

Bush urges med mal liability reform / 3

Huge losses wipe out PBGC surplus / 4

Business Insurance

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\$4

Asbestos revisions continue

More to come: Analysts

By DOUGLAS McLEOD

The rising tide of asbestos claims engulfed another insurer's financial results last week as ACE Ltd. boosted its asbestos reserves by \$1.91 billion and said it is taking a \$354 million aftertax charge against fourth-quarter 2002 earnings.

The reserve increase, stemming largely from the CIGNA Corp. property/casualty operations ACE acquired in 1999, will exhaust the balance of a \$2.5 billion reinsurance cover ACE obtained from Berkshire Hathaway Inc.'s National Indemnity Co. unit at the time of the CIGNA acquisition.

The action caused three rating agencies to place their financial strength and credit ratings of ACE units under review, citing the size of the reserve boost, ACE's reduced reinsurance protection for asbestos claims and its exposure to unrecoverable reinsurance.

ACE's move followed Travelers Property Casualty Corp.'s recent decision to add \$2.45 billion to asbestos reserves and Hartford Financial Services Group's announcement last week that it will launch a comprehensive study of its exposures.

Other insurers are likely to follow suit, analysts agree.

Travelers, which more than tripled its existing asbestos reserves, "basically raised the bar for everybody," said Matthew Coyle, an analyst with Standard & Poor's Corp. in New York. "You're going to see a lot of companies reassessing their asbestos exposure and taking the pain now rather than later."

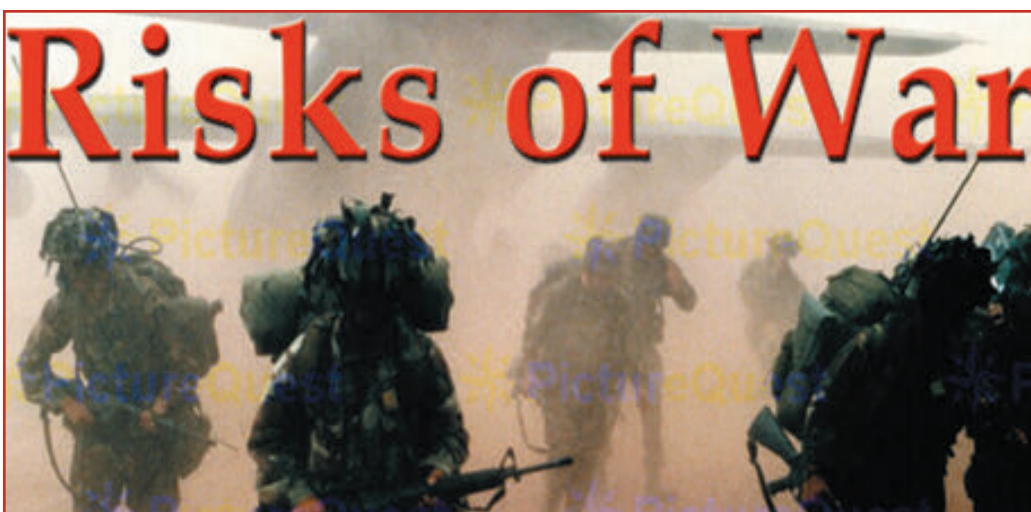
Noting that the Travelers and ACE actions raise "serious questions" about the adequacy of other insurers' reserves, S&P said it will review the issue in the next month with managements of 27 insurance groups that S&P has identified as having significant asbestos exposures.

If a company's reserves appear "materially deficient," S&P will review the company's plans for dealing with the problem and "adjust ratings as needed."

Insurers and analysts cite the same circumstances in explaining the industry's massive underreserving for asbestos claims. The main factors, they say, are that:

- Since the late 1990s, the number of claims

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Offerings to reservists exceed health benefits rule

Employers extend cover

By JERRY GEISEL and MICHAEL PRINCE

As the threat of war in Iraq looms, employers are responding by extending health care coverage to reservists called to active military duty and to their dependents.

Of the 15 employers surveyed by *Business Insurance* last week, all are providing coverage to reservists and their dependents beyond what is required by law.

Typically, employers are paying the same percentage of the premium they paid before the employees were called up for active mili-

tary duty. And some employers are doing more.

The Gillette Co., for example, will pay the same percentage of the premium it paid before the call-up for the first 24 weeks an employee is on military duty. After that period, the company will pay the entire premium for the duration of the employee's military service.

"Gillette has always supported with gratitude its employees who perform their military obligations for their country," said a spokeswoman for the Boston-based maker of

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Businesses preparing for risks arising from war

By DAVE LENCKUS

Growing prospects of war with Iraq are driving some multinational companies to develop or dust off crisis management plans, but Sept. 11 gave many U.S. organizations an earlier start on risk management efforts that should protect them from repercussions of war.

Even so, risk management experts observe, some organizations are more prepared than others.

"Some companies get it," said L. Paul Bremer III, the Washington-based chairman and chief executive officer of broker Marsh Inc.'s Crisis Consulting Practice. Mr. Bremer, an ambassador to the Netherlands during the Rea-

gan administration, also serves on President Bush's Homeland Security Council.

"Some, after Sept. 11, realized it's a pretty dangerous world and you have to be ready," Mr. Bremer said. "And some will do more in the next few weeks," just before the expected invasion of Iraq, he said.

Recent corporate governance concerns have underscored that companies "need to be better organized to deal with any kind of crisis," and the better-run companies are addressing the implications of a war with Iraq, Mr. Bremer said.

But some polls indicate that many companies have not improved their security in antic-

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Late News

Defined contribution overhaul in works

The Bush administration will propose replacing defined contribution plans—including 401(k), 403(b) and 457 plans—with a new type of plan called Employer Retirement Savings Accounts. ERSAs would be similar to 401(k) plans but would feature much easier rules on nondiscrimination and salary deferral limitations. Under the proposal, all 401(k) plans automatically would become ERSAs in 2004. Section 457 plans, offered by state and local governments, and 403(b) plans, offered by nonprofit employers such as universities, could continue but could not accept new contributions after 2004. The proposed changes require congressional approval.

CalPERS settles age bias suit

The California Public Employees' Retirement System will pay about \$250 million to settle an age discrimination suit involving more than 1,700 retired state and local public safety officers who were disabled. The suit, filed under the federal Age Discrimination in Employment Act, charged that the officers' disability benefits were reduced in proportion to their age at hire. CalPERS had based its payments on a California law passed in the 1980s. Under terms of the settlement, CalPERS will pay about \$50 million in retroactive pay, with the remainder to be paid out over the officers' lifetimes.

N.Y. premium tax proposal draws fire

Insurance industry groups are criticizing New York Gov. George Pataki's proposed 2% tax on insurance premiums, reports Crain's New York Business, a sister publication of *Business Insurance*. The proposal would cost New York insurers more than \$160 million, much of which would be passed on

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High on the agenda of the National Assn. of Insurance Commissioners' new president is a push to protect states and consumers against federal encroachment into insurance regulation.

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Company can be liable for commuter's crash

An employer can be liable for damages arising from an auto accident caused by an employee who was impaired by a workplace pesticide exposure, a California appeals court has found.

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This year, the show won't go on

Our most famous weather rodent is sleeping in this Feb. 2, citing the exorbitant cost of his insurance coverage.

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Employers mobilize for possible war

Being prepared is a cornerstone of risk management. Employers are wisely following this approach to protect employees and other assets in case of a possible war in Iraq, one of this week's editorials says.

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Regulators eye credit coverage

Insurance regulators from several countries are voicing concern about billions of dollars of credit risk being assumed by insurers and reinsurers through the coverage of credit derivatives deals.

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REPORTING WEEKLY ON
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Calls for med mal changes in State of the Union address Bush could give boost to tort reform

By MARK A. HOFMANN

WASHINGTON—President Bush's call for the reform of medical malpractice liability during his State of the Union address may signal that more comprehensive civil justice reforms may be possible, say property/casualty insurance observers.

They'd certainly welcome that, as liability reforms rank high on their legislative wish list for the new Congress. But that's far from the only issue risk managers and insurers hope to see resolved by lawmakers. The successful implementation of the federally backed terrorism insurance program, the question of whether or not to allow optional federal chartering of insurers and the possibility of new federal privacy regulations also rank high on individual agendas.

And, of course, the call for medical malpractice reform resonated well with employer groups, which view that effort as part of a larger strategy of holding down health care costs.

"Naturally, we're going to be focused on where the Terrorism Risk Insurance Act goes from here because it's just a three-year program," said Christopher E. Mandel, president of the New York-based Risk & Insurance Management Soci-

ety Inc. "We're very focused now on working with Treasury on implementation rules for the act."

Mr. Mandel said that RIMS has a broad legislative and regulatory agenda, ranging from reforming class-action rules to pursuing the optional federal charter for insurers to implementation of the Occupational Safety and Health Administration's voluntary workplace ergonomics program as well as several other issues dealing with risk and liability.

In addition, "from our perspective, we're very interested in what homeland security—now that it's a cabinet-level department—will really be all about. It's very relevant to risk management, where cyber security is just one element of the risk associated with homeland security. I'm enamored of the concept of Tom Ridge as the federal government's first risk manager. We'd love to find out if we can't find synergies in our respective agendas," Mr. Mandel said.

In his address, President Bush referred to "the constant threat that physicians and hospitals will be unfairly sued" as one of the "prime causes" of higher health costs. "No one has ever been healed by a frivolous lawsuit; I urge the Congress to pass medical liability



PHOTO: REUTERS/JASON REED

In his State of the Union address, President Bush urged reform of medical malpractice liability.

reform," he said. The president also cited the need for "a system in which all Americans have a good insurance policy" and his desire to reform Medicare, an effort that would include adding a prescription drug benefit.

The president's health care agenda drew praise from the employer-backed American Benefits Council.

"In health care, the president outlined three priorities—tackling the uninsured, adding a Medicare

prescription drug benefit and limiting excessive liability," said Paul Dennett, vp-health policy of the Washington-based group. "We would strongly agree that those are the top health care priorities in the country right now. We think the president's remarks focused on the right issues. The uncertainties are whether these difficult issues can get tackled by a Congress that's so closely divided."

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Late News

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to policyholders, insurers say. Insurers now pay both corporate income and premium taxes. Gov. Pataki's proposal, which the Legislature must approve, would replace the income tax with a 2% premium tax. The premium tax, assessed on gross receipts, is now 1.3% for property/casualty insurers, 1% for health insurers and 0.7% for life insurers.



PHOTO: AFP

Firefighters battle the blaze at the site of a Kinston, N.C., plant explosion.

Cause of N.C. blast under investigation

Investigators are probing a destroyed West Pharmaceuticals Inc. plant in Kinston, N.C., to determine what caused an explosion last Wednesday that killed at least three people and injured dozens. The plant, which made syringe plungers and fittings for intravenous equipment, employed 255 workers, but not all were at the facility. Zurich North

America is the plant's primary insurer on property, liability and workers compensation programs. Coverage information and damage estimates were not available.

Regulators seize malpractice insurer

Virginia regulators placed medical malpractice insurer Reciprocal of America into receivership last week and ordered it to stop writing new policies or renewing existing ones. Glen Allen, Va.-based Reciprocal of America, which operates primarily in Alabama, Kentucky, Mississippi, Tennessee and Virginia, in December asked member physicians and hospitals to help raise \$100 million by Jan. 31. In 2001, Reciprocal wrote direct premiums of \$121 million. A major blow for Reciprocal, which faced mounting claims, was the decision by Bermuda-based First Virginia Reinsurance Ltd. not to honor its reinsurance obligations, Virginia regulators said.

Minnesota hospitals partner with Leapfrog

All Minnesota hospitals will begin posting certain data on the Leapfrog Group's Web site as part of an initiative to help patients make better health care purchasing decisions, the Minnesota Hospital Assn. announced. Minnesota is the first state to fully partner with Leapfrog, said Carolyn Pare, chief

executive officer of the Minneapolis-based Buyers Health Care Action Group. Initially, www.leapfrog-group.org will include data on computerized physician order entry, staffing of intensive care units and volume of certain surgeries. The data will be available Feb. 15. Leapfrog represents more than 130 public and private organizations that provide health care benefits.

Max Re enters excess GL market

Max Re Capital Ltd. has entered the excess general liability insurance market. Hamilton, Bermuda-based Max Re, which began in 1999 writing structured financial reinsurance, turned to more traditional reinsurance when investment returns fell. The recent move into traditional lines also was partly driven by low returns, said Keith S. Hynes, executive vp and chief financial officer. Max Re will offer the excess GL coverage to North American clients.

Trenwick reserve add brings downgrades

Trenwick Group Ltd. will boost reserves by \$107 million, including \$20 million for asbestos and environmental liabilities, for fourth quarter 2002. The increase relates to Trenwick's U.S. operations and its London-based Trenwick International Ltd. unit. Reserves at Trenwick's Lloyd's underwriting unit "were not significantly affected" by the company's reserve study, Trenwick said. Standard & Poor's Corp. cut the financial strength ratings of Trenwick America Reinsurance Corp.

and three other underwriting units to CCC from BB-.

Briefly noted

American International Group Inc. Chairman and CEO **Maurice R. Greenberg's successor** has been chosen from within AIG's ranks, but he declined last Tuesday to name the person or say when he plans to retire. AIG last year appointed longtime executives Martin J. Sullivan and Edmund S.W. Tse as co-chief operating officers and created a seven-person office of the chairman that includes top officers of AIG's foreign and domestic property/casualty and life operations....J.P. Schmidt became **Hawaii's insurance commissioner** Feb. 1, heading the state's Insurance Division. Mr. Schmidt is a partner with the Maui law firm of Crockett, Nakamura & Schmidt.

Check out Businessinsurance.com

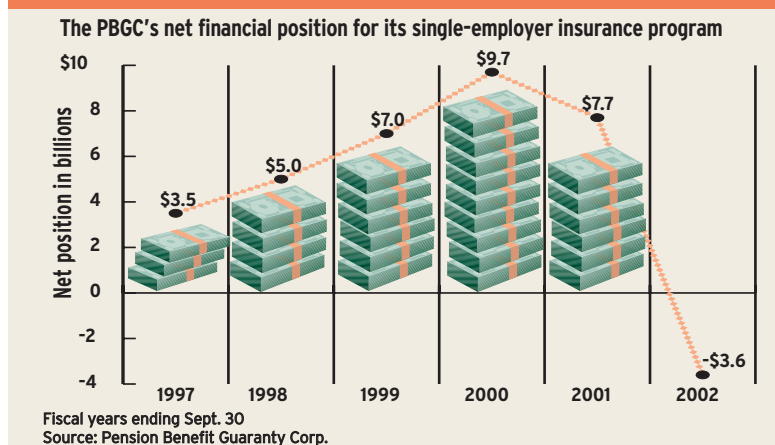
Items in the Late News column originally appeared in *BI's Daily News* feature on www.businessinsurance.com. Visit the *BI* Web site to sign up to receive *BI's Daily News* by e-mail.

Online this week:

- Searchable **directory of third-party claims administrators** has been updated.
- New **Opinion Poll** for readers: How long will your company extend health care benefits for reservists called to active military duty?

Massive losses wipe out PBGC surplus

REVERSAL OF FORTUNE



Plan terminations in 2002 result in record deficit

By JERRY GEISEL

WASHINGTON—Hampered by its biggest losses ever from pension plan terminations, the Pension Benefit Guaranty Corp.'s surplus has vanished, leaving the agency with a record deficit.

In fiscal 2002, the PBGC's financial position turned upside down as it recorded a \$3.6 billion deficit, compared with a \$7.7 billion surplus in 2001 and a \$9.7 billion surplus in 2000.

There has been a "dramatic rever-

sal" in the agency's net position, said PBGC Executive Director Steve Kandarian at a briefing last week at which the results were released.

The chief reason for the change, the magnitude of which is unprecedented in the agency's 28-year history, was record losses from plans the agency took over from failing or failed companies.

In 2002, the PBGC recorded more than \$9 billion in losses from actual or probable terminations, including a \$3.9 billion loss from the termination of bankrupt Bethlehem Steel

Corp.'s massively underfunded pension plan, a \$1.9 billion loss from the takeover of several pension plans sponsored by failed steel-maker LTV Corp. and a \$1.3 billion loss from the termination of pension plans offered by bankrupt National Steel Corp.

And more big losses are likely, given the weakened state of several companies with underfunded plans.

"There are a number of large, highly underfunded plans we are

See PBGC/page 6

Defending the states' purview

New NAIC head wants to stave off federal charter

By MEG FLETCHER

LITTLE ROCK, Ark.—High on the agenda of the National Assn. of Insurance Commissioners' new president is a push to protect states and consumers against federal encroachment into insurance regulation.

Toward that end, the NAIC is creating a new coalition, the "Alliance for Sound State Uniform Regulatory Efficiency," or ASSURE, said Mike Pickens, the NAIC's new president. The Arkansas insurance commissioner was elected to a one-year term in December.

Beginning in 2001, "state insurance regulators saw the continuing trend in Congress toward federal action and decided that enough was enough," according to an NAIC statement.

Specifically, state insurance regu-

lators want to counter efforts by several major insurance trade associations to create a federal charter option that would allow their companies to operate nationally without the limitations imposed by the state-based regulatory system. The current system requires many individual state approvals, despite recent NAIC efforts to modernize oversight by creating a uniform producer licensing process and an interstate compact to provide centralized review of many life insurance-related products.



Mr. Pickens

According to an NAIC statement, the coalition's mission is "to improve and defend state insurance regulation by supporting greater efficiency and uniformity in regulatory practices while proactively and aggressively maintaining vital consumer protections and education initiatives, as well as

promoting streamlined national standards that recognize a unique and evolving state-based marketplace."

Each state will have two co-chairs selected by its chief insurance regulator. Those co-chairs are expected to build membership among a broad base of consumers, legislators, business and industry leaders, according to the NAIC statement.

"The group wouldn't lobby, but individual members may," Mr. Pickens said. That approach would allow the NAIC to operate within Internal Revenue Service guidelines, which limit the NAIC's primary role to engaging in educational and charitable activities.

Congressional oversight continues to be a concern this year, as the General Accounting Office is currently surveying state insurance department operations, especially in the market conduct area, Mr. Pickens said. The GAO is expected to issue a report on its findings in the spring or summer, which will then likely lead to a congressional hear-

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Appeals court finds exemption to 'going-and-coming' rule

Commuter liability in question

By ROBERTO CENICEROS

LOS ANGELES—An employer can be liable for damages arising from an auto accident caused by an employee who was impaired by a workplace pesticide exposure, a California appeals court found.

An attorney for the employer argues, though, that the company is not to blame and said that the appeals court is improperly attempting to shape public policy.

The unanimous Jan. 23 decision by a three-judge panel of the 2nd District Court of Appeal in *Barbara Bussard vs. Minimed Inc.* overturned a trial court's ruling on a summary judgment motion.

