigned, engaged in a small number of late trading transactions over the years.

"Clearly, the industry as a whole needs to clean up its act," because many defined contribution plan participants depend upon the integrity of these fund companies, said Craig Horner, chief financial officer of Towson, Md.-based Riggs, Counselman, Michaels & Downes, an insurance brokerage and consulting firm that made changes to its 240 employees' 401(k) fund lineup in part because of the scandal.

As fiduciaries, plan sponsors are

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General Motors Corp. and Ford Motor Co. have both made large contributions to their retirement plans in recent weeks.

# Carmakers make good on pension deficits

## Is the funding crisis over?

By JOANNE WOJCIK

**DETROIT**—While some pension experts say General Motors Corp.'s announcement last week that it has fully funded its retirement plan obligations may signal the end of the pension funding crisis, others are more cautious.

Last year was definitely a good year for most pension plans, with yields on assets up anywhere from 10% to 20% on average, but past performance is not a predictor of future outcomes, they note. And Congress still must act to resolve what interest rate assumptions employers are to use to value pension liabilities.

The fact, though, that companies are doing better financially and the equities markets are up will reduce funding pressure for many employers, pension experts acknowledge.

General Motors successfully tackled its \$19.3 billion pension

deficit—the largest of any U.S. company—with the sale of \$13 billion in bonds, the spinoff of Hughes Electronics, savings from discontinued operations and a 22% return on pension fund investments, a GM spokesman said. Ford Motor Co. in late December also had good news to report regarding its retirement plan.

"Our underfunding picture dramatically improved this year," said a spokeswoman. "We made a \$2 billion contribution to the U.S. pension plan in 2003, though we were not required to do so until 2008."

The additional contribution was a product of the company's higher 2003 profitability, she explained.

In addition, Ford's plan assets had a 20.9% rate of return through November. While the plan is still underfunded by about \$2.4 billion, "it's an improvement of \$2.5 billion over a

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## Inside Business Insurance

### Cash balance plans in jeopardy

A new survey finds many employers will drop hybrid defined benefit pension plans if last year's IBM Corp. federal ruling is upheld. **Page 4**

### Be more afraid of doing nothing

Fear of litigation can prevent people from taking even common-sense measures, Paul Winston says. **Page 6**

### Trade group merger an industry asset

The recent merger of two venerable insurer trade groups is a net gain for the property/casualty insurance industry, this week's editorial says. **Page 8**

### Aussie med mal bailout fixes crisis for now

Australia's government rescue package may prevent the resignations of public health doctors for a while. **Page 29**



### Parmalat scandal may hike D&O rates

A corporate government scandal at one of Italy's largest companies could affect directors and officers rates and terms offered in Europe. **Page 29**

## Online

- The **Datebook** calendar lists upcoming industry seminars and meetings and allows you to add info on your own event.
- Searchable **directories** let you see all the listings of industry vendors found in *BI*'s Market Sourcebook.
- New **Opinion Poll** for readers: When do you expect that average general liability insurance rates will start to decline?

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### REPORTING ON CORPORATE RISK AND EMPLOYEE BENEFIT MANAGEMENT NEWS

## New NAIC president focused on pushing efforts to modernize state regulation

By MEG FLETCHER

**COLUMBIA, S.C.**—In his 53 years, Ernst Csiszar has attained fluency in five languages, fled Communist Romania on foot, survived cancer and made two holes in one in golf—and this year he faces yet another big challenge.

As the newly elected president of the National Assn. of Insurance Commissioners, Mr.



Mr. Csiszar

Csiszar says he must spur commissioners to take more strides toward modernizing state insurance regulation.

"We made tremendous progress in 2003, highlighted by the adoption of our new plan of action for regulatory reform," said Mr. Csiszar. The South Carolina insurance director was elected to a one-year term as NAIC president in December.

This year "is the time for us to take a strong step forward," he said.

While he would like to see the NAIC continue streamlining life/health insurance regulation, he also wants regulators to modernize property/casualty insurance and consider alternatives to reducing reinsurance collateralization for non-U.S. reinsurers. In addition, Mr. Csiszar supports allowing risk retention groups to continue writing service contracts, as long as those RRGs have adequate reserves.

The state-based insurance regulatory system "is overregulating

the trivial and underregulating the essential," said Mr. Csiszar, speaking with characteristic candor. His biggest leadership challenge will be "moving the organization along."

"I know we need to reform the state regulation, and unless we can deliver a better system, we deserve everything we are going to get," Mr. Csiszar warned. That could mean some type of dual regulatory system with federal authorities, but probably not the individual federal charters some state critics are advocating, he said. Congress is not ready for that, he said.

As a result of his unusual background, Mr. Csiszar has developed a variety of skills that make him an effective regulator, especially in the international arena.

Motivated by his mother and father's desire for him to receive a good education, he and his parents literally crawled out of Communist-controlled Romania when he was 15 and joined relatives in Canada. Although he spoke no English at that time, his advanced math skills caught the attention of professors there and ultimately led to his receiving bachelor's degrees from both the colleges of arts and law at the University of Windsor in Ontario, Canada.

Mr. Csiszar's extensive language skills—which today include fluency in English, French, German, Hungarian and Romanian, as well as a reading knowledge of Italian, Spanish and Russian—have helped him in many ways.

He has held executive-level posts for an investment banking firm, Holborn Holdings Corp. of Geneva, Switzerland, from 1979 to 1988; and for Columbia, S.C.-based property/casualty insurer Seibels Bruce Group Inc. from 1995 to 1998.

He also has taught business-related courses at the University of Windsor and the University of South Carolina.

Mr. Csiszar survived a bout of chronic myelogenous leukemia that was diagnosed in 1995 but is now in remission.

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## Ruling on IBM plan awaited Cash balance controversy chills employer enthusiasm

By JERRY GEISEL

Many employers with cash balance and other hybrid pension plans will exit the defined benefit plan system if a federal court ruling that IBM Corp.'s cash balance plan discriminates against older employees is upheld, according to a new survey.

Forty-five percent of employers with hybrid plans surveyed by Hewitt Associates Inc. said they would freeze their plans and provide future accruals under defined contribution plans, while 29% said they would provide accruals under traditional plans, and the remainder weren't sure or would wait and see.

The survey may, in fact, overstate how many employers would re-establish traditional defined benefit plans if the July 31, 2003, ruling by U.S. District Court Judge G. Patrick Murphy, now under appeal, is affirmed, said Michael Johnston, a Hewitt consultant in Lincolnshire, Ill.

"I suspect very few employers would go back to the old system," Mr. Johnston said. He questioned why employers would opt to return

to such plans if concerns about those plans had driven them to the hybrid plans in the first place.

Cash balance plan sponsors aren't the only ones that may move away from their plans if other uncertainties about defined benefit plans aren't resolved soon, accord-

**If the IBM cash balance plan ruling is upheld, many employers will freeze their hybrid plans and provide future accruals under a defined contribution plan, a survey found.**

ing to the survey, which is based on the responses of about 200 large employers.

The chief uncertainty is whether Congress will allow employers to use a more liberal interest rate assumption to value pension plan liabilities.

Last year, the House passed legislation that would allow employers

for the next two years to use yields from a corporate long-term bond index to value liabilities, a big change from the current methodology that is based on the yield of the 30-year Treasury bond. The switch to a bond index would significantly reduce plan contributions.

But the Senate failed to act on the proposal after legislators got bogged down trying to decide whether to exempt temporarily, in full or in part, employers from federal law that requires them to kick in extra contributions when their plans become underfunded. Senate leaders have pledged to return to the issue later this month, but no one knows how quickly the matter will be resolved.

If the interest rate question is not resolved in the next year, 21% of employers with traditional plans say they will freeze or terminate those plans and provide future benefits under defined contribution plans.

An additional 17% say they will continue their traditional plans for current employees but cover future

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## P/C pricing barometer losing pressure

Average property/casualty rate increases moderated significantly during 2003 but still remained in excess of 10% at year's end, according to the "Market Barometer" of Internet insurance portal MarketScout.com.

However, rate increases should continue to slow in 2004, said Richard Kerr, chief executive officer of the Dallas-based company, which claims that 50,000 agents use its Internet site for placements or for information.

In January 2003, the average year-over-year rate increase on busi-

ness placed through MarketScout.com was 27%, which was close to the average of around 30% reported throughout 2002. But in the spring of last year, the hikes decreased to the upper teens, and by the end of 2003, the average rate increases were hovering around 10%.

But the figures represent averages for all property/casualty business placed through MarketScout.com, and there remain great variations among different lines, Mr. Kerr said. Medical malpractice rates, for example, continue to see significant increases, whereas property rates

have begun declining for some accounts, he said.

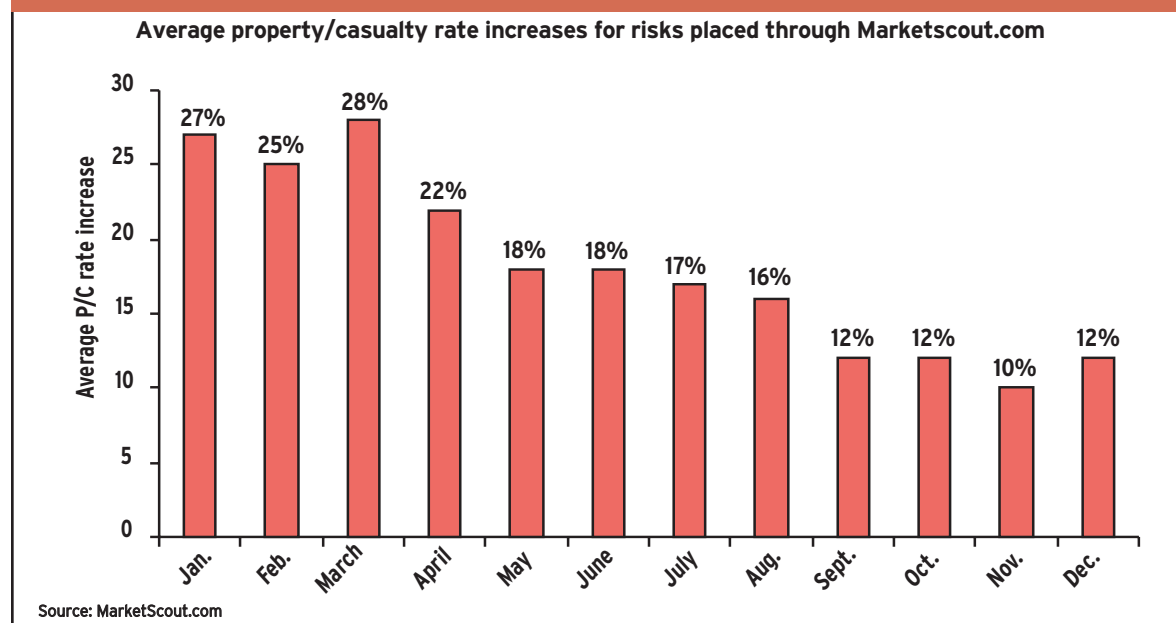
Barring significant losses or insurer insolvencies, rate increases should continue to moderate in 2004, Mr. Kerr said.

"The trend should continue downward, and we expect increases to be in the 8%, 9%, 10% range for the next three months," he said.

Increased competition among insurers and lower reinsurance rate increases are driving the overall slowing in rate increases, Mr. Kerr said.

—By Gavin Souter

### RATE INCREASES DECLINE DURING 2003



### Errors & omissions

• A Jan. 5 story about an arbitration award against managing general agent Fortress Re Inc. listed an incorrect affiliation for one of the arbitrators. Andrew Maneval is

president of Horizon Management Group L.L.C., which manages discontinued operations of The Hartford Financial Services Group Inc.



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## Paul Winston

# Be more afraid of doing nothing

There are plenty of instances when risks engender fear. This is not necessarily a bad thing, as it can spur people to action—be it to avoid the risk or to try and manage it. Fearing the damage from natural catastrophes such as hurricanes and earthquakes, for example, makes many people and organizations take preventive measures and plan to minimize the risk of loss. At least, that's how the theory goes.

But what about situations when fear results in inaction? In such instances, fear can actually create risks of its own.

Unfortunately, this is what happens when individuals and organizations are afraid to act because doing so could trigger a lawsuit and liability.

Fear of litigation can prevent people from taking morally appropriate action, or even common-sense measures. Rather than confront their fears, they do nothing. While their heads are in the sand, the risk remains.

This is especially prevalent in the world of job referrals, in which employers are afraid to provide useful and relevant references about former employees to a prospective employer. Why? Because they might be sued. This paralysis helps bad employees and hurts everyone else.

This situation, and its consequences, is illustrated in the extreme by the case of a nurse in the Northeast who claims to have killed 30 to 40 patients at multiple health care facilities during a 16-year period. The nurse, Charles Cullen, worked at 10 different facilities during the period. According to the Associated Press, he was fired from five of these facilities and quit three others. Despite being fired or leaving under unusual circumstances from so many jobs, Mr. Cullen continued to move around the medical system.

I seriously doubt that any of these former employers realized that Mr. Cullen was a serial murderer, as alleged. But some of them did link the deaths of patients to his inappropriate care before firing him. At other places of employment, it is likely that co-workers and supervisors had valid suspicions that patients had died due to care that was, at best, negligent.

But it would appear that few attempted to confirm or refute their suspicions. And they certainly did not share their concerns with prospective employers, let alone with law enforcement authorities or state medical licensing boards. When new employers checked references, the previous employers never shared their findings or suspicions of Mr. Cullen's substandard (or worse) care because of fear of being sued.

It's terrible that employers have become so afraid that they will not at least indicate to a prospective employer that an employee left under questionable or unfavorable circumstances.

Now, of course, as more information about these employers' failure to communicate emerges, they are likely to be sued anyway for negligent referrals and negligent hiring.

Such is the nature of the messy situation that confronts all employers that fear the consequences of telling other employers why an unsatisfactory worker was terminated—even if there are compelling reasons for providing such an honest accounting. The Cullen

case is an extreme example; a more common scenario could involve an employee fired for harassing co-workers or committing violence in the workplace.

There has to be a better way—a way that enables the exchange of necessary information among employers acting in good faith, while protecting the rights of employees not

to be "blackballed" by malicious employers. Some states have attempted to do this, but this issue needs to be considered by Congress, as it affects all employers.

Legislation could strengthen and reaffirm an employer's existing qualified privilege to make statements to a prospective employer, which has been eroded by many court rulings. This defense means that even if an adverse statement in a job referral is proved to be false, the employer is shielded as long as it made the statement in good faith and not out of malice. The legislation should also raise the burden of proof for an employee to rebut this presumption of good faith, while still protecting an individual's ability to challenge malicious or retaliatory job referrals.

Such reforms would benefit employees and employers alike, as the protected exchange of information would lead to a more transparent and fair basis for hiring.

Many court rulings have eroded the protections afforded by the qualified privilege. So it's little wonder employers feel better saying nothing about a former employee who was fired than saying anything that could give rise to a claim.

In addition to legal reforms, employers must summon the courage to do the right thing in spite of their fears. Inaction caused by fear can spawn its own risks. The Cullen case should make that plain.

*Editor Paul Winston can be reached at [pwinston@businessinsurance.com](mailto:pwinston@businessinsurance.com)*



**Paul Winston**

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## Editorial

# Trade group merger a plus

**I**N AN INDUSTRY in which consolidation has become the rule rather than the exception, the recent merger of two venerable insurer trade groups into one makes more than a little sense.

As we report on page 1, the merger of the Alliance of American Insurers and the National Assn. of Independent Insurers after years of sporadic discussions is being hailed by others—including those that don't share all of the group's views—as a net gain for the property/casualty insurance industry. And although we don't support the entire agenda of the new organization, the Property Casualty Insurers Assn. of America, we couldn't agree more that the union is good news.

One of the biggest problems property/casualty insurers have faced over the years is that the industry spoke not with one voice but in a welter of voices. While life insurers have had a single trade association for years to promote their interests, their property/casualty insurer brethren have had four. Even the property/casualty agents and brokers currently have three trade groups. The result has created confusion among lawmakers

who don't know whom they should listen to as parochial interests have trumped industrywide concerns. Too often, that's been to the detriment of insurers, producers and their customers—the risk managers.

The creation of the PCI should cut through some of the confusion. After all, the NAII and the Alliance have agreed on major issues for years. We're the first to admit that we don't share their positions on every issue. For example, we've long believed that certain insurers should be allowed to pursue optional federal charters rather than continue to chafe under state regulation that is often duplicative, expensive and inefficient.

Nevertheless, we think that the new group will be more effective in promoting positions that we do share. These include such critical matters as class action reform and finding a better way to compensate victims of asbestos-related disease.

The merger of the two groups means that there will be one fewer voice presenting the property/casualty industry's case. Fortunately, the single voice that does emerge from this union should be a strong one.

# Health plan aid a benefit

**I**T'S A SHAME THAT an increasing number of employers feel it is necessary to contract with outside firms to represent their employees in disputes with their health care plans. But it is also a pragmatic approach to what seems to be a growing problem.

It shouldn't be an unattainable ideal for employers and employees to pay serious amounts of money to health insurers and in return get efficient and effective services. However, in the current climate of cutbacks, increased expenses and the push for greater profits, that isn't always the case.

While the disputes can often be due to employees' not knowing or ignoring boundaries of coverage, wrongly denied claims and shoddy service by health care plans also abound.

Bringing in outside experts to help explain benefits or

fight for employees' rights is an option that perhaps more employers should consider. As we report on page 1, this comparatively inexpensive service not only helps employees get the treatment they are entitled to but also ensures they do not have to waste time at work arguing with or being redirected by their health insurers.

In addition, pared-down benefit departments are freed up to concentrate on more strategic projects, such as improving plan designs rather than becoming embroiled in disputes with employees or insurers.

Employers will, of course, need to ensure that an outside advocacy firm is really adding value rather than just another layer of red tape. If they can find a good partner, however, this dose of realism may not be the cure to employees' health care problems, but it might alleviate some of the pain.

## Schillerstrom



## Letters to the Editor

### Another perspective on drug benefit study

To the editor: As one of the investigators in the recent Harvard Medical School/Medco Health Solutions Inc. study on tiered copayments, I would like to offer some additional perspectives on the study's findings that were not included in the Dec. 15, 2003, cover story on the study.

First, while my colleagues and I would agree that comprehensive education and communication is important when changing prescription plan design, the study did not specifically examine education or communications programs associated with the plan changes and, therefore, did not find that better communication is needed when plan changes are made.

Second, the article states "a significant number of employees stop taking certain medications—rather than switching to generics." While it is true that a portion of patients who had been using tier-three drugs did discontinue therapy, a greater number of patients made the switch to a more cost-effective medication. It is also important to note that, contrary to the statement in the article, there were no generic alternatives for proton pump inhibitors during the study time frame.

Indeed, although the copay changes were quite different for the two employer groups included in our study, enrollees in both employer groups who were taking a tier-three drug switched to drugs of a lower tier at a significantly higher rate than enrollees in their respective comparison groups. For Employer A, nearly 42% of patients taking ACE inhibitors switched their current tier-three medication to a lower-tiered drug (only 4% switched in the comparison group); 35% of patients taking tier-three proton pump inhibitors switched to a lower-tiered drug (only 1% switched in the comparison group); and 49% of patients taking tier-three statins switched to a lower-tiered drug (only 17% switched in the comparison group). Similar trends were observed for enrollees of Employer B.

This is the intended effect of three-tier formularies—to sensitize members to the true cost of prescription drugs and to provide financial incentives for them to choose more cost-effective agents.

Our study found that while incentive formularies lead to lower drug costs for payers, large increases in member cost-sharing can also have unintended consequences. We observed that patients faced with large copayment increases stopped taking necessary medications, which may have implications for the quality of care and total health care costs. Health plans and plan sponsors should carefully consider the extent and rate of change in their copayment or cost-sharing structure as well as the type of employee population they serve.

**Dr. Patricia A. Deverka**  
 Vp-Scientific Affairs  
 Medco Health Solutions Inc.  
 Washington

# Spotlight

## 2003 Market Report

Spotlight Editor: Gavin Souter

### Low losses, increased capacity help market moderate

By SALLY ROBERTS  
and MARK A. HOFMANN

Risk managers ringing in the New Year by renewing their property insurance policies have reason to celebrate.

With few large-scale catastrophes since the Sept. 11, 2001, terrorist attacks and two years of hefty premium increases, the property market is once again flush with capacity and competition has returned. As a result, clean property programs are



renewing at flat to, in some cases, double-digit decreases, observers say.

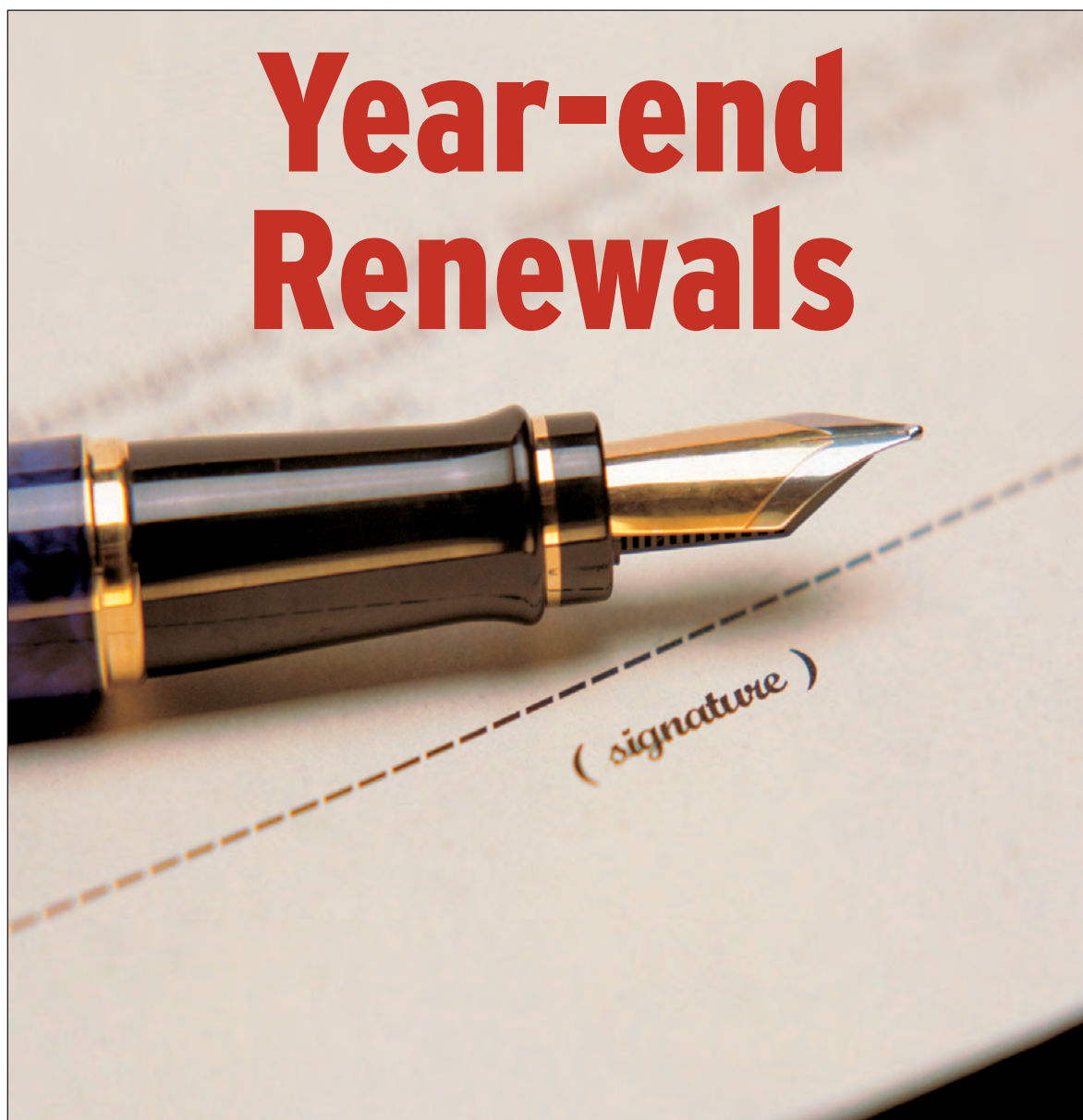
It's not only property coverage that is moderating, though. Terrorism coverage—both stand-alone policies and coverage offered under the Terrorism Risk Insurance Act—also is more flexible today, they say, although opinions vary as to the popularity of actually purchasing the coverage.

"It's a marketplace that's becoming increasingly positive for our clients," said Robert Howe, managing director in charge of property placements at Marsh Inc. in New York. "If you looked at our portfolio over the last couple of months, you'd probably see somewhere in the area of three-quarters of all the placements were experiencing either a flat renewal to a decrease."

"We foresee good news for our clients," agreed Alexandra Glickman, managing director and practice leader of Gallagher Real Estate & Hospitality Services, a unit of Arthur J. Gallagher & Co. in Glendale, Calif. "There is increased ca-

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## Year-end Renewals



### Reinsurance market finds relief following two years of turmoil

By DOUGLAS McLEOD  
and RODD ZOLKOS

After a pair of renewal cycles dominated by terrorism losses, concerns about federally mandated terrorism coverage and reinsurer security, this year's Jan. 1 renewals are being described with some relief by reinsurance market observers as "normal" and even "dull."

Property catastrophe and property treaty programs are renewing at prices that are unchanged or slightly lower than last year, while the market for casualty renewals remains firm, especially for lines such as medical malpractice, professional liability and directors and officers coverages, brokers and reinsurers report.

Some things are changing, though: Numerous ceding insurers,

for example, are buying higher property catastrophe limits in response to new assessments of their exposure.

At the same time, many insurers are ceding less of their noncatastro-



phe property and casualty business because their improving balance sheets allow them to retain more and because the business continues

to offer attractive returns, market sources say.

Overall, though, the renewal market has been relatively free of the turmoil that marked the last two years' Jan. 1 renewals.

"This year was a fairly normal year," observed Sean F. Mooney, senior vp and chief economist with Guy Carpenter & Co. Inc. in New York. "The trends that were already in the market at Jan. 1, 2003, continued on into Jan. 1, 2004."

"There were no new contentious issues across the board," noted John N. Gilbert, president and chief executive officer of New York-based intermediary Holborn Corp.

Steven Bolland, president of New York broker Gill & Roeser Inc., described the market overall as characterized by "just a mild general

See **REINSURANCE**/page 22

### While liability rate hikes slacken, underwriters remain wary

By JOANNE WOJCIK  
and MICHAEL BRADFORD

Rates are higher for commercial general liability insurance policies renewing at year-end 2003, but the degree of increase is nowhere near what it was at the end of 2002, industry observers say.

However, they report, rate increases for first-layer excess generally still exceed those for both primary and high-layer excess liability coverage.



And while capacity appears to be plentiful for 2004, most insurers stuck to their underwriting guidelines and rarely provided more than \$25 million in a single layer, requiring buyers seeking higher limits to line up several insurers. And some first-layer excess underwriters are raising their attachment points.

In an unusual twist, some risk managers turned the tables a bit and put liability insurers on the defensive, rejecting those that had ratings below A- and, in some cases, even requesting that insurers with higher ratings be put ahead of others in multilayered excess liability programs.

"Rates are continuing to rise, although not at the same rate as earlier in the year," said John Doyle, president of American Home Assurance Co., a unit of American International Group Inc. in New York.

"What's different about this market is there's a broader range of pricing change than last year," he said. "In 2004, there had to be major portfolio pricing changes. In 2004, it's more risk-related."

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D&O coverage renewals  
page 12

Workers comp coverage renewals  
page 22

# Rate increases generally slowing for D&O coverage

By **DAVE LENCKUS**  
and **ROBERTO CENICEROS**

While directors and officers liability insurance rates will continue to increase for some risks this year, January renewals demonstrate that risk managers should plan for a somewhat softer D&O market for at least the short term, insurers and brokers say.

Meanwhile, errors and omissions liability insurers are seeking more moderate rate increases in many cases.

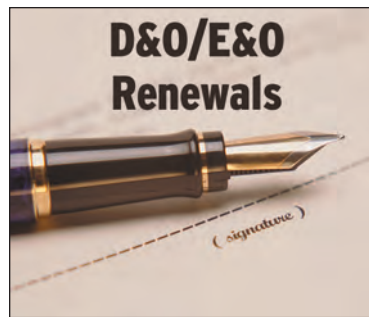
In the D&O market, perhaps the clearest sign that insurers are be-

coming more competitive is that "you don't see them walking away much anymore" from risks, according to Lou Ann Layton, managing director and national D&O practice leader for New York-based Marsh Inc.