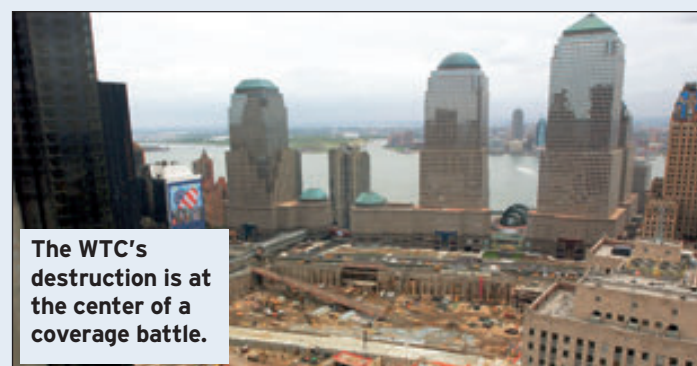
Minimed may appeal the decision and will weigh, among other

factors, whether other employers would join in the legal battle, said William F. Rummmler, a partner at Booth, Mitchel & Strange L.L.P. in Los Angeles.

Mr. Rummmler represented Minimed Inc., which merged with another company and now operates under the name Medtronic Minimed. The company is based in Northridge, Calif.

The case stems from a March 2000 auto accident caused by Irma Hernandez, a Minimed employee. Ms. Hernandez rear-ended a car driven by Barbara Bussard, who sued Minimed and Ms. Hernandez for a neck injury resulting from the accident.

Ms. Hernandez had left work, See COMMUTE/page 24



The WTC's destruction is at the center of a coverage battle.

PHOTO: SPENCER PLATT/GETTY IMAGES

Allianz WTC cover ruled vague on 'occurrence'

By DOUGLAS McLEOD

NEW YORK—A federal judge has refused Allianz Insurance Co.'s request for a ruling that the World Trade Center's destruction was one occurrence under policies it issued before the Sept. 11, 2001, terrorist attack.

U.S. District Judge John S. Martin Jr. ruled instead that the policies' terms could support either a one- or two-occurrence interpretation and that the issue must be decided by a jury.

The ruling is the latest action in a series of battles between insurers and WTC leaseholder Silverstein Properties Inc. over which policy form governs the complex's \$3.55 billion property insurance program: a Willis Group Holdings Ltd. form that defines the attack as a single occurrence or a Travelers Property Casualty Corp. form issued after the attack that Silverstein argues would treat the loss as two events, triggering a \$7 billion payout.

Judge Martin has already ruled that three of the program's 25 insurers are liable for only one policy limit under the Willis form, but he has refused similar rulings to three other insurers.

Allianz directly wrote \$77.9 million in limits and was a fronting insurer for SCOR S.A. on additional participations totaling \$354.7 million. Unlike others on the program, Allianz issued its own policies before the Sept. 11 attack, and Judge Martin ruled

that those policies govern the insurer's participations despite evidence that Allianz expected to follow the Travelers form.

He rejected Allianz's contention, however, that its form defines the loss as one occurrence. The Allianz policies define occurrence as "one loss, disaster or casualty, or series of losses, disasters or casualties arising out of one event." The judge said the term "event" is ambiguous.

"While reasonable people might consider the attack on the World Trade Center as a single event, it is no less reasonable to consider the separate hijackings of two aircraft and the ultimate crashing of those aircraft into different buildings at different times as two separate events," Judge Martin wrote.

He also dismissed the insurer's reliance on a clause defining vandalism and malicious mischief losses arising in the same 72-hour period as one occurrence.

"While it can be argued that the attack on the World Trade Center fits within dictionary definitions of 'malicious mischief' and 'vandalism,' it is doubtful that anyone familiar with the events of that day would describe what occurred" in those terms, Judge Martin wrote.

The Allianz policies' occurrence definition may support a one-occurrence argument, but "that is not the only reasonable construction of the definition," and a jury must therefore decide the case, the judge ruled.

PBGC: Losses wipe out surplus

Continued from page 4

closely monitoring, which could expose the agency to further losses," Mr. Kandarian said.

Indeed, financially troubled US Airways Inc. last week filed a notice with the PBGC that it intends to terminate its pension plan covering pilots and set up a new defined contribution plan. US Airways pilots, though, said they will oppose the termination. If terminated, the US Airways plan would result in roughly a \$500 million loss for the PBGC, agency officials have said.

Despite the massive losses of the last year, Mr. Kandarian said the agency's insurance program, which is funded by premiums paid by employers with defined benefit plans, is not in a state of crisis. With more than \$25 billion in assets, the insurance program can continue to pay benefits promised to participants in terminated plans for a number of years, he said.

Benefit experts concur with that assessment. "They are entirely capable of paying benefits for the foreseeable future," said Janice Gregory,

vp with the Washington-based ERISA Industry Committee, an employer-sponsored benefits lobbying group.

'There are a number of large, highly underfunded plans we are closely monitoring, which could expose the agency to further losses.'

Steve Kandarian
Pension Benefit Guaranty Corp.

But over the long run, the financial integrity of the insurance program must be preserved, Mr. Kandarian said. To that end, administration officials are looking at a wide range of reform proposals.

No final decisions have been made, but a guiding principle of any reform is that companies should make pension promises they can fund and should fund the promises they make, Mr. Kandarian said.

While he did not discuss specific reform proposals, Mr. Kandarian virtually ruled out increasing PBGC premiums for employers with well-funded plans. Such a move, he said, would discourage companies from offering pension plans.

Benefit experts say Congress needs to move cautiously in considering possible PBGC-related reforms.

"You need to be very careful about legislating in this area, due to the risk of action that would jeopardize the ability of companies to offer pension plans," said Nell Hennessy, a senior vp with Aon Consulting in Washington and a former PBGC deputy executive director.

But on Capitol Hill, there already are concerns about the PBGC's financial health.

Rep. John Boehner, R-Ohio, chairman of the House Education and the Workforce Committee, said he plans to hold hearings on the PBGC's condition.

"We expect to take a close look at the PBGC and the challenges facing the agency," Rep. Boehner said.

Punxsutawney Phil

He would chuck the whole event

As I write this, the walkout is planned for Feb. 1.

After that, when people come to me in their time of need, seeking my critical services, I will not be there to help them. I regret that I must take such drastic steps, putting my clients at risk, but the situation is dire and calls for action.

You see, my insurance costs are skyrocketing, and I simply cannot afford to pay any more. And without coverage, I feel that doing my duty puts me at terrible financial risk. Staging a walkout is the only way I know to draw attention to my plight and, I hope, get lawmakers to act to stop the senseless spiral of litigation that is driving my premiums out of sight.

Lobbying through traditional channels has gotten me nowhere.

I know that I swore an oath to do my duty, but I must break it now. I do not do this lightly; I take this step in the name of performing groundhog everywhere who are in a similar situation.

Yes, this year, there will be no Groundhog Day on Feb. 2 because of the insurance crisis.

What brought us to this low, low point?

As you know, when St. Paul exited the market for groundhog liability insurance, the market was thrown into turmoil. Like filthy lemmings (which are as mindless a class of rodent as you'll ever encounter), the other insurers turned tail

and followed suit. Even the hardpan mutuals set up by other burrowing rodents during the last hard market withdrew capacity and cut off their policyholders. We were betrayed in our time of greatest need.

The market became as hard and painful as mistakenly biting into a rock thinking it was an acorn. This happened just as we were going through our own financial hardship. The agent for the Woodchuck Union screwed up negotiations over our royalties for the motion picture "Groundhog Day." As a result, most of us are still residing in musty dirt holes, hoping to find at least one good worm or insect a day, and working pancake breakfasts on Feb. 2 and such.

Good grief, I even read there's now a potbelly pig predicting the weather. To make a long story short, my budget cannot cover the soaring cost of premiums today.

I have heard the arguments of

insurers defending their actions. They contend that our claims record is abysmal and, consequently, they cannot afford to underwrite burrowing rodents without raising premiums threefold. They say that as a class of policyholder we are simply too risky, what with the triple threat of mold in our burrows, animal bite liability and professional negligence exposures.

But I have had a spotless claims record, especially considering that none of those claims I filed were my fault. How can I help it if a jury sees it differently? It's not as if those topsiders deciding my fate were peers of mine.

Besides, those people I bit surely had it coming. Poking and prodding me during hibernation—or, worse, dragging me out of my burrow—is just begging to be chomped on. Those people required very few stitches, really.

Instead of suing me, they should be thankful I don't have the power or cranky disposition of that lioness in a Madrid

animal park who last week ripped the arm off a woman who thought she'd climb up on a fence to wave at the big kitty. Fair's fair: That lion better see its premiums go up 1,000%.

And what about the merits of those malpractice claims? Can you believe all the people who went to court to sue me,

arguing that my forecasting powers are as hollow as the stump I call home? Anyone who really relies on me seeing my shadow to determine investments or make other decisions ought to be locked in a nuthouse, not given the keys to the courthouse. I have a suggestion for them: Try the Weather Channel.

Maybe if my insurer had been a little more willing to spend some cash on an attorney who didn't have to take the bar exam three times, I could have beaten the rap and my loss experience would not be what it is today.

Before I go, let me offer you a little hint about the weather: Look to March 21 on your calendar.

Occasional commentator Punxsutawney Phil can be reached through Editor Paul Winston by e-mail at pwinston@crain.com. Mr. Winston's commentary will return next week.



Punxsutawney Phil

'Can you believe all the people who went to court to sue me, arguing that my forecasting powers are as hollow as the stump I call home?'

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Editorial

Employers must prepare

AS THE NATION gears up for possible war in Iraq, many U.S. employers are going above and beyond the call of duty to reduce the impact of hostilities on their employees.

As we report on page 1, employers voluntarily are continuing to provide group health care benefits for reservists who are called to active duty and for their families, even though they are eligible for generous coverage through a Department of Defense health care program. This voluntary response is particularly impressive given both the general sluggishness of the economy and the fact that health care costs are skyrocketing and show no sign of abating.

Risk managers—particularly those with multinational exposures—are responding to the threat, as well. For example, forward-looking risk managers are updating crisis management plans; others are crafting the plans for

the first time. If nothing else, the gathering storm should underscore for enterprises of all sorts the importance of having an up-to-date crisis management plan in place.

What role terrorism insurance will play in these preparations remains unclear. The property/casualty insurance industry itself is still grappling with how to price the coverage. In addition, many risk managers remain unconvinced that the costly coverage would respond to terrorism losses stemming from an Iraq war.

Being prepared is the essence of risk management and a key component of successful benefit management. Practitioners of both professions are demonstrating their commitment to these principles.

We can only hope that these preparations aren't put to the ultimate test in the coming weeks.

Come clean on reserves

IT'S TIME FOR INSURERS to clear the air on their true financial exposure to asbestos liabilities.

Recent announcements of massive additions to asbestos reserves from insurers ACE Ltd. and Travelers Property Casualty Corp. offer the latest evidence of a troubling trend.

After all, ACE's \$1.9 billion reserve boost and Travelers' nearly \$2.5 billion addition come after several insurers put big money into asbestos reserves in 2002. But is it enough?

Indeed, last week Standard & Poor's Corp. said the newest reserve boosts cast doubt on the industry's reserve adequacy and raise "serious questions" about the ultimate asbestos-related losses the market will face.

How many more insurers have yet to announce the need for massive increases in their reserves? How many more claims will hit insurers, creating added pressure on existing reserves?

These are genuine areas of concern for policyholders, even those that don't currently face asbestos claims. If

insurers cannot adequately predict their asbestos liabilities, their ability to pay claims, regardless of the source, may be jeopardized.

A continual need to boost asbestos reserves will strain insurers' capital. And with equity markets down—and showing no sign of heading up any time soon—the investment income simply isn't there to ease such strain.

Congress may take up asbestos litigation reform and slow the proliferation of lawsuits, but the successful outcome of such an effort is far from assured. While insurers and policyholders alike must continue to press for meaningful tort reform, they cannot assume they will be successful.

In the meantime, insurers can allay customers' concerns by giving policyholders a clearer picture of their asbestos liabilities and adjusting reserves accordingly. Policyholders deserve greater transparency if they are to accurately gauge the financial strength of their insurers.

Schillerstrom



Letters to the Editor

Editorial cartoon offends, angers readers

To the editor: I fail to see the humor in the Jan. 27 editorial cartoon.

It seems that too many of you media types have totally forgotten 9/11. Instead of wishing Godspeed to the men and women who will be risking their lives and futures against the terrorists and the terrorist-supporting regimes around the world, you throw some stupid and uncaring cartoon at them and your loyal readers. I resent the hell out of it.

Hopefully, with God's help, our men and women, our president and the other leaders of this country will be able to count on the full support of our citizens to help them win this war. Isn't it time that you all lent your pen to the effort of building morale instead of trying your damned best to tear it down? Will it take yet another direct assault on our country for the media to get it?

I am ashamed of BI for running such a terrible cartoon.

Herbert R. Martin
North Little Rock, Ark.

To the editor: I was surprised to see the cartoon by Schillerstrom published in *Business Insurance*. That idiot has obviously never boarded the plane as I did to go Vietnam years ago. One would think that the freedom for which those troops boarding that plane are going to fight would be more tastefully used, especially when we are sending so many into harm's way who may have been slapped by this depiction. That really makes me angry, is quite offensive, and is an abuse of the freedom I protected.

James L. Ipock Jr.
New Bern, N.C.

To the editor: Just opened up my Jan. 27 copy of *Business Insurance* and while thumbing through, I was struck by the cartoon on the editorial page.

I find your use of the American service men and women as the brunt of either a joke about life insurance or your own political agenda to be in incredibly poor taste! These people are putting it all on the line—willingly—and to demean their efforts with "a free casket with each policy" is way over the line.

Our men and women in the armed forces deserve better treatment than this!

John K. King
Itasca, Ill.

To the editor: I viewed with dismay the insensitive cartoon by Schillerstrom printed in this week's issue of *Business Insurance*.

How callous! At a time when our young men and women voluntarily go in harm's way to protect freedom—and not just for Americans

See **LETTERS**/page 27

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Claims Management

Spotlight Editor: Regis J. Coccia

Self-insureds lagging in detection of claims fraud

Little investigating done

By JOANNE WOJCIK

Fighting fraud would seem to command greater attention during tough economic times, when bogus or inflated claims are more likely to occur, but that isn't always the case, especially among companies that are largely self-insured.

Fully insured companies often receive fraud detection and investigative services from their insurers' special investigation units, because it's the insurers' money that is at stake. But these services are not always available to companies with large deductibles or self-insured retentions, industry experts point out.

"Almost any claim that is within a self-retention layer, if it's not impacting the insurer, there is little attention that is paid to it," said Joe Dotoli, president of VeriClaim Inc., a Chicago-based claims manager that changed its name from McLarens Toplis North America in October 2002. "There's no one from the insurer's perspective that's keeping an eye on that."

Industry experts say many losses that occur within self-insured retentions are not even reported to insurers, especially if the policyholder doesn't want those losses to negatively affect its claims experience.

In some cases, though, insurers offer fraud detection services to their large-deductible policyholders on a contractual basis, for a fee.

"The services provided to our self-insured clients are contractual because they typically want more-intensive investigations," explained Mark Sidney, senior vp and general claims manager of national market claims at Liberty Mutual Insurance Co. in Boston.

See FRAUD/page 15

'Almost any claim that is within a self-retention layer, if it's not impacting the insurer, there is little attention that is paid to it. There's no one from the insurer's perspective that's keeping an eye on that.'

Joe Dotoli
VeriClaim Inc.



More claims denials seen in current hard market

Lawyers now handling claims from the outset

By ROBERTO CENICEROS

Some policyholder attorneys say they are busier than ever helping their clients obtain settlements from insurers that rejected their coverage claims.

The increased caseload is noticeable across all lines of coverage, said William Passannante, partner and co-chair of the insurance coverage group at Anderson Kill & Olick in New York. But Mr. Passannante said that what surprises him the most about the growing workload is insurers' increasing willingness to challenge even small claims, those valued at under \$1 million dollars.

"The small claims that you previously

thought would not have raised a stir, they do," Mr. Passannante said. "We are similarly seeing a very large volume of large claims related to different events, whether they are product liability claims or 9/11-related claims or directors and officers-related claims. There is an awful lot of disagreement going on in the claims handling area."

While insurers contacted for this story declined to comment, opinions among attorneys, brokers and risk managers differ on whether the current hard market and related conditions have influenced insurers' claims paying practices and led to increased claims litigation.

See CLAIMS/page 14

Employers revisiting integrated benefits

Aiming at cost control

By MEG FLETCHER

Employers' soaring bills for workers' health care and workers compensation benefits are causing some to step back and broadly re-evaluate the cost effectiveness of such programs, so they can better identify true cost drivers and adopt programs to better address them.

While a few observers think this re-evaluation may include reconsidering 24-hour coverage, many others say that concept has been supplanted by programs that focus more on

In today's economy, employers 'are desperate for cost-control measures that do not jeopardize the health of people.'

Mary France
GuilfordPare

integrated disability management and—more recently—on employee health and productivity.

"Companies are hungry for cost savings these days," said Dr. Wayne Burton, corporate medical director of Chicago-based Bank One Corp., which

employs about 75,000 workers, primarily in the United States.

Currently, many employers are seeing a second year of double-digit rate increases for workers' health care benefits, as well as upward trends in workers comp medical and wage-loss costs. In addition, coverage is less available not only for workers compensation risks—which has forced some employers into assigned risk plans—but also for short- and long-term disability risks, according to sources.

Many short- and long-term disability carriers are pulling out of the market or restructuring their offerings and coverage because of inadequate profits, said David A. North, president and chief executive officer of Memphis, Tenn.-based Sedgwick Claims Management Services Inc.