Rates generally are "decelerating," said Gary Dubois, chief underwriting officer for New York-based Liberty International Underwriters, a division of Liberty Mutual Insurance Co.

"Reasonably stable" buyers should expect increases of 10% to 20%, rather than the high double-digit to triple-digit rate hikes that

insurers have imposed across the board since 2001, Mr. Dubois said.



But Mr. Dubois and other market executives stress that rate move-

ment will vary widely by risk and industry.

For example, midsize and small publicly traded companies as well as privately held companies should fare best, negotiating small rate hikes at worst and reductions of up to 20% at best, according to Don Bailey, global practice leader for Willis Executive Risk, a New York-based division of Willis Group Holdings Ltd.

Risks that will continue to face unrelenting rate pressure include large financial institutions, selected health care operations, mutual funds, large high-tech companies

and risks that either are coming off multiyear programs or that came off such programs a year ago and have gone through only one tough renewal, market executives say.

Another measure of heightened competition in the D&O market is the greater number of insurers willing to write primary coverage, market executives say.

And, with several new entrants in recent months and existing insurers willing to bear more risk, the D&O market is adequately capitalized, according to insurance executives. Most executives estimate that "advertised" worldwide capacity now exceeds \$1 billion but that "real" capacity is between \$500 million and \$800 million.

Insurance executive John Keogh said the biggest placement he has seen recently is \$500 million of limits, which covered the buyer's Side A and Side B risks. That amount of coverage is "a stretch, though," for most risks to obtain, said Mr. Keogh, president and chief executive officer of New York-based National Union Fire Insurance Co. of

**In the D&O market, perhaps the clearest sign that insurers are becoming more competitive is that 'you don't see them walking away much anymore' from risks.**

Lou Ann Layton  
Marsh Inc.

Pittsburgh, Pa., a subsidiary of American International Group Inc.

Side A insurance covers corporate executives for losses that their organizations are precluded from covering. Side B insurance reimburses an organization for the D&O losses it has covered for its executives. Side C, or entity insurance, covers the organization for its share of liability for a securities-related loss.

But up to one-third of buyers have dropped their entity coverage recently, market executives note. Buyers are concerned that entity coverage could create problems in retaining and attracting executives. For example, if a corporation were to file for bankruptcy protection while also fighting securities-related litigation, a bankruptcy court could freeze a D&O policy with entity coverage to protect that corporate asset. As a result, corporate executives who face D&O losses could be left without any coverage.

Usually only large risks drop entity coverage, and then they often purchase a separate tower of Side A coverage above underlying Side A and B coverage, Mr. Keogh said. Smaller companies generally have kept their entity coverage, because they "need a little more balance sheet protection," he said.

Nearly an equal number of risks that have dropped their entity coverage have opted to assume either co-insurance or preset allocations

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# D&O: Rate hikes generally slowing at renewal

## Continued from page 12

that set out in advance how much of each loss will be split between covered executives and an uninsured corporation, market executives say.

Co-insurance typically ranges between 5% and 20% and applies to all types of D&O losses, market executives say.

Preset allocations of coverage, which apply only to executives facing securities-related losses, typically range from 80% to 50%, with lower percentages garnering premium breaks for buyers. Some insurers, such as Hartford, Conn.-based

XL Professional, a downstream unit of XL Capital Ltd. of Bermuda, offer 100% allocation, noted John Burrows, a senior vp XL Professional.

Other good news for buyers includes a greater willingness by underwriters to "sever" executives who have committed fraudulent acts from innocent ones for Side A coverage, which prevents innocent executives from losing their coverage.

While the D&O market has softened to an extent, some market executives question whether the turnaround will be short-lived.

"Are we seeing a false bottom, because there's really no loss data that supports what carriers are doing in the marketplace right now?" Willis' Mr. Bailey wondered.

"I think it's still a very shaky D&O market," Mr. Keogh agreed.

## E&O liability

In the E&O market, the average rate increase in 2004 will hover between 10% and 15%, according to brokers and insurers.

In contrast, rate hikes during 2003 averaged about 25%, according to Catherine Kelly, vp and head

of professional liability products in New York for Hartford Financial Products, a unit of The Hartford Financial Services Group Inc.

Some business classes, though, will see steeper rate increases. Financial service companies—as well as the attorneys and accountants who advise them—and publicly traded companies, for example, will be harder hit, say insurers and brokers.

Those entities could see increases of 25% or more, Liberty's Mr. Dubois said.

Recent mutual fund company troubles and fallout from a sluggish

economy could generate professional liability losses, insurers and brokers say.

But in contrast to the trend over the last two years, in which practically every purchaser saw steeper renewal increases, a few accounts recently renewing their business have seen their rates remain flat or even decrease, according to brokers and insurers.

"The majority of deals are having an increase in price, but that doesn't mean there isn't a little bit of diversity, including some price decreases," said Phil Norton, president of the professional liability division for Arthur J. Gallagher & Co. in Chicago.

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Vargo added that RLI's claim services are second to none as far as he is concerned, keeping in close contact with PGT's risk management department, going the extra mile to see that all of PGT's needs are met.

"In our business there is no finish line and you are only as good as your last load, and it is evident that RLI is one company that understands that concept," Vargo said. "Every day, they seem to be working hard to service the customer and work toward building a solid relationship. We have the same type of relationship with RLI that we have with our customers: good, solid, honest."



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**'Are we seeing a false bottom, because there's really no loss data that supports what carriers are doing in the (D&O) marketplace right now?'**

Don Bailey  
Willis Executive Risk

A law firm that recently renewed its E&O coverage, for example, saw the annual premium drop from about \$900,000 to \$700,000. But Mr. Norton said that required switching to an insurer that was more aware of competition creeping back into the market.

Insurers are still paying close attention to underwriting diligence, said Patrick Donnelly, a director in Aon's Financial Services Group specializing in technology and professional risks. But after two years of steady rate increases, along with increased customer retentions, underwriters are feeling they have priced their E&O coverage at a level that is in line with losses, according to Mr. Donnelly and other sources.

Price increases over the past couple of years also mean that a few more insurers are willing to provide capacity to the E&O market, said Jane Keegan, risk manager for the Port of Oakland in California.

That is leading to a slight improvement in the E&O market, she said. "Things actually are a little better this year," she said.

Consequently, as Ms. Keegan looks ahead to a May renewal for public officials E&O insurance coverage, she is not budgeting for a significant rate increase.

Some business classes, though, will continue to face challenges.

Rates for architects and engineers professional liability coverage could remain above average because of the perception that they could face losses related to mold and asbestos claims, Mr. Dubois said. Consultants that advise employers and their pension plan administrators are also perceived as above-average risks.

On the positive side, there is a greater stabilization in the rates for managed care companies, Mr. Norton said. A surge in claim frequency that began about three years ago against health maintenance organizations proved to be temporary.

# Liability: Coverage rate hikes moderate

Continued from page 10

Rate increases are still in the double digits, but not as high as they were at the end of 2002, according to Jim Swanke, North America risk financing practice leader at Tillinghast-Towers Perrin in Minneapolis.

"We're at the tail end of a hard market," he said.

But some industry experts painted a not-so-rosy picture of liability insurance conditions.

"I would prefer to call it a stabilizing market rather than a softening market, if 'softening' means not going up as much," said Amy Bouska, North America property/casualty

insurance practice leader at Tillinghast-Towers Perrin in Minneapolis.

"There's still a lot of momentum for additional lift in rates," said William E. Donnell, president of the P&C Select unit of Westport Insurance Corp., a unit of General Electric Co. based in Overland Park, Kan. "It gets back to loss cost inflation, investment yields and potential adverse development. All those things culminate in uncertainty. Underwriters are fearful and not overconfident."

Indeed, "it's the revenge of the underwriter," quipped Daniel D. Zarletti, vp and chief risk officer at

Chicago-based Kenny Construction Co.

Mr. Zarletti, who is awaiting his August liability program renewal as he hears the year-end horror stories of his peers, said underwriters are trying to make up as quickly as possible for having underpriced the business for so long.

Mr. Zarletti will be replacing Kenny's three-year liability insurance program that did not experience any of the interim rate hikes since the market turned, so he said he expects it will be a "rude awakening."

"Because we are in a fragile insurance market, most of us are holding

on to what we've got and fighting for what we can get," said Lance J. Ewing, executive director of risk management at Caesars Entertainment Inc. in Las Vegas, formerly known as Park Place Entertainment Corp.

Liability renewals at Caesars Entertainment for the most part went smoothly, but the casino company did "ratchet up loss prevention activities to stay in the good graces" of crime coverage insurer AIG, he said.

He acknowledged that the casino and gaming operator has filed some crime claims and made changes

that were needed regardless of "whether it saves money on the premium side or not."

"There has been some tightening up of cash handling," Mr. Ewing said, and changes in how money is transported, including a greater diligence as to "who is transporting our money."

"I have to give the underwriter a lot of credit," he said. "She really got involved in our business a year ago. She held our feet to the fire, but she was also fair in the renewal."

By contrast, Susan Meltzer, assistant vp-risk management at Sun Life Assurance Co. of Canada in Toronto, decided against renewing her company's fiduciary liability coverage because of its cost.

**'Because we are in a fragile insurance market, most of us are holding on to what we've got and fighting for what we can get.'**

Lance J. Ewing  
Caesars Entertainment Inc.



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"My position was, while I understand the insurance industry's problems and their need to change the pricing structure, it was not cost-effective for me," she said.

Instead of renewing, "I bought a fronted program to protect our fiduciaries," Ms. Meltzer said.

Although rate increases for primary and high-layer excess may have tempered somewhat going into 2004, first-layer excess coverage is still problematic in many cases, industry observers say.

"You're still seeing some higher increases in excess and umbrella lines vs. primary," said Mr. Swanke of Tillinghast.

For example, while two years ago perhaps 30% of the total premium for a CGL program may have paid for excess coverage, now 40% to 50% of the total premium is going to excess coverage, he estimated.

But, in some cases, the difference in the rate of increase between first-layer excess and primary coverage is narrowing, according to Mr. Donnell.

While last year, the rate increase for first-layer excess may have been two to three times that of the primary coverage rate hike, this year it's more like 1.5 times greater, he said.

San Diego-based United States Marine Repair Inc.'s renewal exemplifies this trend.

Ellen Vinck, vp of risk management, said she paid around 10% for the renewal of U.S. Marine Repair's "core CGL and all layers of excess. We renewed the whole package."

In fact, much of the price hike was leveled against the primary coverage rather than on the excess layers, she said.

"There's been a shortage of choice in lead umbrella. But that's changing. So the rate of increase

## Liability: Rate hikes moderate

Continued from page 16

has decelerated," said Joe Peiser, managing director at Marsh Inc. in New York.

"Excess underwriters are looking for 15% to 20% increases, but because of competition for lead umbrellas and excess layers, rate hikes will likely stay at about 10%," which is a considerable improvement from last year's average rate hikes of 50%, he said.

Still, "there are few players willing to give more than \$25 million in a single layer," he added.

As a result, buyers trying to assemble large amounts of coverage still must have more insurers on their program than they did during the soft market, experts said.

"Maybe in the last couple of years they've had to piece together a program using seven markets instead of five, as compared with three years ago," said Mr. Doyle of American Home.

"It depends upon the risk," he said. "Higher risks are facing challenges in putting adequate capacity together. But more moderate to low-hazard risks have adequate capacity."

In addition to having to buy from more carriers, buyers are finding they have to raise the attachment points for their excess programs to make the coverage more affordable.

Because of higher tort awards and medical costs, "all excess underwriters would like to see attachment points go to \$2 million," said Mr. Donnell.

In some cases, because first-layer excess rate hikes are greater than that for other primary coverage, "pricing may dictate that they look at a higher attachment point," said Mr. Doyle of American Home. "It's the buyer reacting to what's happening in the market."

"We're still seeing some increases in retention," Mr. Peiser said.

The recent rating agency downgrades are causing a stir among risk managers, industry experts say.

"It's created a lot of concern among the risk management community," said Mr. Swanke of Tillinghast. "There are rules of thumb that people try to abide by, one of which is a Best's rating of A-, and a number of carriers have been downgraded below that," he said.

**'It's clear from an insurance company perspective that the rating agencies are becoming the big gorilla.'**

Amy Bouska  
Tillinghast-Towers Perrin

As more buyers appear to be increasingly sensitive to insurer ratings, "we're starting to see the beginning of a trend, which we really haven't seen before, which is clients asking us to move higher-rated carriers lower down in their program and lower-rated carriers higher up," said Mr. Peiser of Marsh.

"In general, larger companies are more aware. But middle-market companies' treasurers and CFOs are very sensitive to ratings in other areas of their business, so they are also cognizant," he said.

"It's clear from an insurance company perspective that the rating agencies are becoming the big gorilla," said Ms. Bouska of Tillinghast. "If somebody slides toward that awful cliff between A- to B+, you know they're just dying."

"So now the power clearly rests with the rating agencies...it's certainly contributing toward more intensive scrutiny of companies in-

stead of just numerical scrutiny, and that's probably a good sign," she said.

Because the market appears to be leveling off somewhat, observers expressed surprise that so many risk managers are still investigating alternatives to traditional insurance.

"There is more activity today that there has been at any point during the hard market," said Mr. Swanke, who said the number of captive feasibility studies being conducted by Tillinghast is up between 20% and 30% over last year at this time.

"So if you're basically tracking the number of captives being worked on or the number of captives being implemented as a basis for determining whether or not you're ending a hard market and you're going into a soft market, there is no indication of any let-up. Usually, at the end of a hard market, you get a lot of the small and medium-sized organizations banding together and forming group captives, and we're seeing a good deal of that. But the activity level in terms of number of entities or groups looking to set up captives is growing today," he said.

"When you look at this year vs. last, we're still seeing about the same level of activity for captive feasibility studies and looking at alternatives. So the interest is just as high," agreed Marsh's Mr. Peiser.

Another reason for the increasing interest in captives is that buyers are more sophisticated today, suggested Mr. Swanke.

"More risk managers have MBAs. They're doing cost-benefit analyses of their organization's risk-taking and risk transfer," he said. "With Sarbanes-Oxley, corporations are being forced to look at the whole spectrum of risk, going beyond just the hazard risk they were focused on for many years."