In today's economy, "we are desperate for cost-control measures that do not jeopardize the health of people," said Mary France, a

See COSTS/page 17

A ranking of the 10 largest
claims administrators / page 12

Legal services consultants
help lower cost of litigated claims / page 18

LARGEST TPAs BY CLAIMS STAFF

Ranked by number of claims staff assigned to self-insured clients

Company	Staff
Great-West Life & Annuity Insurance Co.	1,918
ESIS Inc.	1,374
NATLSCO Inc.-TPA Services	1,034
Crawford & Co.	743
Acordia Inc.	640
Wausau Benefits Inc.	560
Ward North America Inc.	506
CBCA Inc. ¹	500
The EPOCH Group L.C.	390
GAB Robins North America Inc.	387

¹ Acquired USI Administrators Inc. April 2002
Source: BI survey

MOST PREVALENT CLAIMS

Percentage of companies that provide the following types of claims administration

Company	Percentage
Workers compensation	53.2%
Health insurance	49.5%
General liability	46.8%
Automobile	42.2%
Short-term/long-term disability	39.4%

Source: BI survey

LARGEST BY CLIENTS

Claims administrators ranked by number of self-insured clients in 2002

Company	Number of clients
Great-West Life & Annuity Insurance Co.	7,023
Crawford & Co.	5,100
Cambridge Integrated Services Group Inc.	4,973
Gallagher Bassett Services Inc.	2,363
Fiserv Health	1,983
AIG Claim Services Inc.	1,950
CoreSource Inc.	1,695
Berkley Risk Administrators Co. L.L.C.	1,558
New York Compensation Managers Inc.	1,200
York Insurance Services Group Inc.	1,099

Source: BI survey

Largest claims administrators

Based on 2002 revenues from claims handled for self-insured clients

Rank	Company/Address	Phone/Fax/Web	Parent company	2002 revenues from self-insured clients	2002 claims paid for self-insurers	Total clients	Claims staff	Type of claims administered	Principal officer
1	Great-West Life & Annuity Insurance Co. 8515 E. Orchard Road Greenwood Village, Colo. 80111	303-737-3000 314-525-6622 www.gwla.com	Power Corp.	\$718,710,300 ¹	\$6,000,000,000	7,023	1,918	Employee Benefits	William T. McCallum, president/CEO
2	Gallagher Bassett Services Inc. The Gallagher Centre, 2 Pierce Place Itasca, Ill. 60143	630-773-3800 630-285-4000 www.gallagherbassett.com	Arthur J. Gallagher & Co.	\$275,000,000	\$3,200,000,000	2,363	NA	Employee Benefits & Property/Casualty	Richard McKenna, president
3	Cambridge Integrated Services Group Inc. 4B Cedar Brook Drive Cranbury, N.J. 08512	800-662-1170 609-655-0503 www.cambridge-integrated.com	Aon Corp.	\$215,000,000 ¹	\$2,825,000,000	4,973	2,000	Employee Benefits & Property/Casualty	Tracey A. Carragher, chairman/CEO
4	Fiserv Health ² 255 Fiserv Drive Brookfield, Wis. 53045	262-879-5000 262-879-5245 www.fiserv.com	Fiserv Inc.	\$213,750,000 ¹	\$4,300,000,000	1,983	1,805	Employee Benefits	Jim Cox, CEO
5	Sedgwick Claims Management Services Inc. 1100 Ridgeway Loop Road Memphis, Tenn. 38120	901-415-7400 901-415-7406 www.sedgwickcms.com	Marsh & McLennan Cos. Inc.	\$194,675,846	\$3,022,660,128	360	2,155	Employee Benefits & Property/Casualty	David A. North, president/CEO
6	CoreSource Inc. 400 Field Drive Lake Forest, Ill. 60045	847-604-9200 847-615-3900 www.coresource.com	Trustmark Insurance Co.	\$153,755,000	\$3,290,000,000	1,695	1,549	Employee Benefits	Mark W. Schmidt, president
7	Specialty Risk Services Inc. Goodwin Square, 225 Asylum St., 16th Floor Hartford, Conn. 06103	888-236-4684 860-520-2560 www.specialtyrisk-services.com	The Hartford Financial Services Group Inc.	\$150,800,000	\$1,300,000,000	575	1,212	Property/Casualty	Dennis R. Replogle, president
8	ESIS Inc. 1601 Chestnut St. Philadelphia, Pa. 19103	215-640-2837 215-640-5556 www.esis.com	ACE USA	\$130,000,000	\$2,000,000,000	510	1,374	Property/Casualty	Ed Troy, president
9	The Principal Financial Group-National Accounts 7745 Office Plaza Drive N. West Des Moines, Iowa 50266	515-235-9351 515-235-9280 www.principal.com	-	\$119,788,852	\$1,707,403,359	274	708	Employee Benefits	Jim Charling, vp
10	RSKCo 3500 Lacey Road Downers Grove, Ill. 60515;	630-719-3275 630-719-3306 www.rskco.com	CNA Financial Corp.	\$114,000,000	\$2,200,000,000	525	NA	Property/Casualty	Robert R. Kulbick, CEO

¹ BI estimate ² Includes Benefit Planners, Benesight and Harrington Benefit Services Inc.
Source: BI survey

The full directory of third-party administrators is available online in the directories area of www.businessinsurance.com. The searchable directory allows users to locate claims administrators by company name, type of claims administered and type of clients, among other information. PDF copies of the directory can be purchased by calling the Crain Information Center at 312-649-5476.

LARGEST MULTILINE TPAS

TPAs that offer both employee benefits and property/casualty administration. Ranked by 2002 revenues from self-insured clients.

Company	2002 revenues from self-insured clients
Gallagher Bassett Services Inc.	\$275,000,000
Cambridge Integrated Services Group Inc.	215,000,000 ¹
Sedgwick Claims Management Services Inc.	194,675,846
NATLSCO Inc.-TPA Services	66,300,000
Acordia Inc.	61,700,000
GatesMcDonald	40,700,000
The Frank Gates Cos. Inc.	40,000,000
Cannon Cochran Management Services Inc.	37,000,000
The Loomis Co.	27,830,000
Underwriters Safety & Claims Inc.	18,375,000

¹ BI estimate
Source: BI survey

LARGEST PROPERTY/CASUALTY TPAS

TPAs that specialize in property/casualty claims administration. Ranked by 2002 revenues from self-insured clients.

Company	2002 revenues from self-insured clients
Specialty Risk Services Inc.	\$150,800,000
ESIS Inc.	130,000,000
RSKCo	114,000,000
Crawford & Co.	104,956,000
Risk Enterprise Management Ltd.	88,000,000
GAB Robins North America Inc.	78,152,000 ¹
AIG Claim Services Inc.	60,500,000
Constitution State Services L.L.C.	58,100,000
New York Compensation Managers Inc.	40,000,000
Ward North America Inc.	35,000,000

¹ Estimated
Source: BI survey

LARGEST EMPLOYEE BENEFITS TPAS

TPAs that specialize in employee benefit claims administration. Ranked by 2002 revenues from self-insured clients.

Company	2002 revenues from self-insured clients
Great-West Life & Annuity Insurance Co.	\$718,710,300 ¹
Fiserv Health ²	213,750,000 ¹
CoreSource Inc.	153,755,000
The Principal Financial Group-National Accounts	119,788,852
Wausau Benefits Inc.	89,568,166
Brokerage Concepts Inc.	56,401,000
CBCA Inc. ³	55,000,000
Zenith Administrators Inc.	47,000,000
Alicare Inc.	42,889,000
Central Benefits Mutual Insurance Co.	36,000,000

¹ BI estimate ² Includes Benefit Planners, Benesight, Harrington Benefit Services Inc.
³ Acquired USI Administrators Inc. in April 2002
Source: BI survey



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Claims: Some observers say insurers slower to pay

Continued from page 10

Some observers believe there likely is a correlation between insurers' attempts to increase profitability in the current hard market and their claims handling practices, although they can't substantiate that belief with statistics.

Jane Keegan, risk manager for the Port of Oakland in California, said she has seen no change in insurer claims practices related to her policies.

Claims departments typically judge the merits of a claim by focusing on the underwriting intent when an applicable policy was issued, she said. But Ms. Keegan noted that she has seen higher levels of personnel turnover in insurer underwriting departments, due to hard-market demands on underwriters.

That turnover can make it more difficult to get claims paid, because the original underwriter may no longer be available when the insurer's claim handlers turn to the underwriting department for assistance in understanding the policy's intent. The situation has not led to improved service, Ms. Keegan said.

"We certainly haven't seen that the underwriters are more prompt in their payment," she said. "In fact, there has been some speculation that, because of a push for profitability, they will delay payments. If it's happening, it's very subtle. I haven't seen any evidence of that, (but) it may very well be happening."

Other observers say that current market conditions discourage insurers from needlessly rejecting claims and landing in court.

"Adjusters are a little bit nervous

about bad faith," said Mel Bangs, vp of risk services for broker McQueary Henry Bowles Troy in Dallas. "Costs are up, so they don't want to go before a judge or jury and say, 'I know I am charging enormous amounts of money, but I don't want to pay claims either.'"

So Ms. Bangs said she sees insurers taking a middle-of-the-road stance, although she noted that much of her business is conducted in Texas, which has very strict bad-faith laws that may particularly discourage rejecting claims.

"If a carrier feels like they have very strong contractual reason to

'If a carrier feels like they have very strong contractual reasons to deny claims, they will certainly do it. But they are not looking to deny claims.'

Mel Bangs
McQueary Henry Bowles Troy

deny claims, they will certainly do it," Ms. Bangs said. "But they are not looking to deny claims."

Still, others see claims rejection trends that began about the same time as current hard-market conditions.

Some, but not all, insurers have adjusted their claims handling just as they've adjusted their underwriting requirements, said Sam Boyer, vp of claims in Pasadena, Calif., for broker Sullivan Curtis Monroe.

Those insurers were easier to get along with during the soft market, more often deciding in favor of policyholders when minor doubts arose, Mr. Boyer said.

"But they have tightened up their claims handling," he said. "Where

it may have been easier to get a company to bend on coverage, it's not as easy anymore."

It's a trend the insurance industry veteran has seen during past hard markets, he said.

Some insurers now require more documentation before paying claims, perhaps information they should have required during softer times, Mr. Boyer said.

Others see tougher resistance on the part of insurers.

Insurers, more often, are denying claims with little investigation and offering only one or two reasons for

Continued on next page

Continued from previous page

the rejection, says Kirk A. Pasich, a policyholder attorney at the law firm Howrey Simon Arnold & White L.L.P. in Los Angeles. But once a policyholder sues for coverage, the insurer raises many more reasons for rejecting the claim and insists it needs to conduct significant amounts of discovery.

It minimizes the insurer's up-front claims investigation costs but pushes greater costs onto the policyholder, which must hire attorneys rather than settle its claim through an insurance adjuster, Mr. Pasich said.

"We are seeing denial letters with, say, two grounds for denial. Then you file a suit and, all of sudden, they are saying there are 15 or

20 grounds and now they need hundreds of pieces of financial data," Mr. Pasich said. "It's like a blindside attack, because the denial is premised on very narrow grounds and the coverage position for the lawsuit expands geometrically."

Mr. Passannante said he is witnessing greater attorney involvement in claims from the outset, although in a different manner.

Some insurers are hiring "outside" coverage attorneys to handle claims even before the insurers' in-house claims representatives attempt to resolve coverage requests.

The insurers essentially are using outside counsel and, sometimes, in-house counsel as claims handlers, Mr. Passannante said.

"It's a real problem, because out-

side counsel have different responsibilities than a claims person," he said. "A claims handler has an ethical obligation to be fair and do the right thing for a customer. As a lawyer, you have an obligation to represent a client zealously."

"If you have an increase in lawyers handling claims, it means you are going to have more problems with them, more difficulty getting your claims paid," he said.

To reduce the likelihood of those and other claims handling problems, Mr. Passannante suggested working closely with a good broker when purchasing the coverage. Use the broker to help determine the insurer's claims handling philosophy and ensure that it matches your expectations, he said.

Fraud: Self-insureds lag in investigation

Continued from page 10

"When customers take on more risk, the demand for services goes up."

Self-insured companies also can obtain fraud detection and investigative services from their third-party administrators, but they are not always available or such services come with an additional fee.

Often TPAs, especially smaller, regional ones, subcontract with outside vendors for fraud detection and/or investigative services.

But even if a TPA does provide fraud detection and investigative services, it is more likely to focus on large claims, Mr. Dotoli said. "A lot of the business is done on a per-file, fixed-fee basis," requiring claims adjusters to process claims as quickly and inexpensively as possible, he said.

"Some TPAs will throw \$1,000 at a claim worth \$10,000," but they are more likely to "throw big money" at claims over \$100,000, concurred Don Andersen, president of Corporate Surveillance & Investigations Inc., a Cary, N.C., firm that provides investigative services to insurers, TPAs and self-administered companies.

As an incentive for TPAs to investigate potentially fraudulent claims more aggressively, Mr. Dotoli suggests that companies allow their TPAs to switch to time-and-expense compensation.

Minding the store

Companies that are self-insured and administer their own claims are especially vulnerable to claims fraud because they're pretty much on their own, industry experts point out.

Today, fraud perpetrators "are sophisticated enough to know now there's nobody watching the store, in most cases, on a self-insured program," said Doug Osborne, assistant vp in charge of TPA Cambridge Integrated Services Group Inc.'s special investigation unit in Olympia, Wash. "The word gets out."

Fortunately, resources are available to self-insurers that also self-administer claims, such as ISO ClaimSearch, which is also used by insurers and TPAs.

ClaimSearch is a database of more than 320 million claims from a host of sources, including insurers, state workers compensation insurance funds, self-insurers, TPAs, fraud bureaus and law enforcement entities.

When a claim comes in, an adjuster can search the ClaimSearch database to cross-reference the claimant's information with that of other claims on file. By drawing such comparisons, it is possible to detect patterns, duplicate claims, phony addresses and other information, explained Richard Boehning, senior vp at ISO in Jersey City, N.J.

In some cases, self-insured, self-administered companies have programmed their in-house claims systems to spot potentially fraudulent claims.

"We use our RMIS to detect signs of abuse, such as a clinic that churns out bills," said Jeff Pettegrew, vp of risk management and insurance at Westaff Inc. in California. "Anybody with a sophisticated-enough system can" program a risk management information system to do it, he said.

But all companies, regardless of whether they are insured or self-insured, need to be especially vigilant

See **FRAUD**/next page

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Fraud: Self-insureds are especially vulnerable

Continued from previous page about potential claims fraud during tough economic times, insurance experts say.

"Human nature does change in times like these," lamented Mr. Dotoli.

Fraud business booming

While the industry has not conducted any formal studies connecting increased fraudulent claims activity to economic downturns, the Washington-based National Insurance Crime Bureau, which is supported by insurers and self-insurers,

has pegged the annual cost of insurance fraud at \$30 billion, including personal injury, workers compensation, auto repair and homeowners scams. Only tax evasion ranks above insurance fraud as the costliest white-collar crime, according to the NICB (*BI*, March 4, 2002).

Cambridge has seen some stepped-up fraudulent claims activity, said Mr. Osborne.

"We're seeing an increase (in fraudulent claims), as we normally do when the economy gets bad," he said. In particular, slip-and-fall claims and cases of foreign objects in food seem to increase during

tough economic times, as do workers compensation claims prior to mass layoffs and plant closures, he said.

Claims fraud is also occurring in health plans, with providers filing claims for services not rendered, or "upcoding" so that they can charge higher fees for services that normally would be reimbursed at a lower rate, said Adria L. Garneau, a senior consultant at NiiS/Apex Group in Salem, Mass.

"There are a lot more attempts at 'creative coding' today because reimbursement rates are down," Ms. Garneau said.

Even organized crime is getting into the business of defrauding insurers, TPAs and self-insured employers by stealing the identities of employees and billing their health plans, said Andrea Allmon, director of health care management at Fair, Isaac & Co. in San Diego.

Defrauding companies on small third-party liability claims is perhaps the easiest scam to get away with, especially if claims adjusters are encouraged to settle claims below a certain amount quickly, Mr. Osborne said.

"Claims adjusters look at it as a win if they can settle it for some

nuisance value. But if it's fraudulent, that's not a win; you lost," he said. And if the word gets out that a company pays small claims, it will become an easy target for fraud perpetrators, he added.

Even though it may not seem like companies are losing much on these nickel-and-dime claims, they can—and do—add up, pointed out Tim Fargo, president of Omega Insurance Services, an insurance investigation firm based in St. Petersburg, Fla.

"When people get that file-value myopia, there's a very dangerous piece to that. You can lose a million dollars lots of different ways. And the more likely one for you to get stung by is the dribs and drabs," he said.

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Costs: Employers re-evaluating integrated benefits

Continued from page 10 consultant with the Baltimore-based firm of GuilfordPare.

Both Mr. North and Ms. France say that 24-hour coverage may be re-examined in employers' sweeping quest to come to grips with current market conditions.

Twenty-four-hour coverage "can loosely be defined as any combination of traditional health insurance and workers compensation insurance that attempts to dissolve the occupational and non-occupational boundaries between the two coverages," according to the National Assn. of Insurance Commissioners' last report on the topic, which was issued in December 1999.

Beginning in the mid-1990s, the Kansas City, Mo.-based NAIC monitored and issued reports on efforts by individual states to implement pilot programs that tested various aspects of such coverage.

'Essentially, 24-hour coverage morphed into integrated disability management and that is now morphing into a broader integration of health and productivity-related programs.'

Wendy Manners
Specialty Risk Services

According to the NAIC, proponents of 24-hour coverage at that time emphasized the potential for employer cost savings in areas including medical care, administration and the avoidance of duplicate payments.

Opponents, though, found "major impediments" to the system, primarily due to its structure. For example, employers and insurers were reluctant to relinquish exclusive-remedy protections under the traditional workers comp system because they feared that increased litigation would drive up costs, according to an NAIC statement in its 2001 publication summarizing regulatory issues.

"Twenty-four-hour coverage is something from the past that has a lot of baggage," said Tom Parry, president of the San Francisco-based Integrated Benefits Institute Inc., a national research organization. As managed care techniques adopted in the late 1990s helped control medical costs, "employer and insurer interest in (24-hour coverage) evaporated, because it was price-driven rather than value-driven," he said.

Also, that process-driven approach has been supplanted by a goal-oriented one, he said. The discussion now has changed "dramatically" and focuses on an employer's investment in health, rather than its expenditures, he said.

Essentially, 24-hour coverage morphed into integrated disability management, and that is now morphing into a broader integration of health and productivity-related programs, said Wendy Manners, assistant vp of integrated benefits for

Specialty Risk Services, a unit of The Hartford Financial Services Group. The Hartford, Conn.-based insurer offers a program that combines workers compensation and short- and long-term disability, as well as the administration of the Family and Medical Leave Act.

The services offered under employers' integrated disability management programs may vary, though.

For example, a basic IDM program often seeks to coordinate employees' workers comp and short- and long-term disability leaves, as well as federal and state FMLA ab-

sences, regardless of the cause of the disabilities or the durations of the leaves. A worker with a health care claim crosses the threshold into participating in an IDM program when his or her ailment is of sufficient severity that it requires more than a few days away from work.

Meanwhile, UnumProvident Corp.'s program offers short-term and long-term disability coverages, in addition to coordinating absence management services with the assistance of other vendors, said Cissy Grebowski, vp-return-to-work services for the Chattanooga, Tenn.-based company.

In some cases, such a coordinated approach has netted a large employer a 30% decrease in its new long-term disability claims and a 25% decrease in lost work days, according to a UnumProvident statement.

Midland, Mich.-based Dow Chemical Co. is currently integrating several programs as part of its broad program to help workers.