## Property: Low losses help reduce rates

Continued from page 10

capacity and, as a result, we expect pricing decreases for good risks to be at least double digit compared to this time last year."

"If you go back to the first quarter of '02, the property market had about \$500 million of capacity available," said Gary Marchitello, managing director of Aon Risk Services' national property syndication practice in New York, noting that the figure excludes Factory Mutual Insurance Co. due to its extremely large capacity limits. "Today, we have approaching \$3 billion in capacity available, which is almost back to where we were pre 9/11."

Underwriters have enjoyed two full years of low losses with rates up, on average, 80% from 2002 to 2003, Mr. Marchitello said. "So they've been very profitable, which is attracting capacity back into the marketplace, driving rates down," he said.

Whether the hard property market is over, though, depends on one's definition of "hard," said John Gallagher, senior vp-global property for ACE USA International in Philadelphia.

"If you define 'hard' as an environment where rates are adequate to more than adequate, I'd say that the market is kind of taking a rest or a pause right now," he said. But if "hard" is defined as an environment in which rates are increasing year after year, at least for now that hard market is over, Mr. Gallagher said.

The property market's ample capacity is more than offsetting any disruption caused by the ratings downgrades, exits from the market and merger and acquisition activity that has occurred in the insurance

industry throughout 2003, observers say.

Last year, for example, saw Kemper Insurance Cos. exit the underwriting business, Royal & SunAlliance Insurance Group P.L.C. exit the U.S. market and Travelers Property Casualty Corp. and The St. Paul Cos. Inc. announce a merger.

While capacity may be lessening those effects at the moment, at least one insurer is concerned about what effect the industry's financial strength may have on a softening property market.

**'There is increased capacity and, as a result, we expect pricing decreases for good risks to be at least double digit compared to this time last year.'**

Alexandra Glickman  
Gallagher Real Estate  
& Hospitality Services

"The industry is not all that healthy," said Tom Kaiser, president of the property, energy and marine division of Arch Insurance Group Inc. in New York. "All the bad news is not out. So when you look at some of the fragile balance sheets that do exist, there shouldn't be the dramatic reductions that could possibly happen in the global property area."

"That's the area we're most concerned with as far as what could happen to it in the future—if the rate base is going to be sufficient to

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# Property: Low losses help reduce prices

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turn a decent return on the capital that is in place to run the business," Mr. Kaiser said of the global property market.

Paul Krump, chief operating officer of Chubb Commercial Insurance in Warren, N.J., said, though, that he is "very optimistic that the industry will not return to irresponsible pricing levels."

"Companies are still really underwriting their risks," he said. "We've only seen a few accounts get rate decreases. We hear from brokers that some larger accounts are getting decreases, but we haven't seen that in our book" of business, which focuses on middle-market property accounts, Mr. Krump noted.

John Lawlor, vp-strategic development for Liberty Mutual Property, a unit of Liberty Mutual Insurance Co. in Boston, said that, taking into account all the property market dynamics including the abundance of capacity and the recovery of the economy, it will be important for insurers to remain smart.

"Discipline will be tested in 2004," he predicted. "What we mean by 'smart' is differentiation risk by risk. It will continue to be important to recognize and reward better-quality risks vs. lesser-quality

risks," he said.

In the meantime, the news is good for many risk managers renewing their property books this time of year.

"Our property is looking very much flat—no increases," said Joe Hardy, director-risk management

**'During this hard market, we have become smarter buyers. We concentrated heavily on correctly quantifying insured values...setting appropriate retention levels and so forth.'**

*Jim Hogan  
Lone Star Technologies Inc.*

and insurance for Hudson's Bay Co. in Toronto, whose property program renews Feb. 1.

"We have not gone to market, but, based on what I'm reading and hearing, it looks like it's pretty much going to be status quo," Mr. Hardy said.

Denver Water's property premium came in flat at its recent renewal, said Jim Crockett, manager-risk and benefits. "We paid \$188,000 last year and we're just slightly

above that this year, but I think it's just due to changing values and changing of the rates on one of our plants" from a highly protected risk to non-HPR, Mr. Crockett said.

"We did see some softening in the market for premiums," said Jim Hogan, manager-tax and finance for Lone Star Technologies Inc. in Dallas, who recently renewed all of the company's property coverages. "Most importantly, during this hard market, we have become smarter buyers. We concentrated heavily on correctly quantifying insured values, inventory items covered vs. not covered, setting appropriate retention levels and so forth," he said, noting that, "after reworking some values," rates fell 9% to 10%.

In addition to property premiums, risk managers also are seeing an improved terrorism insurance market.

In the Midtown area of New York City, the cost of terrorism coverage is dropping compared to a year ago, although the decline began about six months ago, said Damian Testa, president of Kaye Insurance Associates, a Hub International Ltd. company based in New York. In New York, the cost is about 20% in addition to the fire rate. Not surprisingly, more clients are buying terrorism coverage because "it's now got

ten broader and more affordable," he said.

"FM Global is still offering the coverage for terrorism. Our clients seem to be highly interested in purchasing it," said Randy Schreitmuller, a vp at Johnston, R.I.-based Factory Mutual, which does business as FM Global. The insurer is experiencing a "60% to 70% take-up rate for our accounts," he said of the coverage.

Other insurers, though, have a different story.

"Take-up still falls in that lower range of 10% to 20%," said Mr. Lawlor of Liberty Mutual.

"Right now in the marketplace, (terrorism coverage) doesn't seem to be as big of an issue," he noted. "I think...it will be interesting to see what happens in 2004 with the pending sunset of TRIA. I don't know what's going to happen with that."

Overall, market observers predict there will be continued moderation in the property market throughout the year.

"We'll continue to see rates trend down," Aon's Mr. Marchitello predicted. "That's all dependent on the earth not shaking and the winds not blowing," he said. "We've seen through a couple of cycles that a large catastrophe can turn the market on a dime."

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 **Endurance**

# Comp rate increases slowing, but buyers see retentions rise

By MEG FLETCHER

Higher retention levels are having a bigger impact than rate increases on buyers of workers compensation coverage during year-end renewals.

"On average, policyholders are increasing their retentions by 20%," said Timothy Brady, managing director of the casualty practice for New York-based broker Marsh Inc.

But two leading risk managers report they took significantly higher retentions.

Jeffrey W. Pettegrew, vp-risk management and insurance for Westaff in Walnut Creek, Calif., said the retention for stop-loss coverage written as part of his paid-loss retrospectively rated program increased 50%, to \$750,000 from \$500,000 per occurrence.

That higher retention level "over-shadows" the "slight" 10% increase in Westaff's stop-loss premium, compared with the year before, he said.

In addition, Dan Kugler, assistant treasurer-risk treatment for Pleasant Prairie, Wis.-based Snap-on Inc., said he was required to increase retentions by 40% for the high-deductible insured plans that the company uses in several states. Mr. Kugler declined to discuss details.

Meanwhile, he said, Snap-on's total premium increases were "basically flat," with an 8.7% increase for the company's high-deductible workers comp program, primarily due to negative experience in California. In addition, he said the company had an 8% decrease in premium for stop-loss coverage for its self-insured comp program, which it uses for risks in Illinois, Iowa and Wisconsin.

In requiring higher retention levels, "carriers overall are trying to get out of the action level" where most claims occur, which is especially true for costly soft-tissue injuries, Mr. Pettegrew added.

To help employers cope in this

climate of higher retentions, The Hartford Financial Services Group Inc. "is selling more of its variable comp deductibles than in the past," said Tom Lehmann, vp-underwriting for the risk management divi-



sion of The Hartford Financial Services Group Inc. in Hartford, Conn. Under such programs, a buyer receives a premium credit for retaining an additional amount of risk beyond a standard deductible retention, but only for a specified number of claims.

Most sources say that other employers, in addition to taking higher retentions, are facing slight to moderate premium increases.

During 2003, there has been a general "deceleration" of workers comp premium increases, brokers say.

"Carriers are still seeking larger rate increases," but in the end the increase has often gone only to 10%, said Craig Simon, managing director and national casualty practice leader for the New York-based Willis North America.

Mr. Brady, though, said he is seeing higher increases, in the range of 10% to 20%. In addition, The Hartford's Mr. Lehmann said rate increases were in the range of 15% to 20%.

According to a recent study by A.M. Best Co., workers comp premiums rose an average of 14.2% in 2002, but "premium increases have been just enough to keep up with the line's rising claims severity,

driven by higher medical and litigation costs."

Other factors that are increasing workers comp coverage costs include the increased severity of claims and fraud, Mr. Lehmann said. In addition, there has been a reduction in the number of insurers writing coverage, concerns about the adequacy of reserves and the fact that reforms have only just begun in problem states like California and Florida, sources said.

"Terrorism coverage remains an important issue for workers comp carriers, as state laws mandate that terrorism must be covered under workers comp policies," according to the Best study. "Reinsurers, on the other hand, are allowed to exclude terrorism coverage, leaving primary companies exposed unless they spend more to purchase the coverage from reinsurers that do offer it," it said.

Sources disagree about whether the hard market for workers comp coverage is ending.

"I don't think it will end for a while in comp," The Hartford's Mr. Lehmann said.

Willis' Mr. Simon is more optimistic: "As far as rates, it looks like it's ending, but when it comes to terms and conditions, we are still in a hard market," he said.

"I think it is definitely peaking, but it is still subject to anomalies" such as a terrorism attack or difficult economic conditions, Mr. Pettegrew said.

While the market is still hard, it is "rational," Mr. Kugler said, "and risks are being thoroughly assessed and reviewed."

Insurers were calling the shots during the past two years, while risk managers were calling them during the 10 years before that, Mr. Kugler said. "Now both sides have settled down and are trying to work together," he said.

"Maybe this is the way the market should be," Mr. Kugler added.

# Reinsurance: Prices ease in some lines

Continued from page 10

softening, but ultimately still at levels that should allow for significant profitability (for reinsurers) in 2004."

Property catastrophe reinsurance prices have flattened or fallen by as much as 15% for the most profitable accounts, market observers agree.

At the same time, though, many insurers are raising the limits on their cat programs, partly in response to updated catastrophe modeling software produced last year by Newark, Calif.-based Risk Management Solutions Inc. The new model showed a potential for higher-severity losses than was previously projected in certain areas and has led insurers to boost cat protection, particularly for North-eastern states and California, observed Rod Fox, chief executive of U.S. operations for Benfield Group Ltd. in Westport, Conn.

Some insurance company executives, seeing the potential for solid financial results in 2004, may also simply want to ward off unpleasant surprises by purchasing the additional protection, noted Mr. Mooney.

The higher limits mean that even where cat reinsurance rates are falling, overall program costs for some ceding companies may be more or less unchanged, observers say.

Meanwhile, some insurers have

negotiated an expansion of the standard 72-hour clause that treats losses from the same storm during a 72-hour period as a single event, Mr. Mooney said. Guy Carpenter has helped some clients extend the single-event definition to 96 hours, he said.

**Even where cat reinsurance rates are falling, insurers' purchase of higher limits means overall costs for some cedents may be more or less unchanged, observers say.**

Like property catastrophe pricing, property treaty rates are generally flat to down slightly, with proportional treaty placements bringing such concessions from reinsurers as larger ceding commissions to insurance company buyers.

"It's a choppy market," said Jack Snyder, senior vp and chief marketing officer for American Re-Insurance Co. in Princeton, N.J. While underlying property insurance pricing remains adequate and reinsurance terms are generally steady, occasional placements have shown a surprising softening of terms, such

See REINSURANCE/page 24

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# Reinsurance: Prices, terms easing in some areas

Continued from page 22

as the inclusion of terrorism coverage at no additional cost, he said.

"You scratch your head (and ask), 'Why?'" Mr. Snyder said, noting that these concessions are being granted despite statements from reinsurance company executives that underwriting discipline is paramount. "The message that a lot of CEOs espouse is not necessarily transmitting itself to the underwriting department level of some of these companies," he said.

On both property and casualty treaty placements, Mr. Snyder added, a major issue for reinsurers is the decision by many ceding companies to retain more of their business. The business is generally profitable after more than two years of primary rate increases, and many insurers have strengthened their balance sheets enough to take the additional risk without triggering rating agency or regulatory concerns, Mr. Snyder noted.

Reinsurance cost containment is another motive for ceding insurers on casualty programs, Mr. Fox suggested, agreeing that insurers are both taking larger retentions and negotiating other changes such as loss corridor arrangements.

As a result, "the growth of reinsurance (premiums) is not as robust as you might think when you look

at some of the underlying growth rates," he said.

Ceding insurer mergers and acquisitions—such as the pending combination of The St. Paul Cos. Inc. and Travelers Property Casualty Corp.—will also pressure reinsurance market volume in the long run.

"Mergers like that will reduce the amount of reinsurance they place in the market, and that's been proven again and again in previous mergers," Mr. Snyder observed.

The market for casualty treaty risks, meanwhile, remains firm, with rate increases slowing for relatively low-hazard general liability programs but conditions still tightening for tough lines such as professional liability, medical malpractice, working-layer workers compensation and D&O, reinsurance sources report.

"In general, casualty is more a story of deceleration of rate (increases) rather than decreases," Mr. Mooney said.

Medical malpractice programs are seeing rate increases of 5% to 10% on top of larger primary rate hikes, Mr. Fox said, while lawyers professional liability—which has lagged behind other professional liability lines—is bringing increases of up to 20% and D&O increases of 5% to 15%.

In the D&O and errors and omissions market, "buyers are not able to purchase the same amount of coverage they had two or three years ago due to rate increases over the last few years," observed Benjamin Gentsch, executive vp-specialty lines with Converium Ltd. in Zurich, Switzerland. "So they either increase retentions, structure co-surety deals or buy less limits for

**In general, the market for casualty reinsurance business 'is more a story of deceleration of rate (increases) rather than decreases.'**

Sean F. Mooney  
Guy Carpenter & Co. Inc.

the same amount of money," he said.

"All of the news coming through the market, such as concerning the mutual fund crisis, still makes us very cautious about returning to the soft market," Mr. Gentsch added.

Bermuda reinsurers are increasingly expanding into casualty business—favoring such specialty lines as med mal and D&O—though their larger presence has not softened the market in these lines, ob-

servers report.

Mr. Gilbert noted that the number of reinsurers writing business in the United States has shrunk in the last year, with several withdrawals from the marketplace.