"Our goal is managing the total amount spent directly for health care, as well as the more indirect costs, by including human performance as a component," said Dr. Cathy Baase, a physician who is re-

sponsible for the company's programs dealing with occupational health, health promotion and epidemiology.

The company also is engaged in a large-scale study of "presenteeism," which measures the extent to which employees are working, but not at full capacity, because of health-related reasons. Data are being collected anonymously by a third party and may be used in the future to develop educational programs, such as migraine management.

"The majority of (workers' health

See **COSTS**/next page

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AGENT/BROKER TOPICS

A MONTHLY EDITORIAL SECTION SENT EXCLUSIVELY TO AGENTS, BROKERS AND CONSULTANTS

Alternative Market Strategies



Buyers show interest, but how to do it?

Some producers seek assistance gaining access to nontraditional markets

By MARK A. HOFMANN

This much is certain: When markets turn hard, customers start looking for alternatives.

That notion was underscored by the Council of Insurance Agents & Brokers' "Commercial Insurance Market Index" for the fourth quarter of 2002, which was released late last month. Seventy-four percent of agents and brokers responding to the survey reported that they are turning to various alternative markets—surplus lines, captives and risk retention groups—more frequently than they had just three months earlier.

However, producers aren't always well versed in how to access those markets and how to make the best use of them for their customers. Experts in the field stress that placing business in alternative markets is not an easy business: It requires expertise, commitment and an understanding that getting involved in such tools as captives and risk retention groups is not for those seeking a short-term solution to a coverage problem.

"It's really amazing, given how important the alternative market is, that so many retail agents don't know much about it. Obviously, the knowledge increases with agency size. The bigger the agency, the more they're go-

ing to know about it," said Chris Burand, president of the Pueblo, Colo.-based agency consulting firm Burand & Associates Inc.

One source of assistance is fellow producers who have experience in such matters, say observers.

"Agents and brokers should talk to their colleagues who are doing some of these things—captives or other ART mechanisms," said Timothy J. Cunningham, a principal at agency management consultant OPTIS Partners L.L.C. in Chicago.

"We find some of our members who are willing to help others understand the basics of setting up a captive and the financial aspects," said Coletta Kemper, vp-industry affairs for the CIAB in Washington. Some CIAB members specialize in captive management and risk retention groups, she said, and producers sometimes can partner with other brokers or insurance companies that already have expertise in the field.

"We have a number of programs that we've set up over the years here to assist these clients in putting together a risk management program that we hope will provide them with a stable source of risk transfer. It's a marketplace that's grown quite large," said Anthony J. Campisi, president and chief operating officer of York, Pa.-based Glatfelter Insurance Group.

"At its simplest form, you'd be looking at working with a wholesaler," said Mr. Campisi. That's "the simplest way for any agent to access alternative risk transfer when the standard markets do not present an option."

But "beyond that, there are a variety of mechanisms. One is through working with affinity groups and associations who are interested in pooling their resources and forming risk retention groups or risk purchasing groups," he said.

'Agents and brokers should talk to their colleagues who are doing some of these things—captives or other ART mechanisms.'

*Timothy J. Cunningham
OPTIS Partners L.L.C.*

Another approach is to link up with insurers that have established alternative risk business units, he said. "You can work with a number of these companies to establish risk retention groups, risk purchasing groups or even captives."

But despite the increased interest in the alternative markets, other producers have not

contacted Glatfelter regarding access to the ART marketplace.

"I can't say that I recall we've ever been contacted by an agent to advise them or show them how to get into the ART marketplace," said Mr. Campisi.

Captive managers themselves are another source of expertise, said Mr. Cunningham of OPTIS Partners. But he warned that they have their hands full right now.

"Many of them will help and work with brokers that have a legitimate situation. The difficulty now, and really post-9/11, is that the market has turned so ugly that these service providers have just been swamped. It's pretty difficult to get in the queue now—you may just get lost in the shuffle," Mr. Cunningham said.

Producers "that are in great positions now were the forward-looking ones that saw ART as an option" before the market began hardening, he said. "They were in the ART areas before 2001."

"Given the hardness of the market, many insureds are starting to explore captive formation, so they go to their agent," said Jon Harkavy, vp and general counsel of Risk Services L.L.C., an Arlington, Va.-based captive management firm. "When you have a very hard market, you're not going to get commis-

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Tough times increasing captives' popularity / 16B

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AGENT/BROKER TOPICS

Alternatives: How to do it?

Continued from page 16A

sion for business you can't place, so sometimes this might involve the agent switching commission for fee-for-service," he said.

"If the brokers have some alternative market expertise, they're perfectly willing and able to talk to a client and discuss those options. But if a broker unfortunately does not, they tend to steer clients away," said George Steadman, executive vp of the Rutherford Cos., a Roanoke, Va.-based brokerage with offices throughout the mid-Atlantic and Southeast.

"You find that with alternative markets, there's a lot of buzz to it

and it's definitely sexy," said Mr. Steadman, who is president of Rutherford's Assurance Capital Corp. subsidiary, which deals with the alternative marketplace. "But you find that many clients, while they're willing to explore the possibilities, walk down the aisle but they're not willing to get married in the end."

Clients' cold feet often stem from a fear of getting locked into a complicated business they really don't understand, Mr. Steadman said. As a result, there is greater interest in group captives now, he said, because participants are part of a large base.

Once clients find that they can successfully finance their risks in a mechanism outside the transitional market, they generally find it is an efficient approach, said Glatfelter's Mr. Campisi.

But he warned that it differs from the traditional market, that programs cannot be shopped every year.

"The alternative risk transfer is not for the faint-hearted—it is a long-term proposition. It works best for those risks that truly have a focus on loss control and maintaining the best eligibility standards for who they may be partnering with," said Mr. Campisi.

Captives gaining in popularity amid market constriction

By MICHAEL BRADFORD

Brokers that provide access to captives or help clients form such vehicles are finding that the hard market is good for that end of their business.

In a marketplace that began constricting even before the Sept. 11, 2001, terrorist attacks made coverage even more scarce, insurance buyers are looking for ways to reduce costs. And the popularity of captives and other alternative market strategies often grows under such market conditions.

"The demand is large," said Thomas Golub, president and chief executive officer of Hobbs Group L.L.C. in Atlanta. "We don't see it moderating," he noted. "It seems to be consistent."

In fact, Mr. Golub noted, "the demand we are seeing is a little broader than just captive services" and includes other alternative funding mechanisms.

Many buyers have raised deductibles and retentions so high that they "want to explore the financing of those," he said. And a captive is a mechanism that can provide such financing.

"We've seen increases in both the formation and utilization of captives," said Lisa Wall, senior vp-account executive with Lockton Cos. Inc. in Kansas City, Mo. "It seems that anyone who has a captive is looking for additional ways to use it."

A lot of risk managers looked at captives in the past but decided they didn't make sense based on their business needs and the marketplace conditions at the time, said Mark Moreland, senior vp at Lockton. "They want to validate now whether it does," he said.

Mike Chapman, executive vp with broker Hub International Ltd. in Wilmington, Mass., said the hard market has prompted more middle-market accounts to consider captives and other alternatives. "We see a lot more buyers becoming more sophisticated," he said.

Many of those clients are being advised by their accountants, attor-

neys or other service providers to look into alternatives, Mr. Chapman said. "They are being told to do this as a way to smooth out costs."

Hub is seeing strong interest in segregated-cell and group captives, according to Mr. Chapman. He said "tougher products" and transportation risks are among those that policyholders want to insure in such companies. Hub offers coverage written by segregated-cell companies in Bermuda and Cayman.

'We've seen increases in both the formation and utilization of captives.... It seems that anyone who has a captive is looking for additional ways to use it.'

Lisa Wall
Lockton Cos. Inc.

Mr. Golub said Hobbs Group clients are interested in a range of vehicles, with the type of captive dependent on the particular insurance buyer's needs.

And, those that already have captives in place are "probably funding more risk through them than they were three years ago," when market conditions were softer, Mr. Golub noted.

"Some people got surprised in '01 and '02," by significant price increases and changes in deductibles and retentions, he said. "They didn't have time to do feasibility studies" to determine whether a captive would work but are now able to address those issues, Mr. Golub explained.

Ms. Wall agreed that the types of captive being formed and the lines of coverage they write are varied and depend on the particular client's needs. "Workers comp is one of the more popular lines, but we see general liability, auto and some property," she said.

Although the lack of fronting companies has become an issue of

late, it hasn't stopped brokers from exploring captives as an alternative for their clients.

"Everything in today's market is a little more difficult," said Ms. Wall. "It's just depends on the risk and what you are trying to transfer."

"There are less people that want to front," Mr. Chapman said, which means more work is involved in finding a fronting company when putting the captive together.

Rising reinsurance costs also have hit captive participants. But, as Mr. Chapman pointed out, it's simply managed as an expense that is part of the program.

He said captive owners also must be prepared to put up capital and share financial information. "If you don't capitalize it up front, it is doomed to failure," he said. Sharing information has become a concern for some, Mr. Chapman added, particularly when a group captive is being formed by participants in similar or competing businesses.

Mr. Moreland of Lockton pointed out that captives aren't right for everyone. A lot of potential owners "think a captive is a magic bullet," he said. "It really isn't. It's an alternative that can make sense for the right company."

Most companies don't get further than the feasibility study, with roughly one in five ending up in a captive, Mr. Moreland said. The other four determine that the economics of the situation don't warrant the use of a captive.

And not all brokers report a surge in interest in captives.

"We've not heard much from our brokers about their customers asking for that kind of opportunity in this hard market or even initiating any captive formations of any kind," said William Robinson, executive vp at Stamford, Conn.-based Alliant Resources Group Inc.

Insurers, he said, are not as vocal about broker participation in captives as they were during the soft market, he added. "Insurance companies have become silent on the notion of brokers having some skin in the game. Those discussions have gone quiet in this market."

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AGENT/BROKER TOPICS

Risk data exchange aims to improve transactions

By SARAH VEYSEY

Project Blue Mountain, a Lloyd's of London-backed electronic information exchange designed to increase efficiency and reduce costs for insurance buyers, brokers and underwriters, will be launched during the first quarter of this year.

Through the system, retail brokers will input risk data and make it available to wholesale brokers. Wholesalers can, in turn, transmit the information to Lloyd's underwriters. The information will be keyed in only once and will be securely tracked, said Ashok Gupta, chief executive of the project.

The system, which will be rolled out in "slow and steady" stages during 2003, will be renamed, Mr. Gupta added. The Blue Mountain project name was a nod to Lloyd's of London's historical origins as a coffee shop, he explained; "blue mountain" is a type of coffee.

While the project initially will focus on increasing business at Lloyd's, it is expected eventually to expand to other insurance markets, he said.

The initial round of funding for the project was provided by Lloyd's, and the market's chief executive, Nick Prettejohn, has publicly backed the project.

"The very enthusiastic backing of Lloyd's is key. It gives us credibility," said Mr. Gupta. But, during further rounds of funding, new investors may be sought. A broader shareholder base will likely be added as the project develops, he noted. And users will also help to fund the system.

Mr. Gupta said the project was born after research undertaken by the Blue Mountain team revealed an alarming number of processing errors in insurance policies. "We did some analysis and worked out that 50% of every policy processed contains errors, and 65% of those errors are caused by rekeying," said Mr. Gupta.

"For every £100 spent in commercial insurance, 10% of that is frictional costs," said Mr. Gupta. "There are huge inefficiencies."

The team's 18 months of research showed that something was needed "to enable people who trade with one another to communicate risk data electronically."

The Blue Mountain project team now has about 50 "launch companies," Mr. Gupta explained. These include brokers and insurers in the United States and the United Kingdom, he said, though he declined to identify any.

Once several of those companies have been "taken live" with the system, other users of the system will be lined up, he said.

Despite Lloyd's financial backing and involvement in the early stages of the project, the Blue Mountain system will not be Lloyd's-centric, Mr. Gupta noted, and will not be restricted to Lloyd's-licensed brokers and underwriters.

The Blue Mountain technology will "fit around existing systems—the way people already

hold their data," said Charles Moore, marketing director of the project. The technology used is similar to that used in other industries such as securities trading, he explained. "We don't want (users) to have to worry about how it works, so we have built our team around technological skills and people skills," he said.

"We realized we needed to be adaptable," said Mr. Gupta. "We asked what systems and processes people have and how they hold their data. We don't force you to hold your data in ways you don't want to."

"It is great news for brokers, because it is using their existing systems," added Mr. Gupta. A system such as Blue Mountain does not disintermediate, he said, adding that "commercial lines is a naturally intermediated market where brokers bring value to the customer."

Blue Mountain will bring several advantages to brokers, Mr. Gupta said. First, it will reduce costs and increase productivity; second, it will help brokers reduce their own errors and omissions exposures; and third, it will enable brokers to improve the service they offer

clients, he claimed.

Project Blue Mountain will also free up time for brokers, Mr. Gupta said, and allow risk information to be efficiently and speedily passed to all participants in a transaction.

And it is hoped the system will enable U.S. brokers to place more business at Lloyd's, he added.

The system will provide greater efficiency for insurance buyers, too, claims Mr. Gupta. It will speed up business completion and minimize conflict and confusion, he said. Blue Mountain will enable buyers to capture pertinent information, and will provide a clear audit trail,

he noted.

The system will comply with ACORD data standards, said Mr. Gupta. "We are not imposing our own standards on people. ACORD is fantastic, so let's fit in," he said.

The system is intended as an information exchange and not a mechanism to bind business online, Mr. Gupta noted.

"We are here to help people communicate, not do business online," he said, drawing a distinction between Blue Mountain and some other technology developments in insurance and reinsurance.

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AGENT/BROKER TOPICS

Preparation essential before approaching underwriters

By Steven Davis

Hard markets drive equally hard decisions. Their difficult terms and conditions, for example, can drop agents and brokers and clients into sweet dreams of sailing off to greener shores—in alternative markets.

Unfortunately for many, those



are only pipe dreams. The wiser player, before responding to that siren call, should first consider a few hard facts.

First of all, there's the hard light of recent industry history, something I can address with experience, having been through three hard markets in my career. The illustrations I'll draw here are largely from the area with which I'm most familiar: construction risk management.

As in so many areas, the construction industry marketplace over the past 10 years has been very, very competitive from the insurance perspective. In dealing with that marketplace, insurers failed to focus on properly underwriting risks, often ignoring basic safety management protocols, for instance. It didn't seem to matter what the loss or safety record looked like; prices went down anyway.

A/BT Perspective

But that's all changed now. Today, there's a tremendous capacity shortage and only a few dozen underwriters who will even consider looking at a construction account. When they do, they now pay close attention to safety management protocols and scrupulously examine factors such as its loss record, the radius of its driving fleet, the management's philosophy, its quality initiatives and so on.

To top it off, pricing is in inverse proportion to the shortage of players. The model shows prices moving up from 10% to 25% all the way to 300% or 400%. There's just no gauge on it any longer.

One thing is certain: Contractors who burned bridges in the competitive pricing cycle will find underwriters who may not want to look at their programs. In their world, the worm finally has turned.

Clearly, then, the tools of the generation that came in 10 or 12 years ago will not work today. It's time to get back to some basic, tried-and-true methods if you want to attract attention, whether you're using an alternative risk financing method or a traditional underwriting facility.

With this as backdrop, let me pass along these tips from my own experience to my fellow producers, who, like me, are struggling to come to grips with this difficult, changed environment.

Be thorough

The information you present to

the underwriter and the format in which you present it should clearly and carefully delineate the activities of the risk.

The very first thing we submit, for example, is a page-and-a-half "chairman's letter" from the client to the underwriter, setting forth his or her business philosophy and role in safety management and citing quality initiatives that have had an impact on safety and profit. The letter sets the tone for the rest of the submission and is designed to show high-level interest and commitment.

There follows a construction exposure analysis, a risk profile that anticipates and answers every question that an underwriter could possibly ask about a client's operations in the submission format. That's my responsibility as a broker, because if I show the underwriter that my client is better than others the carrier is writing in this class, my client should get a better price.

Next we explain the relationship among the client construction firm and the subcontractors and owners. In such "upstream contracts," we have to manage the risk we're taking on through the contracts with the owners, and/or general contractors and multiple subcontractors. Underwriters are paying particular attention to the subcontract/purchase orders of contractors, and the conditions of each can affect not only the rates charged but also whether they will offer terms at all.

Finally, we carefully audit this process before going to market. I have the feeling that 90% of brokers don't do this, but if I don't show that the contractor has very good practices and protocols and that staff is reinforcing the subcontract management process, I'm not going to get the best deal. This one audit event and process is the most effective way to approach both traditional and alternative markets.

Go the extra mile

In this market, you have to go further than before. In the past, we often would show loss runs to the underwriter in excess of a set amount as well as reserves. But now we also demonstrate what

management actions have been taken by the prospective insured to prevent a loss incident from ever happening again—for example, the cessation or sale of a piece of troublesome business or the institution of a particular quality safety program.

These are extremely critical steps today, ones that we haven't taken in the last 10 to 12 years. It's important that we do so now.

All too frequently, doing business with a captive facility is like putting a Band-Aid on a gunshot wound.

Choose wisely

Only at this point is it time to choose a market strategy, to decide whether to go to the traditional or alternative market.

It's a key decision. To illustrate how important, take the matter of guaranteed cost insurance, which isn't readily available to contractors to begin with.

Right now, the contractors least adversely affected in the insurance marketplace are those who never bought into the guaranteed cost concept. They are already in the alternative market, already taking significant retentions on their liability and workers compensation, and already managing their losses—some more formally, via captives, and others through cash-flow methods. They made the wiser choice.

Sure, they've experienced some swings in rates over time, depending on losses, but nothing like the whopping increases in price and retentions of those who went for guaranteed cost. The \$50 million contractor, for example, who had a guaranteed cost last year for which he or she paid \$300,000 to \$400,000 might now be paying \$800,000 in premium with a \$100,000 deductible. The better brokers and the better clients already had that figured out.

Clients buy insurance the way it's being sold. It's our responsibility to guide them to the right choices. Price in this marketplace is not a large selling point. What we've got to do is help clients cut cost, and that is a completely different approach. There are lots of things we can do to help them to reduce their exposures and their losses.

No free lunch

A big trend on the alternative side these days is the flight of construction risks into the captive market, a move that is often wrong. The captive market is viewed as a panacea in the current environment, which it's not.

Contractors often want something to jump into during the heat of the fire, but captives are long-term risk financing methods that exacerbate the client's

problems. There's no free lunch out there, and no free deals. All too frequently, doing business with a captive facility is like putting a Band-Aid on a gunshot wound.

If losses are bad and management is bad, life will be no better in a captive than it was with, say, St. Paul or Zurich. Clients also stand to lose long-term relationships for cheap buys and perhaps short-term solutions. So they should first look in the

mirror, then take a second look, before they leap, focusing on making the necessary changes that would affect them favorably no matter which funding method is chosen.