"Bermuda has picked up the slack, but it has replaced capacity rather bringing in additional capacity," Mr. Gilbert said.

"It has increased the amount of competition, but not to the point where it is driving business to unacceptable levels," said Michael Hayes, CEO of reinsurer Alea North America in Wilton, Conn., a unit of Alea Group Holdings (Bermuda) Ltd.

Reinsurer security, while not the severe concern it was a year ago, remains a significant issue, particularly on casualty placements, market sources agree.

Some ceding insurers continue to seek special termination clauses from reinsurers that would, for example, allow cedents to demand commutation of a contract if a reinsurer's financial strength rating were to fall below the A or A- level, sources say.

While reinsurers are allowing this type of clause, they are generally resisting another type of security provision that would require them to fund outstanding losses in the event of a rating downgrade, ac-

ording to Mr. Fox. Such clauses can accelerate problems for a downgraded reinsurer, he noted, creating a "self-fulfilling prophecy" of financial troubles.

In the accident and health reinsurance arena, meanwhile, insurers and reinsurers have been focused on assessing the concentrations of risk that the Sept. 11, 2001, attack on the World Trade Center highlighted.

"It's been extremely important to manage our risks by finding out about all our concentrations of risk," said Jim Rathburn, vp with ING Re in Minneapolis.

"In 2003, you saw a lot of insurance companies make more of an effort to collect that data, because the reinsurers are asking for it," he said.

For companies with high concentrations of risk, the reinsurance market can be especially tough, suggested Scott Machut, another Minneapolis-based ING Re vp.

"There was a request made of us for reinsurance on one of the large brokerage outfits that had a large concentration—10,000 employees—in a 30-, 40-story building," Mr. Machut recalled. "The cost of reinsurance was so great that, at one point, there was talk that it would be cheaper to relocate than to purchase reinsurance."

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**BI News flash**

# Medicare reform provision could cost employers

## Clarification may ease collections from primary payers

By MARK TAYLOR

A little-known provision of the new Medicare reform law could save the program nearly \$9 billion from 2004 to 2013 and make it easier for the Centers for Medicare & Medicaid Services to collect health care claims payments for beneficiaries that should have been paid by other payers.

Employer organizations, however, are wondering if what was proposed as a technical clarification of the Medicare secondary payer law might unintentionally unleash a flurry of decades-old collections from employers and give the government sweeping new powers.

Medicare is a secondary payer for most working beneficiaries covered by group health insurance plans, patients with end-stage renal disease and other disabilities already covered by private insurance and accident victims with auto insurance policies or workers compensation.

The clarification of the existing law seeks to explain when and how the CMS can approach beneficiaries and other payers to collect money when those entities, and not Medicare, should have been designated

as the primary payers on claims for Medicare beneficiaries. The Congressional Budget Office estimates that the clarification of the law could help the CMS recoup \$8.9 billion over the 10-year life of the bill.

In 2003, *Business Insurance's* sister publication, *Modern Healthcare*, reported that the U.S. Justice Department and the Department of Health and Human Services' inspector general were investigating insurers that may have defrauded Medicare by hundreds of millions of dollars annually by billing the federal programs as the primary instead of secondary payer for their group health plan members who are Medicare beneficiaries. Hospitals also may be at risk under the government inquiry.

Hospitals face liability under the Medicare secondary payer law because they are required to collect accurate insurance billing information. If they fail to do that or bill improperly, they could face civil charges under the False Claims Act.

As the secondary payer, Medicare



**'This could pose real problems for every employer with a health plan, especially smaller employers.'**

Kate Sullivan  
U.S. Chamber of Commerce

is only responsible for what remains after the primary insurer has been billed, such as deductibles and copayments, a far smaller portion of

the total bill.

In 1995, 67 Blues plans settled a Medicare secondary payer lawsuit for \$115 million, paying \$27 million in cash and agreeing not to re-submit \$88 million worth of claims that the plans said Medicare owed them.

Kate Sullivan, director of health care policy for the U.S. Chamber of Commerce in Washington, said the policy clarification may spur unintended side effects. Under the new law, the U.S. Treasury Department can go directly to the employer to collect, even if an insurer is responsible.

"This could pose real problems for every employer with a health plan, especially smaller employers," Ms. Sullivan said. "There are sometimes genuine differences of opinion about who has been billed and for how much they are liable. If the government follows this language to the letter, it can go back as far as 1980 to collect from employers on claims that are old and messy. The retroactivity component could really have a stinging effect. We've had a lot of major issues under serious contention in the drug bill. And now that the dust has settled, we'll have to go start sweeping up some of the messes."

Alissa Fox, executive director of policy at the Chicago-based Blue Cross & Blue Shield Assn., said the Justice Department sought the clarification. "Our attorneys have scanned it and it's still very unclear what it does," said Ms. Fox, who noted that an earlier component of the Medicare bill relating to secondary payer coverage for end-stage renal disease was dropped before final passage of the bill.

"The government wants to get its medical expenses back, but the language wasn't clear whether those funds could be recouped and now it apparently is. The problem in the past has been that Medicare was left holding the bag," she said.

Ms. Fox said she doesn't see the clarification dramatically affecting Blues members but views the changes as spelling out which entities the CMS can go after to collect. Still, she concedes that \$9 billion is a lot of money. "It's got to come from someplace," she said.

An American Hospital Assn. spokeswoman did not see the change affecting hospitals. "It's not an issue for our members," she said.

Mark Taylor is a reporter for *Modern Healthcare*, a sister publication of *Business Insurance*.

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## Between the Lines

Compiled by Joanne Wojcik



### Some guys have all the luck

PHOTO: GETTY

Joey Buttafuoco, who gained notoriety from an affair with a teen-ager in the early 1990s, is facing insurance fraud charges in Los Angeles County for allegedly helping undercover investigators file fraudulent insurance claims on cars that were not damaged.



Mr. Buttafuoco

The co-owner of California Collision in Chatsworth, Calif., was released on \$50,000 bail after his Dec. 17 arrest and has pleaded not guilty on three counts of insurance fraud and one count of grand theft, according to the Los Angeles County District Attorney's Office. He is one of 11 people charged in connection with the alleged scam.

In 1992, his then-girlfriend, Amy Fisher, shot his then-wife, Mary Jo. Ms. Fisher, dubbed "The Long Island Lolita" by the New York City tabloids, served seven years in prison. Mr. Buttafuoco, who pleaded guilty to one count of statutory rape, served six months in jail. He and his wife later moved to California and divorced.

### The weather outside is frightful...

Just as hot weather poses health risks to outdoor workers, prolonged exposure to freezing temperatures can result in frostbite and hypothermia, warns ESIS Inc., the risk management services arm of ACE USA.

To help risk managers prevent injuries, ESIS released a list of precautions workers should take in frigid weather. Among the recommendations are: wear three layers of clothing to protect the body, head, hands and feet; drink plenty of warm, sweet beverages; and increase caloric intake, because workers in cold environments who wear heavy protective clothing expend more heat and require 10% to 15% more calories.

Each year, about 700 people die from hypothermia, which occurs when body temperature drops below 90 degrees Fahrenheit, ESIS said.

### Kerry criticizes Dean on Vermont captives



Sen. Kerry

Mr. Dean

PHOTO: REUTERS

As Democratic hopefuls for the presidential nomination trade barbs, captive insurance has become a debating point. Sen. John Kerry is trying to make an issue out of former Vermont Gov. Howard Dean's support for the state's growth as a captive domicile.

From Sen. Kerry's remarks, it would appear that he regards captive insurers

as mere tax shelters. According to the Wall Street Journal, Sen. Kerry appearing on CBS' "Face the Nation" on Jan. 4 accused Mr. Dean of trying to make Vermont "a snowy Bermuda, as a tax haven for insurance companies."

At a Jan. 6 debate in Iowa, Sen. Kerry echoed that point: "I believe that we can balance the budget, cut the deficit in half in four years, but close loopholes for these corporations that go to Bermuda...many of which were in Vermont where Howard Dean gave up tax revenue to create a snowy Bermuda in the fields of Vermont. It's wrong."

Mr. Dean did not respond to those remarks in the debate.

### HMO liability case a decade old

Dec. 28, 2003, marked the 10-year anniversary of the landmark \$89 million jury verdict against California health maintenance organization Health Net Inc. in Riverside Superior Court.

The case, Fox vs. Health Net, drew national attention in 1993 because it exposed HMOs to new liability for managed care decisions. It involved a 38-year old Temecula, Calif., schoolteacher who was denied coverage for a bone marrow transplant to treat breast cancer. Nelene Hiepler Fox, who died in April 1993, was represented by her brother, Mark O. Hiepler, in the suit, which asserted claims for breach of contract, bad faith and intentional infliction of emotional distress. The jury returned an \$89 million verdict after less than 24 hours' deliberation.

Tips and feedback from readers are welcomed. Please send information to [wojcik@crain.com](mailto:wojcik@crain.com).

## Products & Services

### Book explores terrorism coverage

**DALLAS**—"Terrorism Insurance: What Risk and Insurance Professionals Must Know" is a new book from the International Risk Management Institute Inc. that gives a thorough look at terrorism insurance in the United States.

The book chronicles the industry's approach to providing terrorism insurance, from the initial attempts to develop new exclusions through the passage of the Terrorism Risk Insurance Act and up to the development of new forms that cover requirements in the act.

Linda G. Robinson was the book's primary author, with one chapter by Kathryn A. Westover and parts of the book by the IRMI editorial staff.

The book covers the rights of commercial insurance buyers under TRIA and includes guidelines for determining whether to purchase coverage and how captive insurers can write terrorism coverage, among other topics.

The book is available for \$28 at [www.irmi.com/products](http://www.irmi.com/products) or by calling 800-827-4242. In Dallas, please call 972-960-7693.

### Employee screening services offered

**PHILADELPHIA**—IntelliCorp Records Inc. and Wonderlic Inc. have teamed up to provide comprehensive employee assessment technologies.

Wonderlic, which provides

employment screening information, will integrate its services with IntelliCorp's automated prescreening tool called IntelliSearch.

With the partnership, the two companies aim to provide behavioral profiling, pre-employment assessment technology and employment screening services. The companies will offer a suite of full-service assessment options designed to help employers make successful hiring choices.

More information is available from Solon, Ohio-based IntelliCorp at 440-505-0238.

### Program prevents identity theft

**PORTLAND, Ore.**—Identity Safeguards is offering a program to help employees prevent and recover from identity theft.

The Portland, Ore.-based company provides the program as a part of an employee benefits plan or as stand-alone product available at [www.identitysafeguards.com](http://www.identitysafeguards.com).

The Identity Safeguards service provides credit report monitoring and fraud prevention education. For victims of identity theft, the program helps repair damaged credit, assists law enforcement agencies, provides legal assistance and reimburses lost income and expenses associated with the crime.

More information is available at Identity Safeguards' Web site.

### Coverage responds to evacuation losses

**PHILADELPHIA**—ACE USA is offering a new coverage to protect businesses in coastal areas from losses due to government-ordered hurricane evacuations.

The coverage is designed to pay a

stipulated value for full days of mandated evacuations, even if no physical damage is sustained.

Policyholders can receive a predetermined value for a full day of evacuation. The coverage is designed to help hotels, retail outlets, restaurants, marinas, casinos and manufacturers that lose revenue because of an evacuation. The insurance can also cover municipalities' costs for personnel and emergency services used in an evacuation.

The coverage is available through retail and wholesale insurance brokers. More information is available from Ravi V. Nathan at 215-640-4528 or at [ravi.nathan@ace-ina.com](mailto:ravi.nathan@ace-ina.com).

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# Scandal could hike D&O rates in Europe

## Fraud allegation at Parmalat 'sends a shiver through the ranks of the underwriters'

By SARAH VEYSEY  
and CAROLYN ALDRED

**PARMA, Italy**—A corporate governance scandal at one of Italy's largest companies could have an impact on the directors and officers rates and terms offered to European companies, experts say.

Parmalat S.p.A., a food retailer and a subsidiary of Parma, Italy-based Parmalat Finanziaria S.p.A., was seized by Italian authorities in late December 2003, amid speculation that the company had a multi-billion-euro black hole in its accounts.

Italian authorities have arrested eight people, including Parmalat founder Calisto Tanzi, in connection with allegations of false accounting and fraud at the company.

The New York-based U.S. Securities and Exchange Commission has begun an inquiry after Parmalat admitted that Bank of America Corp. had denied the authenticity of a document purporting to prove that Parmalat's Cayman Islands subsidiary, Bonlat Financing Corp., had \$395 billion in assets in an account with the bank.

The SEC alleges the assets did not exist and that the account document had been forged.

Two senior executives of accounting firm Grant Thornton S.p.A., the Italian arm of London-based Grant Thornton International, were arrested on Dec. 31, 2003, accused of helping Parmalat to falsify accounts.

Grant Thornton S.p.A. acted as the auditor for Bonlat, the company confirmed, and the two executives—Lorenzo Penca and Maurizio Bianchi—have been suspended, Grant Thornton International said in a statement.

The auditor said that the firm itself "may have been the victim of fraud committed by others."

The affair is likely to have repercussions on the European directors and officers insurance marketplace, market sources said.

Parmalat bought D&O coverage with a limit of \$50 million, according to one source.

If Parmalat officials are found guilty of fraud, then D&O policies will not pay out, sources said. But insurers do frequently cover defense and investigation costs until fraud is proved, which may push D&O liability insurance rates up further, they note.

"There is no doubt a high-profile case such as this will be watched closely by D&O underwriters and may impact the market," said Jere-

my Miles, U.K. and Ireland retail manager for executive protection at Chubb Insurance Co. of Europe S.A. in London.

A case such as Parmalat "sends a shiver through the ranks of the underwriters," according to David Gamble, executive director of the London-based Assn. of Insurance & Risk Managers.

Mr. Gamble said AIRMIC's directors and officers task force was watching the progress of the Parmalat case closely.

One repercussion for risk managers, he noted, could be that underwriters shaken by the event might push directors and officers rates higher, or at least not level

See PARMALAT/page 30



PHOTO: NEWSCAST

Eight officials of Parmalat S.p.A. have been arrested in connection with allegations of false accounting and fraud at the Parma, Italy-based food company.

## Flash Airlines sea crash jet insured for \$550 million

**SHARM EL-SHEIKH, Egypt**—A Flash Airlines Boeing 737-700 that crashed into the Red Sea on Jan. 3 was insured by Port Said, Egypt-based El Shark Insurance Co., according to the airline.

The flight crashed into the sea near Sharm el-Sheikh minutes after takeoff, killing all 148 people on board.

Cairo, Egypt-based Flash Airlines, a subsidiary of Flash Group, said the plane was insured for third-party and passenger liability for \$550 million. Flash Group offers vacation packages across Egypt.

The plane, which was built in 1993, was headed for Cairo and then on to Paris.

Investigators are looking into the cause of the crash in which 13 Egyptian crew members, 133 French tourists, one Japanese and one Moroccan passenger died.

The Swiss federal office for aviation has said that in 2002 it banned Flash Airlines flights from Switzerland amid safety concerns.

—By Sarah Veysey

# Australian med mal bailout ends health care crisis for now

By ELIZABETH FRY

**SYDNEY, Australia**—A rescue package unveiled last month by Australian Health Minister Tony Abbott to end the malpractice liability crisis—which prompted 100 public hospital specialists in three states to threaten resignation—is being hailed by medical leaders as a good short-term fix.

But more-radical changes, including creation of a government-backed medical indemnity insurer, might be needed to provide a long-term solution to the crisis, they say.

Under the new arrangement, the federal government will spend \$619 million Australian (\$469.6 million) over four years to protect doctors in the public health system against high premiums by effectively capping them at a percentage of their incomes.

Under the premium support plan, doctors will have to pay up to 7.5% of their gross income on medical liability coverage. The government will pay 80 cents on the dollar for any insurance bills above that 7.5% threshold. Subsidies will be paid directly to insurers.

"The standard premium for a (New South Wales) orthopedic surgeon with under \$200,000 Australian (\$151,740) medical income would fall from \$40,000 Australian

(\$30,348) to \$20,000 Australian (\$15,174) a year. The standard premium for a NSW orthopedic surgeon with \$475,000 Australian (\$360,383) income would fall from \$67,000 Australian (\$50,833) to \$42,000 Australian (\$31,865) a year," said Mr. Abbott in a statement.



Under the plan, the government will pay 50% of claims in excess of \$300,000 Australian (\$227,610) and will dramatically reduce the impact of its controversial "incurred but not reported" levy, introduced three months ago. The compulsory levy, which was designed to recoup the \$438 million public bailout of Sydney-based insurer United Medical Protection Ltd. after its near collapse sparked the resignation threats (*BI*, Oct. 13, 2003). Some members of UMP, which covered

about 60% of the nation's doctors, faced bills of over \$200,000 Australian under the original levy plan.

Thousands of doctors in New South Wales, Queensland and South Australia threatened to resign over the issue. In response, the government withdrew the levy and the medical indemnity policy review panel considered its options. The panel includes Mr. Abbott as chairman, Assistant Treasurer Helen Coonan, former Reserve Bank Deputy Governor John Phillips and Australian Medical Assn. President Dr. Bill Glasson.

Although the Cabinet refused to abolish the levy altogether, it has opted to pay the lion's share. Thus UMP doctors who previously faced a total IBNR levy burden of around \$438 million Australian (\$332.2 million) will now contribute only \$130 million Australian (\$98.6 million). These new measures involve a \$181 million Australian (\$137.3 million) addition to that earlier \$438 million rescue package.

"UMP members will now pay no more than \$24,000 Australian (\$18,209) over six years, whereas previously some specialists would be paying \$25,000 Australian (\$18,968) each year," said Dr. Glasson. "The per-year amount paid will be added to the doctor's standard

See AUSTRALIA/page 31

## World Updates

### Lloyd's reaches record-high capacity

Lloyd's of London has capacity to write £14.9 billion (\$26.58 billion) of business in 2004, the market has announced. At the start of 2003, Lloyd's had capacity of £14.4 billion (\$23.00 billion), according to a Lloyd's statement. By the end of the year, that figure rose to a record-high £14.9 billion, excluding qualifying quota-share reinsurance. Earlier in 2003, Lloyd's announced its intention to curb qualifying quota-share deals, under which investors from outside the market provide capital for what they consider to be profitable business (*BI*, Aug. 25, 2003).

### SCOR completes share issue

French reinsurer SCOR S.A. has completed a share issue and raised 751 million euros (\$945.8 million), the company announced. SCOR issued 682,724,225 new shares in December 2003 as part of a plan to strengthen the shareholders' equity of its subsidiaries—particularly its U.S. operations—and to increase its operational and financial flexibility.

### JLT buys Houston broker

Jardine Lloyd Thompson Group P.L.C. has acquired the business portfolio of Houston-based HCC Employee Benefits Inc. from HCC Insurance Holdings Inc. HCC Employee Benefits specializes in life, accident and health insurance brokering. For 2002, HCC Employee Benefits had revenues of \$22.1 million and recorded a pretax profit of \$11.5 million. London-based JLT announced that its U.S. subsidiary, Capital Risk L.L.C., would pay six times HCC Employee Benefits' 2004 pretax profits to acquire the company.

### Benfield ups stake in space broker

London-based Benfield Group Ltd. has acquired a further 43% stake in New York-based space insurance broker International Space Brokers Inc., bringing its holding in the company to 86%. In a statement, reinsurance broker Benfield said the deal would enable it to increase its business in the space insurance market.

### Italian P/C outlook stable: Moody's

Moody's Investors Service said it has a stable outlook for the Italian property/casualty insurance market. Moody's said in a statement that the quality of underwriting results in the P/C sector in Italy had improved and that the financial fundamentals were good compared with some of the industry's European peers.

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## Parmalat: D&O rates may be affected

**Continued from previous page**  
 them out as buyers had been hoping this year.

Martin Beagley, executive director of professional risks at London-based broker Willis Group Holdings Ltd., pointed out that D&O liability underwriters already had "wake-up calls" in the shape of accounting irregularities at Dutch retailer Royal Ahold N.V. and a large directors and officers settlement at Stuttgart, Germany-based DaimlerChrysler A.G. in 2003.

"Parmalat won't have a massive impact, but may stop the market easing as much as buyers had hoped," Mr. Beagley said.

The problems at Parmalat may make some European insurers more cautious about offering high-level directors and officers coverage, according to James Weatherstone, senior vp for XL Europe Ltd. in London.

But the affair may spark greater demand for directors and officers coverage from European companies, he noted.

Mark Hardinge, managing director of professional risks at Aon Ltd. in London, said that while claims from the Parmalat situation will be small—if any are paid—the affair could bring changes in the directors and officers market in Europe. He said that while he believed rates for directors and officers would not rise in response to the Parmalat affair, and may fall because of increased competition in the market, underwriters may seek to void policies on outstanding claims.

And underwriters may seek to rescind D&O policies when there is a restatement of accounts, he said.

Fallout from the Parmalat affair also is affecting life insurers, some of which invested in the Italian company. According to Standard & Poor's Corp., Parmalat has 7 billion euros (\$8.81 billion) of bonds outstanding, on which it will likely default.

Six life insurance companies that hold bonds in Parmalat have filed a lawsuit in the Cayman Islands seeking to liquidate two offshore Parmalat subsidiaries, Dairy Holdings Ltd. and Food Holdings Ltd.

The life insurers holding unpaid Parmalat bonds are three units of The Hague, Netherlands-based insurer AEGON N.V.: Transamerica Occidental Life Insurance Co., Transamerica Life Insurance Co., and Monumental Life Insurance Co.; Jefferson-Pilot Life Insurance Co., a unit of Greensboro, N.C.-based Jefferson Pilot Corp.; New York-based New York Life Insurance & Annuity Corp.; and Principal Life Insurance Co., a unit of Des Moines, Iowa-based Principal Financial Corp.

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## Captive: Swedish funding plan

Continued from page 1

test, the department required employers to, among other things, use top-rated insurers—those with ratings of A or better from A.M. Best Co.—to issue the benefit policies. Aetna, the insurer SCA has proposed to issue the benefit policies reinsured by SCA Re, currently has an A- rating from Best.

Per Larsson, SCA's group risk manager in Stockholm, said SCA wants to use Aetna because of its relationship with the insurer in Europe through the Aetna/Generali international benefits network. At the time the benefits funding arrangement was being developed, Aetna had an A rating.

In its application with the department, filed by the Groom Law Group in Washington, SCA said a strict requirement that fronting insurers be rated A or better by Best would limit the market and "increase the cost of insurance to plans that wish to engage in captive transactions, diminishing plan sponsors' ability to improve benefits for plan participants and beneficiaries."

SCA for several years has funded the benefit risks of European employees through SCA Re, which in 2002 generated \$16.5 million in gross written premiums. SCA Re also funds property, business interruption and credit lines of business for its parent, which has about 40,000 employees in more than 40 countries and revenues of about \$12 billion. The success of its captive in funding benefits for SCA's European employees has encouraged SCA to expand the program to cover benefit risks in the United States, Mr. Larsson said.

Mr. Larsson said the funding arrangement should, over the long run, save money when compared with the cost of traditionally insuring the benefits.

If the Labor Department approves SCA's application, SCA would join several other employers that have won approval since 1999, when regulators said they would be more flexible in evaluating captive benefit funding arrangements.

Before then, the department said that to win its approval, such arrangements would have to be structured so that no more than 50% of

the captive's business, including benefit risks, would be related to its parent. That was a rigid test that few employers wanted to meet, out of concerns about the hazards of taking on such a large block of third-party business.



But in 1999, the department, while not abandoning the 50% test, said that meeting it would no longer be an absolute prerequisite to winning approval to fund benefits through captives. Among other things, the department said it would consider the quality of the primary insurers used to write the benefit policies, whether plan participants would benefit from the arrangement and whether an independent fiduciary was used to see that all conditions were met.

**The funding arrangement should, over the long run, save money when compared with the cost of traditionally insuring the benefits.**

*Per Larsson  
Svenska Cellulosa Aktiebolaget*

Employers responded to that new offer of flexibility. In 1999, Columbia Energy Group sought permission to use the Vermont branch of its Bermuda-domiciled insurance subsidiary to reinsure LTD policies written by Liberty Mutual Insurance Co. unit Employers Insurance Co. of Wausau.

Adhering to the Labor Department guidance, Columbia Energy agreed to sweeten benefits for LTD plan participants and to use a top-rated insurer and an independent fiduciary. In August 2000, the department approved the arrangement.

Then, closely following the Columbia Energy model, agribusiness giant Archer Daniels Midland Co. in 2002 sought approval for its plan to use its Vermont captive to reinsure life insurance policies written by Minnesota Life Insurance Co.

ADM, like Columbia Energy, agreed to improve benefits for plan participants and to use a top-rated insurer and an independent fiduciary to monitor the arrangement. The department approved the arrangement last year.

In addition, International Paper Co. last year sought and won Labor Department approval to use its Vermont-domiciled captive to reinsure life insurance policies written by Metropolitan Life Insurance Co.

International Paper was the first employer to win Labor Department approval for a captive benefit funding arrangement under a fast-track approval process—available in situations where the department has approved two substantially applications in the last five years. Under that expedited review procedure, the Labor Department must give its initial decision within 45 days of receiving an application and a final decision about 30 days after that.

SCA's application, though, will not qualify for the fast-track procedure because, unlike the other employers that received Labor Department permission, its fronting insurer does not have an A or better rating from Best.

SCA does, however, intend to improve benefits and to use an independent fiduciary—U.S. Trust Co., a subsidiary of Charles Schwab Corp.—to oversee the arrangement.

Risk management and employee benefit experts say funding benefits through captives is a growing trend.

"Since the captive has been a tool that works well to fund property and casualty risks, there is no reason why it can't be expanded to benefit lines," said Sofia Tesfazion, a former benefit manager at SCA and now a consultant with Towers Perrin in New York, which will provide actuarial services to SCA Re's Virgin Islands branch.

Life insurance, she said, is especially well-suited for a captive because of typically low loss severity.

## 401(k): More scrutiny

Continued from page 3

responsible for monitoring their funds' performance. Observers agree that as long as sponsors do so, they are unlikely to be held liable for a fund's wrongdoing.

"If a plan sponsor has an investment-policy statement in place and either has an advisory investment committee or an outside investment adviser that works with them to monitor the funds on an ongoing basis, they're in a perfect position and should be very comfortable that they're fulfilling their fiduciary duty," said Mark Gensheimer, senior vp-sales and marketing for Pittsburgh-based Investment Inc., a 401(k) plan administrator.

However, "even if you have none of the funds named, you ought to be just double-checking. Maybe that's only a five-minute phone call," said Joe Hesselthaler, a principal with Towers Perrin in Philadelphia.

Plan sponsors' reactions have varied.

"Our clients have reacted quite promptly," said Angie Parrish, Tampa, Fla.-based senior vp and practice leader for Aon Investment Consulting. "They were immediately concerned about the plans that they were offering in their retirement programs, and they wanted to review generally each one of those firms to see if fiduciary violations had occurred."

Virtually all Aon client plan sponsors that had funds directly affected by the scandal made a change, said Ms. Parrish.

According to a survey of 236 chief financial officers by Florham Park, N.J.-based Financial Executives International and the Durham, N.C.-based Duke University Fuqua School of Business, 23% have responded to the mutual fund industry scandal by making changes to the investment options available to their employees in their 401(k) plans, while another 29% are considering such changes.

"By and large, plan sponsors have reacted in a deliberative manner, which is really appropriate," said David L. Wray, president of the Profit Sharing/401(k) Council of America in Chicago. "They're not rushing to do things. Let's say that you decide to change from one fund to another. What if the new fund is named next week?"

"Is it a panic stage? No," said Greg Wood, chief operating officer of Mobile, Ala.-based DailyAccess.Com Inc., a 401(k) plan administrator. But Mr. Wood noted that changes in plan composition are "probably double what we normally would do" in the wake of the scandal.

If the problem was caused by the actions of a rogue employee, a plan sponsor may decide to stay with the fund but keep it on a watch list, said Matthew Gnasbasik, founder of consulting firm Blue Prairie Group in Chicago. Conversely, another company may decide it does not want to be associated with a "tainted" company.

"Different companies are going to have bona fide, legitimate responses to the same set of factors,"

said Mr. Gnasbasik.

St. Louis-based Arch Coal Co., which offers a Putnam international fund that holds \$9.8 million—or 4.25%—of its 401(k) assets, has not yet made any change, said a spokeswoman for the company.