Keep nose to the wind

There are a few other trends in my own market that are worthy of tracking.

Large wrap-up or owner-controlled projects have been profitable for the industry. Why? They reduce redundancies in the process and eliminate a lot of the action-over claims or litigation, because everything is written under one master policy.

This trend will continue to grow, not only because it reduces losses but because an owner and a contractor can manage cost better, as well as fix over a period of two to three years the risk transfer cost on a large segment of business.

Another trend is that large contractors are beginning to start their own captives, in the face of rising premiums and deductibles, to smooth out the spikes in the marketplace.

They're also joining rent-a-captives as another way to get insurance, a trend that concerns me. If you're not an expert on this, why share your business on a blind basis with people whom you don't know and who may not share your focus on safety and claims?

And contractors are looking not only to single-parent captives. We're seeing a trend of contractors banding together in groups of six to 10 and starting their own group captives that focus on construction concerns in the areas of safety management, claims controls and contracts.

Whatever you do and however you do it, though, it bears repeating that, in today's hard marketplace it's best to get your own house in order first. If you don't do that, nothing else matters.

Steven Davis is a director of construction risk services for McGriff, Seibels & Williams Inc. in Birmingham, Ala., an Assurex Global partner.

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Costs: Re-evaluation Legal bill auditors offer help in cutting litigation costs

Scrutiny of billing also can curtail duration of claims

By MICHAEL PRINCE

Continued from previous page care) costs may be related to presentism," but that is more difficult to quantify than production-related benchmarks, said Bank One's Dr. Burton.

His major focus, though, is on integrating a wide range of employee health programs, including short-term disability, wellness, fitness centers, worksite nurses and leave under FMLA. In addition, the bank offers an array of programs to enhance employee health, including free flu shots and lunchtime discussions about managing diseases such as diabetes. Another educational program for pregnant women pro-

motes their health and that of their babies.

These educational programs are coordinated with other bank programs that provide long-term disability, workers comp and health benefits, he said.

Mergers and acquisitions over the past seven years have allowed the bank to demonstrate that worker disability costs generally can be reduced by about 20% through such coordinated programs, he said.

Underlying Dr. Burton's educational program is the fundamental belief that "employees want to feel better, and they want reliable information about health," he said.

As the cost of litigating claims rises, more employers and insurers are looking at strategies to help reduce the amount they pay to outside attorneys.

Perhaps the most common approach involves bringing in an outside consultant that specializes in auditing attorneys' bills. These con-

sultants help companies and insurers set guidelines for outside law firms to follow and scrutinize the attorneys' bills for errors and charges outside of the prescribed guidelines.

The need to control outside legal costs is greater than ever. A survey released in 2002 by PricewaterhouseCoopers that looked at 207 companies with in-house counsel

shows that median outside legal costs stood at \$12.5 million during 2001. Outside legal costs had a median increase of 9.2% in 2001, with litigation costs rising even faster, the survey states.

A growing trend among legal consultants has been to monitor every bill as it comes from the attorneys instead of performing a billing audit only after the case has ended, said John Marquess, president of Legal Cost Control Inc. in Haddonfield, N.J. "It's a lot more proactive," Mr. Marquess said.

The first year after adopting such a program, a company can see savings of 10% to 20%, Mr. Marquess said, with the exact amount varying by how aggressively the client had previously been monitoring its spending.

In subsequent years, companies can expect to see savings of 4% to 7%, as the firms keep their work within the guidelines set by the client, he said.

Billing guidelines are the key to any litigation cost control program, experts say. When they are established, "the costs will simply go down," said Mark Noonan, managing director at Marsh Inc. in Boston.

With guidelines laying out both the client's and the attorneys' responsibilities, the entire process of claims management becomes more efficient, resulting in "legitimate savings," Mr. Noonan said.

In addition, the guidelines can specify which law firm personnel should be assigned to a particular case, making work by others non-billable. They can also set prices for copying, faxing and other expenses. And the client can specify which types of research are permissible or whether approval is needed before such research can be undertaken, Mr. Marquess said.

While Legal Cost Control will provide a client with some general guidelines, the client sets the final rules. "They can be as broad as your imagination," Mr. Marquess said.

Mr. Noonan cautioned against using auditing firms whose fees are based on the amount of money they shave from the legal bill, because it creates too great an incentive to slash the bill. "They may be challenging too much," he said.

"A flat fee or per bill review, without any incentive to beat counsel to death, is probably, in the long run, better," he said.

Mr. Noonan, who helps companies develop litigation management strategies, said an in-house program requires coordination between the legal department and the risk manager. On some types of claims, it's also appropriate to involve operations managers, he said.

Saving time and money

The Enron Corp. bankruptcy proceedings provide an example of a
Continued on next page

Continued from previous page

legal consultant in action. In 2002, the law and accounting firms working for Enron submitted bills to the bankruptcy court for almost \$56.4 million. Legal Cost Control scrutinized those bills and disqualified fees and expenses of more than \$4.1 million, or 7.3% of the total costs, bankruptcy records show.

Besides saving money, outside legal service auditors also free up in-house attorney time, said Janet Dongarra, former director of legal administration at Heller Financial Inc. in Chicago, a unit of General Electric Co.

Using Legal Cost Control allowed Heller's own staff "to focus on the strategic opportunities and not how to pay a legal bill," Ms. Dongarra said.

Through the auditor, Heller Financial was able to reduce the number of its outside law firms, from more than 400 to fewer than half that, and to save about 15% of the \$40 million it spent annually, she said.

Heller Financial also selected its best-value law firms and funneled more business to them, eventually placing about 85% of the company's spending at its top 10 firms, she said.

Another strategy to control costs is to have one law firm handle most of a client's legal work while overseeing the work performed by other firms, Marsh's Mr. Noonan said.

"They know the client's dos and don'ts," he said. "It's an extremely efficient way of doing business."

A new billing approach

But Mario Ciano, managing partner with Reminger & Reminger in Cleveland, pointed out that auditors fail to alter the way outside lawyers are paid and, thus, don't truly resolve the problem of rising legal costs. Rather than pay attorneys an hourly rate, he said, lawyers should receive fixed fees.

"They're taking the wrong approach, because the client itself has taken the wrong approach," Mr. Ciano said.

"You get what you reward," he

said. "If you reward time, that is what you will get."

A fixed fee, either for an entire case or for each segment of the case, aligns the incentives of the client and the attorney, Mr. Ciano said. It motivates the lawyer "to solve the problem with the least amount of time and the least cost to the client," he said.

Reminger & Reminger handles about 80% of its medical malpractice defense cases on a fixed-fee billing basis. In some cases, the firm makes less money than it would through hourly billing; in other cases, the firm makes more. But in the long run, both the firm and the client come out ahead, Mr. Ciano said, because they develop a strong relationship based on trust.

"What you are doing with the fixed fee is sharing risk," he said. One legal consulting firm has put

Paying an attorney on a fixed fee basis, rather than on an hourly basis, motivates the lawyer 'to solve the problem with the least amount of time and the least cost to the client.'

Mario Ciano
Reminger & Reminger

in place a program using the fixed-fee concept.

Examen Inc. in Sacramento, Calif., launched its LegalPath program in 2000. Since then, more than 50,000 cases, mostly litigated claims, have been run through the Web-based service, said Kipp Johnson, Examen's chief executive officer.

The program reduces billings by about 40%, he said. In addition, the costs of settlements and jury awards have also dropped by about 40%. This stems primarily from shortening the length of a case, on average, from about two years to about nine months, Mr. Johnson explained.

"The longer a legal matter goes on, the more something can go wrong," he said.

With LegalPath, attorneys post

on Examen's Web site their rates for each stage of a case, along with their resumes and work experience. The companies or insurers review the list of attorneys and make their selections based on the attorneys' prices, expertise and past dealings with that firm.

"It creates a marketplace in the location for these legal services," Mr. Johnson said.

The system works best for cases with which the attorneys are familiar, so that they can accurately forecast how much time and effort a given case will require. But Mr. Johnson said he has found the use of the fixed-fee system is not limited to just certain types of cases. "It's applicable in all areas of law," he said.

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Mr. Alfieri



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Brokers:

John J. Alfieri has been named executive vp and managing director of Willis Risk Solutions, Willis Group Holdings Ltd.'s North American large-account practice. Mr. Alfieri joins Willis from Munich-American Risk Partners, where he was executive vp.

Michael P. Sabanos has been appointed to the newly created position of director of mergers and acquisitions at Hub International Ltd. Mr. Sabanos has been employed for the past six years by New York-based Kaye Group Inc., Hub's largest subsidiary, where he is executive vp and chief financial officer—positions he will retain.

Another Hub subsidiary, C.J. McCarthy Insurance Agency Inc. of Chicago, has hired **David DiPerna** as executive vp in charge of the broker's risk management/alternative financing division. Mr. DiPerna most recently served as a senior vp at Aon Corp.

Timothy Jablonski has been named senior vp and chief operating officer at Lockton Insurance Brokers of San Diego Inc. Mr. Jablonski, as one of the founding members of Lockton Cos. Inc.'s new San Diego office, will be responsible for insurer relations, human resources and management of commercial insurance. Prior to joining Lockton, Mr. Jablonski spent more than 20 years with Marsh Inc.

Insurers:

Carol A. Harnett has been named national practice leader for group disability and life insurance for The Hartford Financial Services Group Inc.'s group benefits division in Simsbury, Conn. Ms. Harnett, a clinical psychologist, has been with Hartford since 1996, most recently as director of wellness and ability management.

Gary Bakalar, formerly national accounts regional manager in New York for American International Group Inc., has joined XL Winterthur International America Insurance Co. as country manager-United States. Mr. Bakalar, who will be based in New York, will have management responsibility for all of XLWI's U.S. offices.

James C. Tudor has been promoted to executive vp of the California State Compensation Insurance Fund. Mr. Tudor previously served as vp of the executive committee for the Sacramento, Calif.-based competitive workers compensation state fund.

Elizabeth M. Lestan has been named head of Zurich Global Energy's Risk Engineering, a unit of

Schaumburg, Ill.-based Zurich North America. Ms. Lestan, who will be based out of Zurich Global Energy's New York office, was a senior risk engineer in Zurich North America's services unit.

William Robert Berkley Jr., a senior vp of W.R. Berkley Corp. of Greenwich, Conn., has been named to head the company's specialty insurance operations. Mr. Berkley succeeds Edward A. Thomas, who will consult for the company on special projects.

Donald Lee has been named senior vp of AIG Trading Group Inc., a member company of New York-based American International Group Inc. He will serve as AIG Trading's global head of foreign exchange options and head of foreign exchange in Greenwich, Conn. Mr. Lee previously was a managing director at Goldman Sachs & Co.

Other:

The national law firm of Kirkpatrick & Lockhart L.L.P. is expanding its Boston office with the additions of **Michael S. Greco**, **Thomas A. Hickey III**, **Nicholas S. Hodge** and **Michael Sacco** as partners. All are formerly of Hill & Barlow.

Shelly Wolff has joined Watson Wyatt Worldwide as the firm's national leader of health and productivity for the group health care practice. Ms. Wolff, based in Watson Wyatt's Stamford, Conn., office, will focus on employee productivity, workforce effectiveness, benefit design and strategic planning for Watson Wyatt clients. She previously was leader of absence management programs at General Electric Co.

Dr. Rene Lerer has been named chief operating officer of Magellan Health Services Inc. Previously, Dr. Lerer was president of Internet Health Group, an organization he co-founded.

Joe Girardi has been named head of client and technical services at Pilat NAI, a human resources software firm in Lebanon, N.J. Mr. Girardi formerly was a project manager at Electronic Data Services.

Business Insurance would like to report on senior-level changes at commercial insurance companies and service providers. Please send news of recently promoted, hired or appointed senior-level executives to: Joanne Wojcik, Business Insurance, 777 E. Speer Blvd., Denver, Colo. 80203-4212; jwojck@crain.com. Photos should be sent to: Kathy Barnes, Business Insurance, 360 N. Michigan Ave., Chicago, Ill. 60601-3806; kbarnes@crain.com.

February 3, 2003

Employers taking steps to manage hospital costs

By JUDITH NEMES

Employers like Aircraft Gear Corp. may be clairvoyant. Months before two studies singled out soaring hospital costs as the main culprit behind rising health care spending, Aircraft Gear and 50 other companies in a health insurance purchasing group had taken steps to reduce payment rates to hospitals.

Last spring, the coalition added a contract provision to pay hospitals a lower rate if a member is readmitted soon after discharge because of a complication from the initial care, explained Jim Knutson, risk manager for Rockford, Ill.-based Aircraft Gear, which manufactures components for cars and airplanes.

"We're taking an approach of purchasing health care for value as opposed to purchasing for a constantly rising unit price," he said. The purchasing group provides self-insured health benefits to 60,000 employees and dependents in Rockford and some Chicago suburbs.

Rising pharmaceutical costs were once blamed for steep increases in health care spending, but hospitals are on the hot seat now. A national study commissioned by the Chicago-based Blue Cross & Blue Shield Assn. found that hospitals contributed to rising costs more than any other health care sector. Another study by a Washington-based research group echoed those findings.

Indeed, benefit costs increased an average of 15% in 2001 and 2002, said Linda Ruth, senior health care strategist at Hewitt Associates inc. in Lincolnshire, Ill.

The Blues' study, released in October, showed inpatient costs grew 5.9% annually between 1998 and 2001. The overall rise accounted for 34% of the increase in health care spending—the largest portion among all health care categories.

The study found higher prices for hospital services despite hospital and health system consolidation, which should have led to lower charges. The report noted that for every 1% increase in market share from consolidation, there was a 2% jump in inpatient charges.

A separate study published in the fall by the Center for Studying Health System Change in Washington reported that hospital costs accounted for the lion's share of a 10% jump in health care spending in 2001. Expenditures on inpatient and outpatient care rose 12% in 2001 from the year before, accounting for more than half of the overall spending increase, said Paul B. Ginsburg, president of the center and co-author of the study. He notes that loosened managed care restrictions have allowed patients to seek more hospital services.

Some Chicago-area hospital executives are bristling at the reports.

Earl Bird, president and CEO of the Metropolitan Chicago Healthcare Council, which represents 98 area hospitals, says the Blues' study deflects attention from insurers that make hefty profits without passing savings to employers.

Administrative and other savings do occur when hospitals consolidate, but they're outweighed by un-

related cost pressures, such as underpayments from government payers, labor shortages that have led to higher wages for nurses and skyrocketing rates for malpractice insurance, Mr. Bird said.

"If hospitals were driving costs up and doing it with any lack of care for the community, you'd be seeing 8% to 9% operating margins, and that's just not happening," argued Gary Fennessy, vp of finance at Northwestern Memorial Hospital in Chicago.

The hospital reported a 3.5% operating income margin in fiscal 2002, up from 2.7% the year before,

he said. And a survey conducted by MCHC found that about 60% of Chicago hospitals had average operating margins of 3.65% for the first nine months of 2002.

The Blues' study also found that hospital overspending on technology was driving higher costs. Doctors and hospitals want the latest equipment, but the volume of tests or procedures may not substantiate the need for the investment.

To reduce costs, some insurers have crafted hospital networks with tiered copayments. Plan members pay more for tests and treatments at more expensive hospitals.

Workers have been insulated from much of the rising cost, but some employers are requiring them to share more of it, said Hewitt's Ms. Ruth. Health maintenance organization enrollees may have to pay deductibles for hospital stays, and HMO and preferred provider organization enrollees may have higher copayments, she said.

Blue Cross & Blue Shield of Illinois is trying to contain costs by requiring hospitals to submit quality report cards before contract renegotiations, said Brad Buxton, the health plan's senior vp of health care management in Chicago.

"We're telling hospitals that we're willing to pay them more only if they're willing to improve certain clinical outcomes," Mr. Buxton said.

The Chicago Business Group on Health is assembling a coalition of hospitals for a pilot program this year to collect uniform patient satisfaction data that employers can tap next fall, said Larry Boress, executive director of the nonprofit employer group.

Judith Nemes is a reporter for Crain's Chicago Business, a sister publication of Business Insurance.

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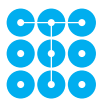
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Uncertainty plaguing insurers

By Myron M. Picoult

Within the first week of the year, as we were chattering with industry participants and gurus, we were struck by a vision.

We were confronted with the image of Spike Jones and his band playing "Cocktails for Two" with all of the lunacy that accompanied their performance. Intermingled with that was the sight of classic comedian Ernie Kovacs and his accomplices performing their infamous routine of the Nairobi Trio with their deadpan faces.

Finally, running through these two commingling "videos" were the Roadrunner and Wile E. Coyote, holding the stick of dynamite just as it was about to explode! In an instant it was obvious that there was a tie here to the property/casualty industry and its penchant for chaos.

It should not come as a surprise to anyone in the industry that there would ultimately be a natural deceleration in pricing. Nonetheless, even though the industry has been through this several times, it always seems to come as a shock. Industry observers were very focused on the recent Travelers Property Casualty Corp. earnings release, its \$2.0 billion asbestos charge and how the charge and the incisive disclosure were likely to put pressure on other carriers in terms of both absolute dollar reserves for asbestos and their own prospective disclosures. Subsequent earnings releases have borne these points out.

From our perspective, however, the key story from the Travelers release was the information about seeing moderation in rate increases.

In a previous column, we referred to industry dynamics as an "endless transition." Some have called it a period of profitless prosperity. To be sure, investors have been disappointed that an industry that began to raise prices in the fall of 1999 has not yet produced meaningful bottom-line

Taking stock

results. This underscores the horrendous deficiency in pricing and the underwriting sins of the 1990s, all exacerbated by various Murphy's Law components that always arise at the worst possible moments. This would include not only reserve shortfalls, but also a precipitous decline in the yield curve, in some instances too heavy a reliance on returns from alternative



investments and a much tougher—but needed—stance from the rating agencies. Many managements (if they are still around) must be taken to task not only for the degree to which they compromised their balance sheets, but also for not reining in earnings expectations over the past few years that were unattainable.

Considerable progress has been made by most companies in addressing their problems. Some have done a better job than others, and that will become obvious over the next year or so. However, there is a gnawing concern that some will once again succumb to the market-share syndrome at the expense of profitability. While projected returns in some lines may be approaching sufficiency on an accident-year basis, calendar-year results leave much to be desired for most underwriters. Hence, one can clearly argue the need for rates to at least be sustained if not to continue to rise, albeit at a more modest pace.

The industry is walking a fine line. On one hand, a continuation of stark rate increases could alienate clients who are struggling with their own economic stresses and could encourage more to "shop around" or seek alternatives to traditional insurance. On the other side of the coin, we have an industry that is counting its pennies when only a few years ago it was flush with capital.