"We just don't think we have all the information we need to make a decision," she said. The spokeswoman also noted that the company is pleased that Putnam has promised full reimbursement for losses that may be identified down the road as the result of any wrongdoing.

Cornell Cos. Inc., which has assets in both Janus and Strong funds, also has not made any changes, said Pat Perrin, its chief administrative officer. Houston-based Cornell provides corrections, treatment and education services to government agencies.

"We didn't perceive there was any risk or any type of material impact that could be put on our participants," he said. He noted the funds in question account for less than 1% of the firm's \$17 million in 401(k) assets.

Some companies, though, have decided to eliminate certain funds.

Portland, Ore.-based Standard Insurance Co., a 401(k) plan administrator, dropped nine Janus funds from its lineup, both for its own employees' 401(k) plans and for the plans it administers, said a spokesman.

In addition, Whitehouse Station, N.J.-based Merck & Co. dropped two Putnam funds in November, a company spokesman said.

Some are taking a third course: continuing to offer an implicated fund but also introducing a comparable option from another company, said Mark Faulds, Chicago-based national practice leader for retirement plans for Willis Inc.

Meanwhile, some plan sponsors are beginning to place restrictions on the number of trades participants can make, sometimes at a mutual fund's request. The mutual fund scandal has accelerated this trend, said Judy Schub, managing director of the Bethesda, Md.-based Committee on Investment of Employee Benefit Assets, which is part of the Assn. of Financial Professionals.

Last year, Dallas-based Electronic Data Systems, Corp. instituted a seven-day minimum holding period on transfers into three international funds—none of which has been named in the scandal—to prevent excessive trading, said a spokeswoman.

E. I. du Pont de Nemours & Co. has also introduced a 15-day holding period for five international funds, said a spokeswoman for the Wilmington, Del.-based company.

Stamford, Conn.-based International Paper Co. introduced a one-day "time out" for all its funds in November but has been dissatisfied with its success in discouraging frequent trades, said Bob Hunkeler, vp of investments. The company is now considering other alternatives, including a 10- or 15-day holding period, and may focus just on international funds, he said.

## Australia: Crisis ended for now

Continued from page 29

insurance premium and will attract premium support."

While some medical leaders complained that the levy wasn't scrapped completely and talked ominously about more doctors resigning, Dr. Glasson denied that there has been a groundswell of dissatisfaction among doctors. He pointed out that most had not had time to assess the package to determine what was being offered at this stage.

Dr. Glasson said, "Most of our recommendations were accepted by Cabinet, and I think what we have is a very good short-term solution, a

very reasonable outcome."

Dr. Glasson said he does have questions about the longer term. "The current indemnity model with seven (medical indemnity insurers) is not sustainable, so I think we will end up with one or two insurers—perhaps doctor-owned," he said. He also mentioned that improved risk management methods at the practitioner level were part of the deal with the government.

Peter Somerville, the executive director of the Australian Salaried Medical Officers Federation, expressed less enthusiasm about the reforms, noting that few of the federation's members would exceed

\$5,000 Australian (\$3,794) per year in medical liability fees. But Mr. Somerville said that the government subsidies should make the medical indemnity insurers financially stronger.

Mr. Abbott said that if the reforms failed within 18 months, the government would consider creating a doctor-owned monopoly medical insurer. While the health minister reported that premiums could fall by 10% if there were a single insurer, Mr. Somerville said he believes that administrative efficiencies and lower reinsurance costs would cut premiums by as much as 30% if there were just one insurer.

# Advocacy: Firms help employee benefit plan woes

Continued from page 1

sensitive health information is no longer being passed on to the benefits department by employees with specific health plan questions and problems.

While employers offering advocacy services say the \$2 to \$3 per employee per month cost is well worth it, other observers note that if an outside firm is needed to resolve claims disputes, employers may be better off fixing their health plan rather than outsourcing the task of resolving problems.

According to the most recent statistics from Hewitt Associates Inc., of the nearly 2,500 plan issues reported and tracked by its participant advocacy services over an 18-month period ending in June 2001, 71% of the issues originated due to errors by the plan administrator or care provider.

Those results show that while employees are taking the correct steps to resolve benefit plan issues, they still need assistance in navigating the sometimes frustrating and complex health care system, Hewitt said.

"We resolve access to care issues like authorizations and referrals. We do a great deal of work with claims and billing, everything from claims not being received, to improper processing...to balance billing issues," explained Marie Kobos, the practice leader for Hewitt's participant advocacy services business group in Lincolnshire, Ill. Hewitt began offering its advocacy services in 1999.

"Some of the places that we're really able to help—and employers really appreciate it—is invariably there are employees or retirees in a population who are very fragile or have a catastrophic type of situation," Ms. Kobos explained. "They can become completely overwhelmed by not only access to care situation problems but also claims.

"We, for example, helped an employee who had a very premature infant and had 600 bills to get through and (explanation of benefits) to match and resolve and a number of billing and balance billing issues," she said. "For us, it took six weeks of an advocate's time to resolve all of that. We were able to take that all off the employee's plate so they could concentrate on

their family and then return to work."

Indeed, lost productivity is one of the driving factors behind growth in patient advocacy services.

"As almost anybody knows these days...it can take endless hours of calling and being transferred and waiting on hold and then being told 'No you have to call a different number,' then following up and finding out that the issue, which was promised to be taken care of, wasn't," said Larry Gelb, president and CEO of CareCounsel L.L.C., a six-year-old patient advocacy firm based in San Rafael, Calif.

"The hidden cost of lost productivity at work is definitely a factor," said Sandy Wandelt, senior vp-human resources for Sun National Bank. The Vineland, N.J., bank began offering advocacy services to its roughly 700 employees last August through Health Advocate, a Blue Bell, Pa.-based advocacy firm.

"If you think about it, most of the time if you have a serious issue and you've got to make calls to your insurance carrier...a preponderance of those calls are going to be made during the day," Mr. Wandelt said. "You make one call to Health Advocate and one consistent person is your advocate...and they do all that legwork."

In addition to productivity issues, more employers are offering advocacy benefits as a value-added service as they shift more of the cost of health care onto employees.

"One of the things that's driving the advocacy industry is the move toward more consumer responsibility," said Jane Cooper, president and CEO of Patient Care, a two-year-old advocacy firm in New Orleans. "Employers are shifting more of the cost to employees without giving them the tools to know what to do," she said.

"We're in a time of pretty hefty increases in health care costs, and we, like a lot of employers, are in that mode of sharing more and more of that burden with employees," said Craig Reynolds, corporate director of employee benefits at Briggs & Stratton Corp. "So we believe that we should try to ease the pain of their increases through some better service capabilities and Patient Care is a step in that direction."

The Milwaukee-based small engine manufacturer began offering Patient Care's advocacy services to all of its roughly 6,500 employees last October. In addition to a number of self-insured health plans, Briggs & Stratton offers a consumer-driven health care plan, for which Patient Care provides additional negotiating services to employees enrolled in that plan, Mr. Reynolds said.

He noted that one of the additional benefits is that Patient Care has extended hours on the weekdays and weekends offering employees more flexibility. "Our staff

**Health care is a lot more complicated than income tax, yet many people have a tax accountant. It's just as reasonable to think that in the near future everyone is going to have a personal health advocate.'**

*Dr. Abby Leibowitz  
Health Advocate*

here can't match that," he said. "And even if we could, we've still got issues with HIPAA. This gives us an added arm's length, if you will, on the privacy matters," he said.

Indeed, HIPAA privacy compliance is another added value to the advocacy services, benefit managers say.

"This is another vein where an employee can talk to a designated representative to discuss very personal health issues that they may not necessarily want to talk to the benefits manager at the bank about," said Mr. Wandelt of Sun National Bank. "They provide the employee another vehicle outside the bank to help ensure confidentiality."

While some outside benefit experts say some of the advocacy services are a good employee benefit, they do have some concerns.

Barry Barnett, a principal with PricewaterhouseCoopers Human Resource Services in New York, said that while he thinks advocacy services that help explain benefit plans

and options to employees are great—especially as more employers move to consumer-directed health plans—he does have concerns about advocacy firms fighting employees' claims battles.

"When you get into 'I didn't get my claim paid could you go beat up my carrier,' I think that's a different style of advocacy that I don't see a lot of palate for," Mr. Barnett said. "I think it creates expectations by the employees that they will have it paid, No. 1, and, No. 2, it creates an adversarial relationship between the advocate and the plan," he said. If an employer needs to contract with an advocacy firm to fight claims battles, "they've got a problem with their vendor and should change their vendor," he said.

Helen Darling, president of the National Business Group on Health in Washington, said middle-market employers with fully insured plans are probably more interested in these type of advocacy services than larger employers that tend to self-fund their health care plans.

"Most large employers feel they have benefit packages that their employees understand and they're not necessarily going to pay another company to go and negotiate and navigate their benefits plans," she said.

"In a way, you could say that's kind of shooting yourself in the foot. If you felt that your plans were not operating the way they should be, then you would work on making certain they operated the way they should," she said.

Ms. Darling noted that when she was the benefits manager at Xerox Corp. she spent "a lot of time and money" making sure employees understood their benefits and letting them know if there were any problems to contact the benefits department. "That's why we employed employee benefits people," she said.

But in a day and age where corporations are asking benefits and human resource staff to do more with less, contracting with an advocacy firm is seen as a welcome addition to some employers.

That is the case at Cost Plus World Market, the Oakland, Calif.-based retail store, which has 2,000 benefit eligible employees in 27 locations.

"Philosophically we believe in being an advocate for our employees. We want them to understand their health care and we want to make it a true benefit, but we really didn't have the resources to dedicate some of the time to educate them about billing and claims issues," said Diane Del Conte, Cost Plus' benefits manager.

Cost Plus began offering advocacy services from CareCounsel in September 2001.

CareCounsel "provided an extension of our benefits department and enabled us to provide a service to our employees to help them understand their benefits and provide them with people who truly...know their stuff," she said. "They do the job better than we can because they have the time to devote to it. So, where it may take me weeks to get a claim resolved, they can get it resolved in two days."

The way Ms. Del Conte sees it, Cost Plus was able to add a new company for the cost of expanding the benefits staff. "I feel the tradeoff is well worth it," she said.

Indeed, while any increase in benefit costs is important today, adding the services of an advocacy firm is "paper clip money" compared to what employers spend on their employee health care, according to Dr. Abby Leibowitz, executive vp and chief medical officer of Health Advocate.

"Health care costs are going up 12% to 20% a year and employers are paying \$6,000 to \$8,000 per employee for health care," Dr. Leibowitz said. "To walk into a large employer and say this service is going to cost you \$16 per employee per year, it's not even an issue," he said.

As to the future of health advocacy, Dr. Leibowitz compares it to tax accountants.

"Health care is a lot more complicated than income tax, yet many people have a tax accountant," he said. "It's just as reasonable to think that in the near future everyone is going to have a personal health advocate—somebody who can help them through the system. The difference between income tax and health care is you use health care randomly and anytime through the course of the year. You only pay your taxes on April 15."

## Plans: Cash balance controversy

Continued from page 4

employees under defined contribution plans.

Employers are upset that Congress, so far, has failed to change pension interest rate rules. Employers, Mr. Johnston said, "feel they are being asked to fund a liability" that is not being realistically measured.

One possible reason as to why Congress has not resolved the issue could be that as the number of employers with defined benefit plans has shrunk, the lobbying clout of the remaining employers with the

plans has declined as well, he said.

At the same time, he said, the Bush administration appears more focused on defined contribution plans than defined benefit plans. In his upcoming State of the Union address, President Bush is expected to make a new push for more financially attractive savings plans.

Among other survey findings:

- The No. 1 reason employers say they offer pension plans—cited by 47% of respondents—is to provide a competitive benefits package. Just 14% of employers said the top reason they offer retirement plans is to

retain employees.

- The biggest threat to pension plans—cited by 33% of respondents—is the volatility of costs. Nineteen percent of respondents cited the level of overall costs as the biggest threat, while 13% cited cash balance plan litigation and the lack of regulatory certainty.

*Copies of "Current Retirement Plan Challenges: Employers' Perspectives," are available for \$100 each from Hewitt at 847-295-5000 or at infodesk@hewitt.com.*

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## Merger: Greater lobbying clout

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think we mostly work cooperatively. But it's a more unified voice that should emerge from this, and there should be less confusion on Capitol Hill about who represents whom," Mr. Wood said.

The Risk & Insurance Management Society Inc. "is supportive of the new combined organization," said Janice Ochenkowski, vp-external affairs for New York-based RIMS. "In the past, we have worked jointly with the separate groups whenever possible, for example on the Superfund issue in the mid-1990s. We're hopeful that we'll be able to work with the new organization on issues that will ensure stable and affordable coverage to meet the needs of the insurance buyer," said Ms. Ochenkowski, senior vp-global finance for Chicago-based property manager Jones Lang LaSalle.

The creation of the PCI ends years of on-again, off-again talks between the two associations. NAII President Jack Ramirez will head the PCI, which will be headquartered in the NAII's old home office in Des Plaines, Ill. Former Alliance President Rodger Lawson will serve as executive vp.

The organization will represent more than 1,000 companies of varying sizes, generating annual premium of about \$154 billion, roughly 40% of the U.S. total. The companies underwrite about 38.8% of the private workers compensation market, 31.1% of the commercial property and liability market, 47.1% of the automobile insurance market and 37% of the homeowners market, according to PCI.

The fit is particularly good regarding public policy and advocacy, said Carl Parks, the senior vp who heads the PCI's Washington office.

"The Alliance and the NAII have worked together in the past very

well to advance sound public policy at the state and federal level," said Mr. Parks. "What this does is create a bigger and stronger organization with more staff to advocate on behalf of our members and provide member services. Collaterally, because we now represent over 1,000 companies—which represents 40% of the entire property/casualty market—it gives us tremendous ability to present the interests of property/casualty insurers and their consumers and members across the country."

**The merger will 'make us the largest political action committee representing property/casualty insurers in the country and provide for powerful grassroots political action.'**

Carl Parks  
Property Casualty Insurers  
Assn. of America

The group will have six full-time lobbyists in Washington, Mr. Parks said. PCI plans to continue lobbying on traditional industry issues such as regulation, as well as on some nontraditional issues of interest to PCI members, such as e-commerce, pension and human resources matters, he said.