Much attention has been paid to environmental and asbestos problems that have beset the industry. Some of the difficulties are of insurers' own doing, but some are the result of numerous unforeseen twists in what and how coverages are now being defined. Not enough attention has been paid to the development of business written from 1998 through at least 2001, and, in some instances, into last year too. Adverse development belies subsequent rate trends and loss picks. One has to wonder whether this has been sufficiently addressed by carriers that are currently capital-short, and it raises the question of whether too many underwriters at this juncture are just order-takers.

And there is yet another factor: the mark-to-market accounting cloud that covers a whole host of things, including derivatives and reinsurance recoverables. How many balance sheets can absorb that pressure?

We applaud the general industry move to go back to basics and focus on what management refers to as "core competencies." However, one wonders whether the corporate machines have been sufficiently downsized to offset the need to "...feed the machine" and whether managements will accept the thesis that "smaller but more profitable" is better than "bigger with a shrinking prospective profit base."

Logic suggests that industry earnings in 2003 should be better than they were in 2002, even adjusting for a relatively light level of catastrophe losses in 2002. However, the true fruits of the industry's labors may not really show until 2004 and 2005. We wonder what phrase will be substituted for the "...but for" comment in 2003.

Myron Picoult is an advisor to Lazard Freres & Co. in New York. He is a past president of the Assn. of Insurance & Financial Analysts and a member of the New York Society of Security Analysts. An archive of Mr. Picoult's columns for Business Insurance can be viewed at: www.businessinsurance.com.

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NAIC: Guarding state authority

Continued from page 4
ing, he said.

In regulating market conduct, "we should have more effective and efficient market conduct examinations in which states work together," said the 41-year-old attorney. Such cooperation is especially important to regulators from small and midsize states that lack the resources of larger states, he said.

Arkansas' \$8.8 million budget for 2003 makes it the 26th largest insurance department.

Mr. Pickens said that another of his priorities is monitoring price increases related to terrorism coverage.

In addition, he said he believes that the development of product standards for the new Interstate Insurance Product Regulation Compact "will give large states a greater comfort level with the concept of the compact" (BI, Dec. 16, 2002).

Meanwhile, Mr. Pickens said he has been told that about a half-dozen states plan to introduce legislation to participate in the interstate compact during their current legislative sessions.

In other areas, Mr. Pickens said he plans to visit China, "to put some meat on the memorandum of understanding" that was signed last year. Under that agreement, U.S.

regulators will offer advice to their Chinese counterparts as that nation liberalizes its insurance market.

Mr. Pickens is currently serving his second four-year term as commissioner, following appointments by Republican Gov. Mike Huckabee. He previously worked as a partner in the Little Rock law firm of Friday, Eldredge & Clark.

He received his law degree from the University of Arkansas at Little Rock and a bachelor of arts degree from the University of Mississippi in Oxford.

Mr. Pickens is married to a high school science teacher and is the father of two children.

Commute: Employer not immune

Continued from page 4

complaining of a headache and nausea after a pesticide company sprayed Minimed's facilities the night before, according to court papers. Before she left work, Ms. Hernandez's supervisors asked her whether she was well enough to drive home and whether she needed a doctor. She maintained that she was able to drive, court papers show.

Under a wide-reaching California legal doctrine known as respondeat superior, an employer is liable for injuries that employees cause others in the course of their work.

But a "going-and-coming" rule generally exempts employers from liability for injuries caused by employees commuting to and from work. A trial court relied on the rule and granted a summary judgment in favor of Minimed.

But the state appeals court in Los Angeles found that the going-and-coming rule is not ironclad and held that Minimed's case falls under an exemption to the rule. The

appeals court reversed the trial court's summary judgment, allowing Ms. Bussard's lawsuit against the employer to continue. The case will now return to trial court.

The exemption to the going-and-coming rule applies when an employee endangers others because of

California employers generally are shielded from liability for injuries caused by commuting employees, unless an employee endangers others because of a risk arising from the workplace.

a risk arising from the workplace. For a danger to be deemed work-related, the occurrence must be a generally foreseeable consequence of the work activity.

"Hernandez suffered pesticide ex-

posure at work to which she attributed illness and impaired driving," Justice Laurence Rubin said. "That an employee might not be fit to drive after breathing lingering pesticide for several hours is not such a startling or unusual event that we find a car accident on Hernandez's commute home was unforeseeable."

Other courts have found exemptions to the going-and-coming rule when employees cause auto accidents after drinking alcohol at office parties.

But, in those cases, the employer intentionally produced the situation leading to employee drinking, Mr. Rummeler said. In Minimed's case, however, the company did what it was supposed to do by inquiring about Ms. Hernandez's ability to drive and offering to send her to a doctor.

"In this case, although they used the same logic (as in the alcohol-related cases), the underlying facts are considerably different," Mr. Rummeler said. "Minimed did nothing wrong."

Mr. Rummeler said he believes the appeals court attempted to shape public policy by making the employer responsible without regard for wrongdoing because the employer has a greater ability to pay than an employee.

The published appeals court decision, however, does not indicate that the three justices considered the employee's or the employer's ability to pay a claim.

Barbara Bussard vs. Minimed Inc., California Court of Appeal, 2nd Appellate District, No. B158537.

Between the Lines

Compiled by Joanne Wojcik



When is a reinsurer not a reinsurer?

Has the New York Attorney General's office inadvertently given a legal leg up to policyholders that want to force Lloyd's of London runoff reinsurer Equitas Ltd. to obtain a New York reinsurance license and meet state solvency requirements? Policyholder attorney Eugene Anderson of Anderson Kill & Olick P.C. thinks so.

In an earlier case involving U.S. members of Lloyd's, Assistant Attorney General Daniel A. Schulze characterized Equitas as a reinsurer, Mr. Anderson says. But in a recent hearing, Mr. Schulze argued that the facility is not a traditional reinsurer. The potential problem for the attorney general's office and New York insurance regulators is that, under the doctrine of judicial admission, a litigant cannot argue the same point differently from case to case.

Mr. Schulze, the attorney general's office and the New York Insurance Department would not comment. State Judge Marcy S. Friedman will make the call on Equitas.

Competition creep

Even while the U.S. property/casualty insurance industry argues for prolonged rate firming to restore profitability, some companies are seeing an opportunity to compete for business. Last week, Max Re Capital Ltd. said it would enter the excess casualty market, while Arch Capital Group Ltd. said it would begin writing D&O for individual directors. Neither said anything about offering lower rates than existing players, but they do represent a new source of competition. More to follow?

Frankel estate on the auction block



PHOTO: AP/WIDE WORLD

U.S. authorities last week were set to auction off the luxurious Connecticut mansion where rogue financier Martin Frankel ran one of the biggest insurance scams in U.S. history. The geeky financial whiz secretly bilked more than \$200

million out of seven small life insurers. Mr. Frankel was captured in Germany in 1999 after an international manhunt. He pleaded guilty in May 2002 to federal charges of racketeering, conspiracy, wire fraud and securities fraud and is in prison awaiting sentencing.

Workplace safety by Smith & Wesson?

Larimer County, Colo., is considering a "Workplace Violence Prevention Policy" that would let all 1,400 county employees carry guns. The County Commission chairman, a gun rights advocate, wants to "uphold workers' rights to bear arms, even on the job." Colorado lawmakers also are pondering measures to liberalize residents' ability to obtain permits to carry concealed weapons, one of which would even allow firearms in schools. A similar bill in 1999 was vetoed in response to the Columbine High School shootings.



NYPD blues

A New York Police Department employee has pleaded guilty to operating a multimillion-dollar insurance scam inside a police station. At a Jan. 23 hearing, an administrative aide in the 113th Precinct admitted to filing 22 phony accident reports using her office computer that were used to create \$900,000 in fake medical claims and a potential \$3 million in bogus liability claims.

Touché

It seems lawyers, who some say are responsible for the latest wave of wage-and-hour litigation, may be victims themselves. A federal judge in Washington has ruled that for about 20 years, the U.S. Department of Justice denied attorneys overtime pay in violation of the Fair Labor Standards Act. Court of Claims Judge Robert Hodges Jr. said the department apparently simply declared itself immune from overtime-pay law for attorneys. Is that legal?

Tips and feedback from readers are welcomed. Please send information to jwojcik@crain.com.

Business Insurance

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Business Insurance

Seeking info on insurer, reinsurer exposure to credit derivatives Regulators eyeing credit hedge coverage

By CAROLYN ALDRED

Insurance regulators from several countries are voicing concern about billions of dollars of credit risk being assumed by insurers and reinsurers through coverage of credit derivatives deals.

The huge risks being transferred to insurers from investment banks and the premium being charged for the risks are difficult to accurately assess in insurers' financial statements, regulators say.

Insurers and reinsurers contend, though, that in spite of some instances where reinsurers have suffered significant losses by covering credit derivatives risks, underwriters are capable of properly assessing the risks and the business provides a way to diversify their underwriting portfolios.

Still, regulators want more information from insurers on the credit derivatives risks they are taking on. Issuers of credit derivatives, which are financial instruments that help transfer and repackage credit risk, can purchase insurance to hedge

their own risk to losses from a credit event, such as a bankruptcy. There are various forms of credit derivatives that are being insured (see story, page 26).

"We have underscored the importance of insurance regulators and supervisors becoming more aware of what insurance companies

have done in this area and whether they have understood what they have gotten into," said Svein Andresen, secretary general of the Financial Stability Forum, an organization made up of international regulatory and financial institutions.

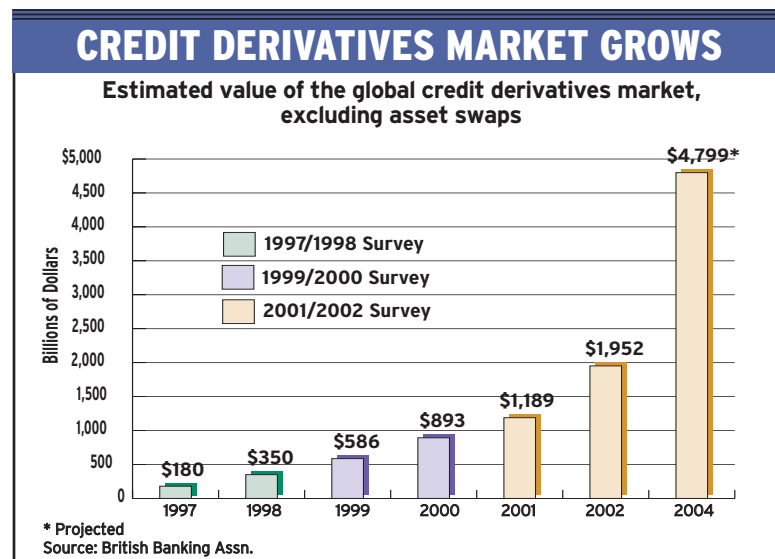
While there is no fundamental

objection to insurers and reinsurers involvement in the credit derivatives market, there are concerns over the lack of transparency, the potential for "regulatory arbitrage" and possible underpricing of the risks, he said.

"We are encouraging industry participants—banks, insurance companies and others—to make more information available and to improve disclosure of their credit derivative activities," Mr. Andresen said.

The British Banking Assn. estimates that total outstanding debt in the global credit derivatives market is about \$2 trillion and is likely to grow to about \$5 trillion by 2005. Investment banks created credit derivatives in the 1990s as a means of trading and hedging credit debt.

Although the hedges were originally a bank-to-bank product, the BBA estimates that the share of insurers and reinsurers selling credit protection has increased dramatically to about one-third of the total market.



See CREDIT/page 26

AIG Corporate Governance seminar

Good handling key to pension changes

By SARAH VEYSEY

LONDON—Turbulent times for defined benefit pension plans in the United Kingdom are putting pressure on employers that sponsor such plans, said Lesley Browning of the London-based law firm of Norton Rose.

"You can barely open a newspaper today without seeing a headline about a pension scheme," Ms. Browning told attendees at the AIG Corporate Governance seminar, held in London last month.

In the United Kingdom, 'you can barely open a newspaper today without seeing a headline about a pension scheme.'

Lesley Browning
Norton Rose

A new accounting regulation is drawing attention to pension funding shortfalls, and some employers' proposed closures of pension plans have met with labor protests in recent months.

Many companies have closed their defined benefit plans—known in the United Kingdom as final-salary schemes—to new entrants or are considering doing so, Ms. Browning said. She spoke in a joint presentation, "The Implications of Closing or Restructuring Final Salary Schemes," with her Norton

Rose colleague Peter Hardy.

Pressures on employers such as falling equity markets have meant that many pension plans have developed shortfalls in the past five years, Ms. Browning noted. The need to address such problems leaves the employer with the options of amending the contribution level and benefits provided in the defined benefit plan to save costs; closing the plan to new members; or triggering the winding up of the plan and providing a defined contribution plan for the future pension needs of some or all employees, she said.

But all of these options could result in litigation by plan members unless implementation is properly handled, Ms. Browning cautioned delegates.

In making amendments to a plan, there are staff issues and other factors to consider, Ms. Browning warned. She noted, for example, that workers could view a change to pension plan contributions as an indirect pay cut.

Should an employer decide to close a pension plan to new members, the employer must comply with the so-called "duty of good faith," among other things, according to Ms. Browning.

This duty applies at all times but is not a fiduciary duty, Mr. Hardy explained. Employers can take into account their own interests when considering whether to close a pension plan, he noted. But an employer could leave itself open to poten-

See PENSIONS/page 27

AIG Corporate Governance seminar

U.K. flex time law creates exposures

By SARAH VEYSEY

LONDON—Employers in the United Kingdom will face increased employment liability risks when legislation restricting employers' ability to refuse flexible work time requests from parents of young children takes effect later this year, a lawyer says.



Ignoring the legislation could result in large fines or court awards and could damage an employer's reputation, said Elizabeth Adams, head of the national employment law department at London-based law firm Beachcroft Wansbroughs.

Ms. Adams spoke at the 6th an-

nual AIG Europe Corporate Governance seminar in London late last month.

The Employment Act 2002, provisions of which come into force on April 6, gives employees with young children the right to request flexible working hours and limits the ability of employers to reject the requests.

Under the act, employees with responsibility for a child under six—including adopted children, foster children or the children of a partner—will have the right to request a change in their work terms and conditions to enable them to work flexible hours to care for that child.

Employees with responsibility for the care of disabled children have the right to request flexible work schedules until such children are 18.

Workers who have been employed by the same employer for 26 weeks prior to their request can ask for a change in the hours they work, the times they work or the location of their work, explained Ms. Adams.

The law will cover gay and lesbian couples as well as heterosexual partnerships, Ms. Adams added.

Employers are not obliged to grant the request for flexible working, noted Ms. Adams, but must meet with an employee who makes a flexible working request within 28 days to discuss the request and must notify the employee of any

See FLEX/page 27

World Updates

Lloyd's chairman bullish on market

Lloyd's of London is "a beacon" in a time of financial uncertainty and is confident of its future, Chairman Peter Levene told the Assn. of Insurance & Risk Managers at AIRMIC's annual lecture last week in London. Lord Levene said reforms, such as a shift toward annual accounting and away from unlimited-liability membership, will strengthen Lloyd's.

FSA pension funding shortfall grows

The U.K. Financial Services Authority said a pension funding shortfall could force it to curb salary increases. The FSA reported a £31.5 million (\$44.9 million) shortfall in its pension fund—which includes a defined benefit and a defined contribution plan—as of March 31, 2002, led by plunging stock markets. As of March 31, the fund had assets of £1.48 billion (\$2.11 billion) and liabilities of £1.80 billion (\$2.56 billion).

Endurance Specialty grew rapidly in 2002

Hamilton, Bermuda-based Endurance Specialty Holdings Ltd. reported rapid growth in its first full-year results. The property/casualty insurer and reinsurer wrote \$798.8 million in gross premiums in 2002. Net income was \$102.1 million. Endurance's combined ratio was 86.2%. Endurance began writing business in December 2001 and launched U.S. and U.K. operations in the fourth quarter of last year.

Swiss Re realigns Mexican unit

Swiss Reinsurance Co. has converted its Mexican operation from a separately capitalized company into a branch office of Swiss Re Americas in Armonk, N.Y. The change will not affect the amount or type of business that the reinsurer writes, nor will it lead to any job cuts, a spokesman said. "It optimizes the use of our capital and gives clients better access to all our services throughout the Americas," he said. He would not disclose how much business Swiss Re Mexico S.A. wrote.

Lloyd's elects council members

Two new members have joined the Council of Lloyd's following elections last week. David Shipley, an underwriter with Managing Agency Partners, was elected as a working member. Peter Morgan, of AJSLP9 Ltd., was elected as an individual external member. They will serve three-year terms, pending approval from the Financial Services Authority.

Credit: Regulators eye hedge coverage

Continued from page 25

"Credit risk transfer has attracted the attention of regulators everywhere and is still on our radar screen," according to a spokesman from the U.K. regulator, the Financial Services Authority. However, after consultation with the insurance market, the FSA has no immediate plans to introduce additional regulation, he said.

Germany's financial regulator, BAFIN, also is monitoring the movement of credit risk to the insurance sector, said a spokeswoman.

Reinsurers and insurers involved in the credit derivatives market say the instruments offer an opportunity for insurers to diversify their business.

According to a report by Swiss Reinsurance Co., "Credit reinsurance and structured credit underwriting have proven to provide low-volatility results due to inherent risk mitigants and prudent risk management."

Munich Reinsurance Co. said in a statement that credit derivative business accounts for less than 2% of its overall credit insurance premium. Its credit derivative business has never made a loss and the company expects it to continue to be profitable, the statement said.

With sophisticated financial risk management, providing coverage of credit derivatives can help an insurance or reinsurance compa-

ny improve its risk structure, said Munich Re in the statement.

Providing credit risk protection allows the insurance industry to earn premiums on risks to complement their existing portfolio of underwriting risk, agreed Nicola Harrison, director of global markets for Deutsche Bank A.G. in London.

"For monoline financial insurers, it provides an extension of the business they are already writing. For multiline reinsurers, credit risk protection adds diversity to their traditional property/casualty business," she said.

Meanwhile, Ms. Harrison added, "reinsurers are used to analyzing and assessing risk on a daily basis and are some of the more-sophisticated players in the market."

However, some analysts see the additional risk as a negative.

"This area is a concern. It is a very volatile and risky activity and it is very difficult for us to evaluate" the extent of activity in the industry and by individual companies, said Emmanuelle Cales, an analyst for Standard & Poor's Corp. in London.

"The concern is that insurers are far less resourced to assess the fundamentals of credit risk than the investment banks seeking to transfer such risk," said Julian Roberts, director of Aon Capital Markets Ltd. in London.

Some insurers and reinsurers have already

faced large credit derivatives losses.

SCOR S.A., which stopped writing credit derivative reinsurance in November 2001, in December 2002 announced a 30 million euro (\$32.4 million) increase in its credit derivative reinsurance provisions, to 131 million euros (\$141.3 million). The Paris-based reinsurer reported total reserves for credit and surety reinsurance of 435 million euros (\$469.2 million) and has dramatically reduced its U.S. credit business.

Risk management is the key to the success of underwriting credit risk, according to Keith Nicholson, KPMG's London-based senior insurance partner.

While banks have developed sophisticated financial risk management modeling systems for credit and derivative risks, many insurers and reinsurers still lag behind, said Mr. Nicholson.

Moreover, he said, insurers and reinsurers may be using credit derivatives as an investment tool as well as a source of underwriting, which would expose them to a double hit if credit derivatives were to produce losses.

And insurers and reinsurers do not fully disclose the extent of their credit derivative business, said Paul Ebling, project director for the London-based Accounting Standards Board.

"Most derivatives are not captured in insurers accounts at the moment," he said.

Derivatives take on various forms

Credit derivatives are financial instruments that help transfer and repackage credit risk, which can include such events as bankruptcies or loan defaults, among others.

They include:

- Collateralized debt obligations, which are securitized portfolios of debt that allow a bank to sell a pool of loans.

- Synthetic collateralized debt obligations, which were developed in the late 1990s to allow banks and other financial companies to transfer credit risks, through special purpose vehicles, without selling the assets. Dozens of banks and insurers have set up such structures in offshore domiciles.

- Credit default swaps, which transfer credit risk for a premium.

By purchasing coverage that assumes some of the risk of these derivatives, investment banks are able to spread their risk, or even expand the gross amount of derivatives they issue.

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LEGAL NOTICE

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re

PETITION OF DAN YORAM SCHWARZMANN and MARK CHARLES BATTEN, as foreign representatives of

ASSURANTIEMAATSCHAPPIJ "DE ZEVEN PROVINCIËN" NV (also known as "THE SEVEN PROVINCES" INSURANCE COMPANY LIMITED);

"TRANSATLANTICA" HERVERZEKERING MAATSCHAPPIJ NV;

NATIONALE-NEDERLANDEN SCHADEVERZEKERING MAATSCHAPPIJ NV;

NATIONALE-NEDERLANDEN INTERNATIONALE SCHADEVERZEKERING NV (also known as NV THE NETHERLANDS INSURANCE COMPANY EST. 1845 LTD); and

MERCANTILE MUTUAL INSURANCE (AUSTRALIA) LIMITED,

Debtors in Foreign Proceedings.

In a Proceeding Under
Section 304 of the
Bankruptcy Code

Case No. 02-16430

SUMMONS: TO ALL INSURANCE, REINSURANCE AND RETROCESSION CREDITORS: A petition dated December 23, 2002 (the "Petition") in a case ancillary to a foreign proceeding has been filed in the United States Bankruptcy Court for the Southern District of New York, The Alexander Hamilton Custom House, One Bowling Green, New York, New York 10004-1408 requesting an order pursuant to 11 U.S.C. § 304 (the "Order") giving full force and effect in the United States to the Scheme of Arrangement (the "Scheme of Arrangement") dated October 28, 2002 between Assurantiemaatschappij "De Zeven Provinciën" NV (also known as "The Seven Provinces" Insurance Company Limited), "Transatlantica" Herverzekering Maatschappij NV, Nationale-Nederlanden Schadeverzekering Maatschappij NV, Nationale-Nederlanden Internationale Schadeverzekering NV (also known as NV The Netherlands Insurance Company Est. 1845 Ltd), and Mercantile Mutual Insurance (Australia) Limited (collectively, the "Companies") and their respective Scheme Creditors (as defined in the Scheme of Arrangement) in respect of certain insurance, reinsurance and retrocession liabilities, and making the Scheme of Arrangement binding on and enforceable against all Scheme Creditors in the United States.

YOU ARE SUMMONED and required to submit to the Clerk of the said Court, on the Court's internet site: www.nysb.uscourts.gov, with a copy to the chambers of the Honorable Robert D. Drain, United States Bankruptcy Judge at the said Court, at Room 632, a motion or answer to the Petition, on or before March 18, 2003. At the same time you must also serve a copy of your motion or answer on the Petitioners' United States counsel at the address listed below. If you make a motion, your time to serve an answer is governed by FRBP 1011(c). If you fail to respond to this summons, the Order may be entered.

A hearing to consider any timely opposition to entry of the proposed Order will be held at the said Court, Room 610, on March 25, 2003.

The foregoing summons is served upon you by publication pursuant to an order of the Honorable Robert D. Drain, dated January 3, 2003 and filed with the Petition and other papers in the office of the Clerk of the said Court.

PLEASE TAKE NOTICE that copies of the Scheme of Arrangement, together with the related Explanatory Statement, the Summons, the Petition, and a form of the proposed Order are available upon written request to the Petitioners' counsel:

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Comings & Goings-Buyers

Camilla Davis has been promoted to vp of administration at F.A. Richard & Associates Inc., a third-party administrator in Mandeville, La.

In this newly created position, Ms. Davis is responsible for risk management, legal issues, licensing and compliance, company vehicle management, major asset purchasing, telecommunications and records management. She also serves as FARA's property and facilities manager.

She reports to Reed A. Bell, executive vp and chief operating officer at FARA.

Ms. Davis began her career with FARA in 1990 as an administrative assistant and was promoted to corporate office administrator and manager of administrative services before being named to her current position.

She holds a bachelor of arts degree in journalism from Louisiana State University in Baton Rouge.

Ms. Davis has earned the Association in Risk Management designation from the Insurance Institute of America.

Lauren Edelheit has been named corporate risk manager at The Boler Co., a truck-component manufacturer in Itasca, Ill.

In her newly created position, Ms. Edelheit will continue to provide insurance and risk manage-

ment services to Boler's operating divisions, and her role will expand to include overall management of corporate insurance programs.

She reports to Nancy B. Coons, vp-risk management and benefits services.

Ms. Edelheit joined Boler three years ago as assistant risk manager. Prior to that she was a risk and insurance analyst at Ace Hardware Corp. in Oak Brook, Ill.

She holds a bachelor of science degree from the University of Illinois at Champaign-Urbana with a double major in actuarial science and finance. She plans to complete her master of business administration from the University of Chicago in March.

Ms. Edelheit earned the Associate in Risk Management designation from the Insurance Institute of America.

Amy Wagner has been named group director of risk management at transportation company Ryder System Inc. in Miami.

Ms. Wagner is responsible for risk management functions and oversees more than 60 employees who handle various insurance, claims and risk management functions. She replaced **Wayne Johnson**, who retired.

Ms. Wagner reports to Dan Susik, senior vp and treasurer.

She has held various positions

with Ryder for the past 13 years, most recently as director of investor relations.

Ms. Wagner holds a bachelor of science degree in health care management and a master of business administration from Florida International University in Miami.

Janet Whitehouse has been named vp-human resources and administrative services at Sun Life Financial in Wellesley Hills, Mass.

Ms. Whitehouse has responsibility for employee benefits as part of her new position, and also will oversee human resources, public relations and administrative services.

She reports to Davey Scoon, vp and chief financial and administrative officer.

Ms. Whitehouse previously served as vp, strategic initiatives at Sun Life, a position she held since joining the company in 2000. Prior to that she was a senior vp at Duncanson & Holt Inc. in Wayne, N.J.

Ms. Whitehouse earned a bachelor of science degree in education from the University of Connecticut in Storrs and a master of business administration from the University of New Hampshire in Durham.

We'd like to report on staff changes in your risk management, safety and employee benefits departments. Contact Michael Bradford, Business Insurance, 329 Calhoun St., New Orleans, La. 70118; phone: 504-269-3788; fax: 504-269-8115; e-mail: mbradford@crain.com.

Letters to the Editor

Continued from page 8

but for people everywhere—Schillerstrom's crude message might be expected from a newspaper in Baghdad, but not *Business Insurance*.

Shame on Schillerstrom for creating it. Shame on *Business Insurance* for printing it. An apology is in order.

Robert L. Larson
Hinsdale, Ill.

P.S. I sell life insurance. My son is a lieutenant colonel in the Marine Corps. I hope you can understand the depth of my feelings upon viewing this insulting cartoon.

Editor's note: We do apologize for the cartoon and are chastened by the response of our readers. The Opinions page is for BI staff and readers to express their opinions on the insurance industry. We regret that in this instance, the page was used as a forum for a viewpoint not directly related to BI's editorial mission.

Expanding EAP services can fill gaps in coverage

To the editor: The Jan. 20 article, "Mental Health Cuts Could Bring Quick Savings, Long-term Regrets," on mental health care benefits cuts by Michael Prince is right on target.

Mental health benefits are one of the first to be sacrificed in attempts

to reduce group medical plan premium increases. The current benefit cuts are among the most severe in years. They usually come in the form of overly aggressive managed care or making the benefit so minimal that it becomes meaningless.

The long-term results of poor or nonexistent mental health benefits have been well documented. These include various workplace productivity problems and increases in medical, disability and workers compensation costs.

Most mental health patients are treated successfully on an outpatient basis. An effective way to fill gaps or overcome reductions in mental health and substance abuse coverages is to enhance the employer's employee assistance program. EAPs are conceptually different delivery vehicles for outpatient behavioral health care services.

An external, independent EAP contracting directly with an employer can usually achieve cost savings of 50% or more compared with the same or similar outpatient benefits provided within a typical group medical plan.

Employers that are forced to reduce mental health and substance abuse coverages in their plans but that initiate creative expansions of their EAPs will find it easy to offer greater benefits at reduced costs.

Leo H. Bradman
President, Chief Executive Officer
UniPsych Corp.
Hollywood, Fla.

Flex: U.K. law creates exposures

Continued from page 25

decision within 14 days of that meeting.

Employees will only be allowed to make one such request a year, Ms. Adams explained, and must set out what changes to their work pattern they propose and what effects, if any, such changes would have on their employer.

An employer can refuse a request for flexible working only if certain outcomes would apply.

These include: Accommodating the request would impose additional cost; it would have a detrimental effect on the ability to meet customer demand; inability to reorganize work within existing staffing; detrimental impact on quality; detrimental impact on performance;

inability to recruit extra staff; and insufficiency of work during the periods the employee proposes to work.

If an employee wishes to appeal an employer's decision to refuse a flexible worktime request, he or she must write to the employer within 14 days, outlining the grounds of the appeal. The employer must then set up a further meeting to hear the appeal and then give the employee a decision within 14 days of that meeting, Ms. Adams said.

An employee can take his or her case to an employment tribunal only after completing this appeal process, and only where the employer has refused their request for a reason other than the specified business reasons, or if the employ-

er's decision to reject the request was based on incorrect facts, she said.

Ms. Adams told delegates that the U.K. Department of Trade and In-

dustry will soon publish detailed guidance on the new law, with suggestions on making and responding to a flexible working request.

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Pensions: Changes

Continued from page 25

tial claims if, for example, it were to fail to take into account alternative proposals put forward by labor unions or other interested bodies, he said.

In putting forward proposals about closing a pension plan, employers must avoid discriminating against certain groups of employees, he said, such as closing a plan to manual workers.

Even if an employer decides to wind up a plan, it still must meet minimum funding requirements, said Ms. Browning.

Mr. Hardy and Ms. Browning stressed that when employers are changing, closing or winding up a defined benefit pension plan, they must follow closely the trust deeds and rules of the individual plan to protect against legal challenges by plan participants.

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Asbestos: Reserves get boosts

Continued from page 1

has exploded, driven mainly by plaintiffs with few or no symptoms of disease.

• Plaintiffs' lawyers have targeted a wider array of defendant companies as the major asbestos producers have filed for bankruptcy.

• Policyholders have tapped new areas of their insurance programs—principally premises and operations coverage in general liability policies—to cover asbestos losses.

Little more than a year ago, S&P pegged the industry's asbestos reserve shortfall at \$5 billion to \$10 billion and estimated that asbestos-

related charges would add one to two percentage points to the industry's combined ratio for 2002.

The huge additions by Travelers and ACE, however, "call both assumptions into question," the rating agency said.

Several insurers had already begun building up reserves last year. Hartford, for example, increased asbestos reserves by reclassifying \$600 million in reserves it already held for other lines. Chubb Corp. boosted reserves by \$625 million, creating a \$242.1 million loss for last year's third quarter; St. Paul Cos. Inc. posted a second-quarter 2002 net loss after a \$380 million aftertax charge for its settlement with one asbestos defendant; and Allianz A.G. Holding funneled \$750 million into asbestos and environmental reserves at its Fireman's Fund Insurance Co. unit during the third quarter. American Re-Insurance Co. boosted its asbestos reserves by \$286 million in July 2002.

These increases were dwarfed by this month's multibillion dollar increases at Travelers and ACE.

ACE's gross reserve boost totaled \$2.18 billion, including \$1.91 billion for asbestos claims and \$266 million for environmental and other exposures.

The increase followed ACE's internal review of its exposures and a simultaneous study by outside actuaries of reserves at Brandywine Holdings Corp., which has managed the runoff of old CIGNA property/casualty business.

The action exhausts the remaining \$533 million of a \$2.5 billion retroactive reinsurance cover ACE bought from National Indemnity for a \$1.25 billion premium as part of the CIGNA acquisition. Losses reported under the reinsurance cover are on an incurred basis, though, meaning that National Indemnity will actually pay out the \$2.5 billion in steadily declining annual increments until the year 2024, ACE projected. ACE will be responsible for Brandywine claims after 2024, but the insurer projected that these will amount to only about \$50 million in 2025 and decline steadily thereafter.

Analysts would not fault ACE for underestimating the level of reinsurance protection Brandywine might need.

"No one at the time envisioned this massive opening of the floodgates on asbestos claims," according to an insurance analyst who asked not to be named. "The size of that underreserving could not possibly have been known until recently."

The surprise in ACE's announcement was less the size of the reserve increase than the relatively small net charge it produced, said Michael A. Smith, an analyst with Bear Stearns & Co. in New York.

After deducting reinsurance recoverable from National Indemnity and others—and adding a \$145 million bad debt provision and the \$53 million cost of ACE's 10% retrocessional share of the National Indemnity cover—the insurer's net pretax

charge amounted to \$516 million. After taxes, the charge dropped to \$354 million.

ACE may issue \$300 million in debt or trust preferred securities to make up the capital lost in the charge, the insurer said.

Rating agencies reacted to the announcement by putting ACE's financial strength and credit ratings under review.

The exhaustion of the National Indemnity cover "leaves the (ACE) group exposed to potential prospective additional adverse development on the asbestos exposures incurred with its acquisition of CIGNA," Frederick Loeffel, an S&P analyst, noted in a statement.

S&P also expressed concerns about ACE's "capital adequacy, accumulated credit risk to reinsurance recoverables" and exposures arising from the runoff of the CIGNA business and other discontinued lines.

Among the ratings S&P placed under review were ACE's A+ financial strength rating and Brandywine's BBB financial rating.

Chicago-based Fitch Ratings likewise placed ACE's credit ratings and the A+ financial strength rating of several U.S.-based ACE insurance units under review while downgrading Brandywine's financial strength rating to BBB- from BBB.

Moody's Investors Service also placed ACE credit ratings and Brandywine's financial strength rating under review, while affirming its financial strength ratings of ACE's active underwriting units.

A.M. Best Co. has not taken any action on ACE's ratings.

S&P, meanwhile, cited the massive ACE and Travelers reserve addi-

tions in questioning the reserve adequacy of other insurers with known asbestos exposures.

"It is worth noting that both Travelers and ACE more than tripled their asbestos reserves from the levels held at year-end 2001," the rating agency said. "These startlingly high reserve additions highlight the difficulty of making industrywide ultimate loss estimates."

Given the huge increase in claims and uncertainty about Congressional asbestos reform efforts, "insurers with significant exposures that have not materially added to their asbestos reserves to reflect this new environment of claims could be underreserved," S&P said.

The rating agency listed 27 insurance groups with large asbestos exposures with which it plans to meet to discuss reserve adequacy and the companies' plans to address deficiencies and raise capital if necessary.

In addition to the unrated Equitas Ltd.—the runoff reinsurer for Lloyd's of London syndicates' pre-1993 long-tail liabilities—the list includes 18 insurers rated A- or above and eight insurers rated BBB+ or below by S&P.

ACE, Travelers and several companies that added to reserves last year are among those listed.

Insurers looking to replace capital lost in reserve charges by selling stock, meanwhile, are going to find the exercise "awfully expensive," Mr. Smith observed. Insurance stocks are selling at low multiples to earnings and book value, making a public share offering more difficult to accomplish without diluting the value of outstanding shares, he said.

War: Businesses prepare for risks

Continued from page 1

ipation of fallout from such a conflict, he said.

"There generally is a lot of indecision among companies about how they're going to respond to a war," said Chris Flint, a crisis management adviser with London-based Special Contingency Risks Ltd., a unit of broker Willis Group Holdings Ltd.

But many companies are in the process of formulating response procedures and evaluating their staff and property exposures in the Mideast, Mr. Flint said.

Assessing risk

Risk managers' responses to the potential repercussions of war with Iraq have been based on three factors, said Lance Ewing, first vp and chief risk officer for the Risk & Insurance Management Society Inc. and executive director-risk management for Las Vegas-based Park Place Entertainment Corp. Those factors are:

- The value of their organizations' industry as a potential terrorism target.
- Their organizations' risk appetite.
- The coverage their risk financing programs provide.

Continued on next page

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Continued from previous page

After the Sept. 11 terrorist attacks, many U.S. corporations and public entities began beefing up their risk management efforts to protect themselves against future attacks. While a war with Iraq raises a few additional concerns, U.S. organizations' post-Sept. 11 efforts address most risk management issues that the war would raise, according to risk managers and consultants.

For example, nuclear power plants took several protective measures immediately after the Sept. 11 attacks, and those measures remain in place, said Brian K. Grimes, a consultant for the nuclear industry through the International Atomic Energy Agency, a Vienna, Austria-based agency of the United Nations.

"There is nothing going on in Iraq that will force a big change securitywise" at nuclear plants, said a spokesman for the Nuclear Energy Institute, a Washington-based trade group.

Coverage questions

Despite the November 2002 enactment of the Terrorism Risk Insurance Act, a major unresolved concern for any organization is whether it would be covered for losses from acts of terrorism that a war with Iraq might spawn, risk managers and consultants say.

Under TRIA, the federal government agreed to cover the bulk of insured terrorism losses after insurers were to strike planes in flight, Mr. Duncan explained. Airlines also want the coverage if terrorists were to strike planes on the ground at airports, he said.

The current coverage for the loss of passengers, crew and planes, as well as third-party losses on the ground, is available only if terrorists were to strike planes in flight, Mr. Duncan explained. Airlines also want the coverage if terrorists were to strike planes on the ground at airports, he said.

Mr. Duncan, who applauded the FAA efforts to sort out airlines' coverage concerns, said he felt "confident the government will address these issues."