The merger "will now make us the largest political action committee representing property/casualty insurers in the country and provide for powerful grassroots political action" said Mr. Parks. He said he expects the organization's PAC to raise more than \$500,000 during the current two-year cycle of Congress.

Other insurance groups hailed

the merger.

"I've thought for some time that there was great potential to a merger of the two organizations," said Franklin W. Nutter, president of the Reinsurance Assn. of America in Washington. "The memberships are compatible and the advocacy resources are complementary. They generally have compatible positions on issues. The potential to enhance the organizations' effectiveness is great," said Mr. Nutter, who is a former president of the Alliance.

"The new organization will be good for the P/C industry," said a spokesman for the American Insurance Assn. in Washington. "It eliminates some of the fragmentation and redundancy that has hampered the industry's effectiveness in the public policy arena. AIA has common interests and common policy positions with PCI, particularly on our priority issues for 2004—asbestos litigation reform, improving the California market environment, insurance regulatory modernization and terrorism insurance. We look forward to working with the new organization's staff and members."

"NAMIC has historically had a policy of working very closely with these and other organizations that are aligned with us on policy issues. We would certainly plan to continue these good working relations," said Chuck Chamness, president of the National Assn. of Mutual Insurance Cos. in Indianapolis.

But the CIAB's Mr. Wood notes that there remains a division within the industry over the best way to regulate insurance. The CIAB, AIA and RIMS all support allowing interstate insurers to choose an optional federal charter over state regulation. PCI and NAMIC, as well as some agent associations, oppose optional federal chartering while calling for reform of state regulation.

## Judge confirms Sphere Drake arbitration ruling

**NEW YORK**—A federal judge last week confirmed an arbitration award allowing reinsurer Sphere Drake Insurance Ltd. to rescind six workers compensation carve-out reinsurance policies it wrote for Clarendon National Insurance Co.

The policies, worth more than \$4 million, are among those central to the morass of litigation and arbitration actions filed in the United States and London over whether an affiliated group of London-based brokers and Sphere Drake's own agent committed fraud in placing the unprofitable excess-of-loss contracts with the reinsurer, a Fairfax Financial Group Holdings unit formerly known as Odyssey Re (London) Ltd. that is now in runoff.

Last July, the London High Court ruled that Sphere Drake had been duped by its own agent, London-based underwriting agency Euro International Underwriting Ltd., and by London brokers Stirling Cooke Brown Reinsurance Brokers Ltd. and Stirling Cooke Brown Insurance Brokers Ltd., which are subsidiaries of Bermuda-based Stirling Cooke Brown Holdings Ltd., now called AlphaStar Insurance Group Ltd. (*BI*, July 21, 2003).

Sphere Drake's cedents, mostly U.S. life insurers, were not

party to the fraud litigation, but legal observers predicted that the London court's ruling would bolster the reinsurer's efforts to rescind the policies at issue. That coverage has resulted in more than \$250 million of claims for the reinsurer.

On Nov. 18, 2003, an arbitration panel voted 3-0 to allow Sphere Drake to rescind six of the policies it wrote for New York-based Clarendon. Sphere Drake then asked a New York District Court to confirm the confidential award, which Judge Alvin K. Hellerstein did on Jan. 6.

"This case is the first domestic impact of the London judgment," said Sphere Drake attorney Harold C. Wheeler, a partner with Butler, Rubin, Saltarelli & Boyd in Chicago.

Clarendon, a unit of HDI US Group, has not decided how it will respond to the judge's decision, said the insurer's attorney, Glen H. Kanwit, a partner with Foley & Lardner in Chicago.

Sphere Drake also is attempting to rescind 12 other reinsurance contracts it wrote for Clarendon, but those policies were not part of the arbitration action. The judge ordered both sides to confer on those contracts and report their progress to him by Feb. 9.

—By Dave Lenckus

## Csiszar: Pushing modernization

Continued from page 4

In 1999, he accepted an appointment by Democratic Gov. Jim Hodges to the post of South Carolina insurance director. When Republican Gov. Mark Sanford was subsequently elected, Mr. Csiszar was the only holdover reappointed by the new GOP leader. He does not have a fixed term.

In relatively few years, he has worked his way up through the NAIC to its top leadership post. In the process, he has analyzed the organization's approach to modernization as well as its operational style.

During the past several years, he said, the NAIC has placed "heavy emphasis" on life insurance-related reforms, including developing the System for Electronic Rate & Form Filing and national product standards.

While he wants those efforts to continue, Mr. Csiszar said he would like to see the NAIC place new emphasis on matters related to property/casualty insurance, including examining asset-related issues for risk-

based capital.

P/C insurance is "an entirely different agenda and a more solvency-driven one," he said.

Overall, he plans "to operationalize the theoretical framework" spelled out in the NAIC's latest modernization plan.

Specifically, instead of establishing a proposed new "J Committee" to take the lead on insurance product regulation, he wants to establish "steering groups" of six to eight individually participating commissioners—not staff members—who will review proposals and present alternatives to NAIC members for serious discussion and possible action.

Among the issues he is specifically concerned about is a proposal from non-U.S. reinsurers to reduce collateralization requirements.

He is a member of the NAIC's Reinsurance Task Force, which is reviewing issues that include the collectibility of U.S. judgments in other countries and the lack of uniform accounting standards.

"The fundamental problem,"

though, is that any outright reduction in collateral places a ceding company at risk of downgrades by rating agencies, he said. Mr. Csiszar said he would like to hear from insurance industry representatives about other alternatives, such as a working trust arrangement or some type of securitization proposal to protect ceding companies.

Mr. Csiszar said he is also interested in an NAIC subgroup's review of the collapse of the National Warranty Insurance Risk Retention Group (*BI*, Dec. 22/29, 2003). But he said it is "nonsense" to consider banning RRGs—including some based in South Carolina—from writing similar service contract business.

State regulators can prevent such financial problems by requiring RRGs to have adequate reserves, he said.

In addition, Mr. Csiszar has been active in representing the NAIC in the international arena and currently serves as chair of the International Assn. of Insurance Supervisors' Reinsurance Task Force.

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## Late News

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providing coverage for the United Food & Commercial Workers union. But as of Jan. 1, nearly 28,000 of those UFCW members ceased to be eligible for coverage under the plan because participation requires union members to work a certain number of hours.

### Commerzbank to close pension plans

German bank Commerzbank A.G. plans to close its employer-sponsored pension plans for German staff from January 2005 as part of a cost-cutting drive. About 26,000 German-based employees of the bank will be affected by the move. The affected plans include those into which employers and employees contribute as well as plans that take only employer contributions, according to a spokeswoman for the bank. Employees at the bank will receive benefits accrued up to the January 2005 cutoff point.

### Wisconsin group promotes no-frills health care

A group of employers, health care providers and insurers in Wisconsin is proposing health care reforms in the state that would allow employers to purchase bare-bones insurance policies stripped of benefit mandates. However, changes in state law would be required to implement some of the proposal, which was made by the Wisconsin Manufacturers & Commerce, the Wisconsin Assn. of Health Plans and the Wisconsin Hospital Assn. in Madison.

### Schwarzenegger renews call for comp reform

California Gov. Arnold Schwarzenegger, in his state of the



Gov. Schwarzenegger

state address last week, called on legislators to deliver "real workers comp reform" to him by March 1. "If modest reform is all that lands on my desk, I am prepared to take my workers comp solution directly to the people, and I will put it on the ballot in November," Gov. Schwarzenegger said. Workers comp reform proposals introduced by the governor in December include guidelines for permanent disability ratings.

### Kandarian to resign as PBGC head

Steve Kandarian, who has been executive director of the Pension Benefit Guaranty Corp. for the past two years, will step down next month and return to the private sector. Mr. Kandarian said he is leaving to spend more time with his family. During his tenure at the PBGC, he worked in Washington during the week and traveled home to Boston on weekends to be with his wife and three children. Mr. Kandarian's successor has not been named.



Mr. Kandarian

### USI to acquire Los Angeles brokerage

USI Holdings Corp. will significantly increase its presence in Southern California with the acquisition of Los Angeles-based broker Dodge, Warren & Peters Insurance Services Inc. Terms of the transaction were not disclosed. USI is the 9th-largest broker of U.S. business, with \$328.2 million in 2002 brokerage revenues, while DWP ranks as the 87th-largest broker, with \$23.4 million in 2002 brokerage revenues. The deal is expected to close in the first quarter.

### U.S. Steel timber rights pension contribution OK'd

The Department of Labor has given final approval to a proposal by U.S. Steel Corp. to contribute timber rights on two parcels of land it owns to its pension plan in lieu of cash. Under the transaction, U.S. Steel will contribute to its pension plan timber rights that have been independently appraised at \$60 million. The rights will permit the U.S. Steel plan to grow, cut and harvest timber on about 170,000 acres of land near Birmingham, Ala.

### NAIC discloses top 2003 salaries

In 2003, salaries for three of the five highest-paid staff members of the National Assn. of Insurance Commissioners declined from the previous year. Even with the reductions, salaries for the five staff members ranged from \$294,805 to \$158,116 in 2003. Catherine J. Weatherford, the Kansas City, Mo.-based executive vp of the NAIC, was paid \$294,805 last year—up 3.67% from 2002—for serving as the

organization's chief executive. Chris Evangel, managing director of the NAIC's New York-based Securities Valuation Office, was paid \$246,010 last year, down 0.83% from the previous year. David Wetmore, director of federal and international relations in the NAIC's Washington office, was paid \$184,062, down 5.45% from 2002. Kansas City-based Andy Beal, general counsel, was paid \$162,286, up 3.04% from 2002, and Kansas City-based Mark Peavy, a life and health actuary, was paid \$158,116, down 4.95% from 2002.

### Briefly noted

President Bush has signed legislation, S. 1929, that extends through the end of this year a 1996 federal law that bars group health care plans from imposing lower annual or lifetime dollar limits on mental health benefits than for other medical conditions.... Dallas-based APEX Global Partners' acquisition of Hamilton, Bermuda-based broker The Park Group from IAS Park Group closed Dec. 30, 2003. The acquisition is the first for APEX, the alternative risk management brokerage recently formed by insurance veteran Gary R. Griffith.... XL Capital Ltd. has added \$100 million in capital to XL Capital Assurance Inc., its financial guarantee insurance unit. The unit now has about \$225 million in total capital.

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## Online Poll

[ 1/5-1/9 ]

Do you think employers should be allowed to reimport prescription drugs from Canada?



Yes 42.5%

No 57.5%

## BI Stock Index

[ 1/2-1/9 ]

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2,232.72

**Dow Jones** ↑ 0.47  
10,458.90

**S&P 500** ↑ 1.21  
1,121.86

### Largest gains

Vesta Insurance Co.	15.32%
Unico American Corp.	15.16%
Seibels Bruce Group Inc.	13.74%
Allmerica Financial Corp.	12.52%
SCOR	8.97%

### Largest losses

SCPIE Holdings Inc.	-13.76%
Gainsco Inc.	-12.00%
Humana Inc.	-11.16%
Pacificare Health Sys.	-10.39%
Sierra Health Services	-6.89%

### Weekly change by market segment

Brokers	-0.85%
Insurers/Reinsurers	1.35%
Managed Care Organizations	-3.53%

Source: FinancialContent Inc. (<http://financialcontent.com>)

# Pensions: Is the funding crisis over?

Continued from page 3

year ago," the spokeswoman said.

"It's clear we've turned the corner in the pension funding crisis," observed Mike Johnston, practice leader for Hewitt Associates Inc.'s North American retirement business based in Lincolnshire, Ill.

"Everybody did have a good year, so the situation has changed dramatically since last year. Most employers are at least thinking about putting some extra money in," he said.

While some, like Ford, are doing it with cash on hand, others are taking GM's approach and taking advantage of low interest rates to borrow money to invest in their pension plans, he said.

"If you can borrow money at 5%, put it in the pension fund and then have an expected rate of return of 8% or even above that, in effect you've got an arbitrage going on," Mr. Johnston said.

There's also a tax arbitrage, pointed out Ethan Kra, chief actuary at Mercer Human Resource Consulting in New York.

"The company now will deduct the interest it pays on that debt, and it doesn't pay tax on the interest it earns in the pension plan," he

explained.

But while this route may work for companies with good credit ratings and big tax obligations, like General Motors, it may not be an option for every company, he said.

**'In general, the last year was probably the best year pension funds have had in quite some time. The question is, how long will it be replicated?'**

Ethan Kra  
Mercer Human  
Resource Consulting

"Some employers don't have the debt capacity. They go to the market, but the market won't lend them the money," he said. Furthermore, such a strategy could backfire if the returns on pension fund investments lag behind the amount of interest paid on the debt, Mr. Kra said.

"It's a pure tax advantage as long as the company's aftertax cost of debt is less than it will earn tax-free in the pension plan," he said.

If was for this reason that Mr. Kra was less optimistic than Mr. Johnston that the recent turn of events bodes well for the future of pension funding.

"In general, the last year was probably the best year pension funds have had in quite some time. The question is, how long will it be replicated?" he said. "Looking forward, many people expect the markets to be subdued over the next 10 or 20 years."

Mr. Kra pointed to historic stock market performance as an indicator.

"The 1920s were gangbusters. But the market was in the doldrums for 20 years after that. The market did well in the 1950s. In 1962, the Dow Jones was in the mid-600s, but by 1982 it was only in the mid-800s," he recounted.

"People have to look at the 'What if's?' and make their decisions based on the spectrum of possible outcomes, and while they may expect good times, make sure they can survive if the results are adverse," Mr. Kra advised.

Alan Glickstein, senior consultant at Watson Wyatt Worldwide in Wellesley Hills, Mass., was cautiously optimistic.

"Things are definitely looking up, but the problem didn't occur in one year. So I think it's a little premature to declare victory and go home," he said.

"Part of the reason we're seeing such significant short-term improvement is because many organizations have put a lot more money in their plans than they were required to," he said, pointing to Ford as an example.

"This is a three-year problem of subpar investment return and low interest rates. We had one year of good returns, but we still have low interest rates. We're far from being completely out of the woods yet," Mr. Glickstein said.

Acknowledging that the upturn may be only temporary, Hewitt's Mr. Johnston suggested that Congress take advantage of the reprieve to address the systemic problems that led to the pension funding crisis in the first place. For example, Congress should pass funding reforms that control the volatility of plan liabilities.

"I think employers are willing to wait a little longer now that the financial issues aren't as big, but it hasn't eliminated the need for Congress to act," he said.