Organizations also are dealing with the economic risks of war.

For example, managers of public entity insurance pools have been meeting monthly with financial advisers to ensure their surplus investments "will stand up" in the event of war, Gallagher's Mr. Chino noted.

"I don't recall public entity pools ever doing that kind of financial analysis, and I didn't see it 12 years ago" at the outset of the Persian Gulf War, Mr. Chino said.

Mr. Chino said.

Survey on crisis leadership

The views of *Business Insurance* readers are being sought as part of a survey that will be presented during a session at the Risk & Insurance Management Society Inc.'s annual meeting in Chicago.

The survey is seeking examples of creative solutions to risk management and crisis challenges. Results will be discussed during RM 206: Creative Leadership in Crisis, scheduled for Thursday, April 10.

To participate in the survey and share your experiences, please visit the Online Forum area of the *Business Insurance* Web site, or <http://209.186.191.72:4007/cgi-bin/board-View.pl>.

over profits his organization lost when several popular tour venues were shut down after the Sept. 11 attacks. In addition to Key West, Historic Tours also has operations in Boston, San Diego, Savannah, Ga., and Washington.

While he is considering purchasing the TRIA coverage, he said that, because of his current coverage battle, he is not "comfortable" that the new coverage would respond adequately for Historic Tours.

A problem for public entities that self-fund their terrorism risk and purchase reinsurance is that reinsurers are not obliged to offer TRIA coverage, observed John Chino, area vp in the Orange County, Calif., office of broker Arthur J. Gallagher & Co.

Of the 1,000 terrorism insurance quotes that Marsh has analyzed, risk managers have rejected two-thirds.

Jill Dalton
Marsh Inc.

U.S. airlines now can obtain terrorism coverage from the government under the terms of the recently enacted Homeland Security Act, but the industry is negotiating with the Federal Aviation Administration over the breadth of the coverage, noted Chris Duncan, vp-finance and chief risk officer for Atlanta-based Delta Air Lines Inc.

Mr. Duncan, who applauded the FAA efforts to sort out airlines' coverage concerns, said he felt "confident the government will address these issues."

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Mr. Chino said.

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The Uniform Services Employment and Reemployment Act of 1994 sets precise rules on benefits for employees called up from the military reserves. At right, Sgt. Nilda Ferrer prays during a farewell ceremony in Orlando before her reservist detachment was deployed.



PHOTO: CHRIS LIVINGSTON/GETTY IMAGES

USERRA, regs clarify benefit obligations

By JERRY GEISEL

WASHINGTON—U.S. employers today have far more guidance on the benefits they must extend to employees called up from the reserves and National Guard than they had during the last major military conflict in the Middle East.

Congress, in reaction to the 1991 Persian Gulf War and the employee benefit issues it raised for the 245,000 men and women called up from the reserves, in 1994 enacted the Uniformed Services Employment and Reemployment Rights Act.

That law, which significantly updated World War II-era laws, sets precise rules on how employers must extend benefits to employees called up from the military reserves. For employers with defined contribution pension plans, such as 401(k) plans, the law broadly expands their benefit obligations.

Under the 1994 law, employers with 401(k) plans must give returning veterans the opportunity to make retroactive contributions to their retirement savings plans. Companies must match those retroactive deferrals to the same extent they matched other workers' contributions during the period of military service.

Employers, though, do not have to credit employees' retroactive contributions with the interest that would have been earned during the employees' period of military service.

For the purposes of calculating profit-sharing contributions and 401(k) deferrals, an employee's salary and wages are set at what he or she would have earned during the 12 months preceding his or her active military service.

A returning employee has three times the length of his or her military service—but in no case more than five years—in which to make retroactive contributions.

A 1996 law known as the Small Business Job Protection Act resolved a potential legal problem involving those retroactive 401(k) and other defined contribution plan payments.

Prior to that law, employers could have faced a dilemma on the issue of retroactive savings plan contributions. While the USERRA mandated that employers must give returning veterans the right to make retroactive contributions, it didn't make changes to the Tax Code to accommodate that requirement.

An employee returning from active

military service might want to make, for example, a retroactive contribution to a 401(k) plan for his or her time in the military service as well as for the current year. If, though, those combined 401(k) deferrals contributions exceeded the annual limit on contributions—currently \$12,000—tax law would have been violated.

A provision in the small business law took care of that potential problem. The provision, which Congress made retroactive to Dec. 12, 1994, makes clear that complying with the reservists' law would not cause a plan to fail the tax rules on maximum contributions that could be made to pension and savings plans during a year.

In addition, regulations have clarified certain retirement savings plan issues. Internal Revenue Service regulations published in 2000 said that, in the case of a leave of absence due to military service, the period of time in which a loan made through a 401(k) or other sav-

ings plan would have to be repaid would be extended by the length of the military service.

Subsequent regulations affirmed a 1942 law that the maximum amount of interest that could be charged on an outstanding loan while an employee is on leave for military service is 6%.

USERRA also set modest health insurance continuation requirements. For military leaves up to 31 days, an employee can be required to pay no more than the same percentage of the premium as before the leave began.

If the leave were to exceed 31 days, employers would have to offer COBRA-like coverage to employees who joined the military. Under COBRA, short for the Consolidated Omnibus Budget Reconciliation Act, employers can charge beneficiaries a premium equal to 102% of the group rate.

Unlike COBRA, the health care continuation mandate under USERRA applies to all employers, not just to organizations with more than 20 employees.

Few employees called up for military service likely would opt for COBRA, though. That is because their own health care would be provided free by the military branch in which they serve. In addition, their dependents could enroll in a Department of Defense health care program—known as TRICARE—that has relatively modest cost-sharing arrangements.

Reservists: Cover extended

Continued from page 1

Employers differ widely with regard to the period of time they are extending coverage, with some offering as few as 90 days' coverage and others providing it indefinitely. Most fall within a range, though, of six months to two years.

While this extension of coverage is generous and goes far beyond what is required by law, the cost isn't significant. For most employers, only a small percentage of their employees have been called up for active duty.

"If your organization has only a handful of employees (called up), it won't cost that much," said Jeff Kritzer, a group health care consultant with Watson Wyatt Worldwide in Chicago.

To date, about 95,000 men and women have been activated from reserve and National Guard units in preparation for possible military action against Iraq, according to the Department of Defense. That compares with the activation of 245,000 reservists in 1990 and 1991 before and during Operation Desert Storm.

However, substantial call-ups from the reserves and National Guard are expected in the weeks ahead. In the last week alone, the number of reservists activated for military service rose by 15,000, the Defense Department reported.

Activated reservists automatically receive free health care through the Defense Department. In addition, dependents are eligible for coverage through a program known as TRICARE, provided a reservist's active duty commitment is at least 30 days.

Although TRICARE has low cost-sharing requirements, it generally requires a beneficiary to use a military facility for inpatient services if such a facility is relatively close by.

Unlike the pension area, where a 1994 federal law imposes broad requirements on what employers must provide to reservists called up for active service, federal health care continuation requirements are modest (see related story).

Health care coverage must be extended—on the same basis as before the call-up—for service periods of up to 31 days. After that, COBRA coverage, under which beneficiaries pay a premium of up to 102% of the group rate, must be provided.

Employers say they are continuing coverage beyond legal requirements to ensure the provision of ongoing care for affected employees and their families.

"We want to reduce disruption for families who already have experienced a lot of disruption," said Natalie Bachman, benefits officer at The Principal Financial Group in Des Moines, Iowa. Principal, which pays about 80% of its employees' health care premium, is extending coverage for six months. Since January, eight of Principal's 15,500 employees have been called up for active military duty.

"It's an effort to protect employees called up for a military operation in what is now a new environment," said Larry Cook, program leader for benefits at General Electric Co. in Fairfield, Conn. GE will extend coverage until the employee returns from military service.

About 100 GE employees now are on active military duty, out of a total U.S. workforce of 180,000.

"We want to do what we can as a company to minimize any disruption military service has on our employees and their families," said a spokesman for health insurer Humana Inc. in Louisville, Ky. Humana will continue to pay its share of the premium—about 80%—for 15 months after employees' military service begins. If any reservists remain on active duty at the end of that 15-month period, Humana will decide whether to extend coverage further. Humana, which has about 13,000 employees, employs about 60 reservists, of whom 11 have been called up.

Patriotism and the desire to support public service are the driving factors behind many em-

ployers' decisions to extend health care coverage to employees called up for active military duty.

"We support the United States of America and the contributions and sacrifices our employees are making," said a spokesman for Federal Home Mortgage Corp. in McLean, Va. Freddie Mac, which purchases mortgages from commercial lenders, will continue coverage for one year on the same basis as before employees went on active military duty. At Freddie Mac, which pays about 80% of employees' health insurance premiums, fewer than a half-dozen employees—out of a workforce of 4,000—have been called up.

A spokesman for Mellon Financial Corp. in Pittsburgh said that "Mellon encourages volunteerism and public service on the part of its employees, and we see support for reservists as being part of that commitment." Mellon, which has six employees on active military duty out of a workforce of about 25,000, will pay its share—about 75% of the health care premium—for 90 days.

Other employers extending health care coverage for employees called up for active military duty—and for their dependents—include:

- Office supply retailer Staples Inc. in Framingham, Mass., which offers six months of health coverage at the same rate reservists paid prior to their activation. Since Sept. 11, 2001, 40 Staples employees out of a workforce of 55,000 have been activated.
- American Express Co. in New York, which extends health care coverage for up to five years.
- United Parcel Service Inc. in Atlanta, which extends coverage for one year. About 400 employees, out of a U.S. workforce of 230,000, have been activated from reserve units.
- New York Life Insurance Co., which is extending coverage through Dec. 31, 2003. At that point, the insurer will decide whether another extension is necessary. Five employees out of a workforce of about 7,000 have been called up.
- Blue Cross & Blue Shield of Massachusetts in Boston, which will continue paying its share of the premium—roughly 80%—for five years. Just one employee out of a workforce of 3,500 has been called up in the last month, while one is on a state of high alert, a spokeswoman said.
- WellChoice Inc. in New York, which will continue coverage on the same basis for 90 days. To date, only two of the company's 5,700 employees have been called up.

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For the Record

This roundup of news from the previous week is generated by *BI's* Daily News reporting.

AXIS to purchase Kemper D&O, EPL rights

Pembroke, Bermuda-based AXIS Capital Holdings Ltd. has agreed to purchase the renewal rights to Kemper Insurance Cos.' financial lines business, which includes directors and officers liability, employment practices liability and other lines written through Kemper's Financial



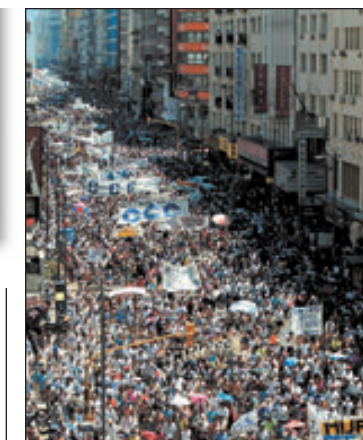
Mr. Kuhn

Insurance Solutions division. Terms were not disclosed. Long Grove, Ill.-based Kemper said that John A. Kuhn, president of the division, will

lead the new unit at AXIS.

Political risks growing for U.S. businesses: Aon

Political risk is becoming more of a concern to U.S. businesses, the head of Aon Corp.'s U.S. political risk practice said. The potential of war with Iraq, political upheaval in Venezuela, continuing severe economic troubles in Argentina and the recent bombing of a nightclub in Bali, Indonesia, underscore the risk, said John M. Minor, national director-political risk for Aon Trade Credit in Chicago, at a Washington press conference last week to unveil Aon's 2003 Global Credit & Political Risk Map. For example, anti-American feeling in the MidEast could create



Economic troubles put Argentina on Aon Corp.'s latest version of its credit and political risk map.

losses for U.S. companies, he said, noting that after the U.S. bombing campaign in Afghanistan, U.S. exports to Saudi Arabia dropped 15%.

Gallagher revenue surpasses \$1 billion

Itasca, Ill.-based insurance brokerage and risk management services company Arthur J. Gallagher & Co.

reported that its 2002 net income rose 3.6%, to more than \$129.7 million. Net earnings were affected by several factors, including \$10.4 million in nonrecurring investment losses and a reduction in tax credits generated by the company's alternative energy and qualified affordable housing investments. Gallagher's total operating revenues grew nearly 24.0% in 2002, to \$1.2 billion. President and Chief Executive Officer J. Patrick Gallagher Jr. attributed the revenue growth to new business development, account retention, property/casualty insurance rate increases and acquisitions.

Assurex Global adds four network partners

Risk management and commercial insurance brokerage group Assurex Global has added new broker partners in Vancouver, British Columbia; Guayaquil, Ecuador; Auckland, New Zealand; and Nashville, Tenn. Columbus, Ohio-based Assurex Global's new partners are Shaw Sabey & Associates Ltd. of

Vancouver, Ecuaprimas Cia. Ltda. of Guayaquil, Auckland-based Risk Solutions Ltd. and Nashville-based Crichton Perry Brandon Jackson & Ward. Assurex Global comprises about 12,000 agents and brokers in more than 130 offices worldwide.

Briefly noted

The U.S. Supreme Court has refused to review suspended Louisiana Insurance Commissioner Jim Brown's 2000 felony conviction for lying to an FBI agent during an investigation of Cascade Insurance Co. Mr. Brown, who is more than halfway through a six-month sentence in federal prison, can petition the court to reconsider....The Illinois Supreme Court on Jan. 24 affirmed that an insurer that mails a notice of a material change in a policy must maintain specific proof of such a mailing for the policy change to take effect. That decision, in *Denise Guillen vs. Potomac Insurance Co. of Illinois*, is part of ongoing litigation over a lead exclusion to a commercial liability policy.

Address: Tort reforms possible

Continued from page 3

"We would certainly hope that part of the uninsured priority includes new incentives for saving for retiree health. One of the biggest segments of the uninsured are those who retire before age 65 and, for the first time, pay the high cost of health care entirely on their own and often end up with no health care coverage," Mr. Dennett said. Only the very largest employers now provide retiree health care coverage, and their ability "to continue with those programs is under serious doubt with the escalation of health care costs," he said.

But the impact of the president's comments may go beyond medical malpractice reform, say some insurance industry experts.

"In our view, the president's support for the need for a more balanced civil justice system was evidenced by his strong support of liability reform in the health care system," said David Farmer, senior vp in the Alliance of American Insurers' Washington office. "When you couple this with the support that we saw for a balanced civil justice system in the terrorism insurance bill that he signed in November, it gives us some confidence that other issues on the agenda for consideration in the 108th Congress, such as class-action reform and the asbestos liability issue, might receive support from the administration."

"He did whack a good number on the trial bar generally in the medical context," said Joel Wood, senior vp of the Council of Insurance Agents & Brokers in Washington.

"There are two things that Gov. George Bush did in Texas that were very strong, well-identified accomplishments—education reform and tort reform. The presence of a Republican-controlled Senate for the first time offers President George Bush an opportunity to replicate his actions as Gov. George Bush."

"We are very supportive of the legal reform agenda—that encompasses med mal, class action and asbestos," said a spokeswoman for the National Assn. of Independent Insurers.

Leigh Ann Pusey, senior vp of the American Insurance Assn. in Washington, said that reforming the current asbestos liability system ranked atop the insurer trade group's list. She said asbestos gets top billing because there's more of a sense of "urgency" about the issue due to increased congressional interest in reforming a compensation system that is not functioning as it should. The AIA also supports reform of both the medical malpractice and class-action lawsuit systems, she said.

"The ACE and Travelers reserve actions in recent days have dramatically upped the pressure on the Washington lobbying community to get some relief on the asbestos liability front," the CIAB's Mr. Wood pointed out, referring to the large increases to asbestos reserves made by ACE Ltd. and Travelers Property Casualty Corp. (see story, page 1).

"The optional federal charter is very important" as well, said Ms. Pusey. She noted, though, that this issue is one that will probably take longer to resolve than asbestos reform.

The CIAB also puts insurance regulatory reform high on its list, whether it is achieved through incremental reform or legislation allowing optional federal charters, Mr. Wood said.

But the insurance industry is not united behind a single course of regulatory reform.

The NAII "strongly supports state regulation of insurance," said the spokeswoman. "The association opposes federal encroachment into insurance regulation and believes that efforts to establish an optional federal chartering system are prema-

ture and undermine the efforts of state regulators, state legislators, insurers and consumer groups to improve state regulation. We believe that markets in which competition is the primary regulator better serve consumers and companies and that Congress should allow the states ample time to fully implement these reforms," she said.

Getting the new federally backed terrorism insurance program up and running is also drawing attention. "There's a lot of uncertainty about the implementation of the terrorism insurance act," said Mr. Wood.

In addition, both Ms. Pusey and Mr. Wood pointed out that insurers expect to fight a defensive battle over federal privacy regulations. Mr. Wood, in particular, cited the potential impact that overly restrictive regulations could have on employer-provided health benefits plans. Restrictions could hamper the ability of employers to shop their programs in order to get the best possible deal for their employees, he said.

One area the president only touched upon was retirement policy, and Mr. Dennett's colleague John Scott, the American Benefit Council's director of retirement policy, outlined a three-priority pension agenda.

"We would like to see the retirement saving provisions that were enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 become permanent. We would also like to see acceleration of the contribution and benefits limits contained in EGTRRA. The other priority is a new round of pension reform," Mr. Scott said. He said that the council expects Reps. Rob Portman, R-Ohio, and Ben Cardin, D-Md., "to introduce another round of pension reform in the next few weeks, and we'd like to have that move forward."

Online Poll [1/27 - 1/31]

Does a cut-through endorsement on policies issued by a property/casualty insurer that has been downgraded make you more likely to:

Renew with the downgraded insurer **69.74%**

Shop for a higher-rated insurer **23.39%**

Ignore the downgrade **6.87%**

Take part in our weekly poll at www.businessinsurance.com

BI Stock Index [1/27 - 1/31]

Up-to-the-minute data for all 87 companies that comprise the BI Stock Index can be found at www.businessinsurance.com

Percentage change of BI Stock Index vs. key indicators

-1.74 BI Stock Index 1753.20

-0.95 Dow Jones 8053.81

-0.66 S&P 500 855.70

Largest gains

ProAssurance	8.55%	Trenwick Group Ltd.	-20.59%
Argonaut Group	6.68%	SCOR	-11.16%
ESG Re Ltd.	6.67%	Gainco Inc.	-10.00%
RenaissanceRe Holdings	6.57%	CNA Surety	-6.49%
SAFECO Corp.	6.13%	Arthur J. Gallagher & Co.	-4.86%

Weekly change by market segment

Brokers	-2.24%
Insurers/Reinsurers	-1.09%
Managed Care Organizations	-0.95%

Source: CNET Investor (investor.cnet.com)