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In Brief

AIG boosts estimate of credit swap losses

American International Group Inc. said in a filing with the Securities and Exchange Commission that its auditors determined AIG had a material weakness in its internal control over financial reporting and oversight related to AIG Financial Products Corp.'s super senior credit default swap portfolio. AIG said it had addressed that problem. In addition, AIG said that mark-to-market unrealized losses on that portfolio totaled $5.23 billion through Nov. 30, up from its previous estimate of $1.6 billion. AIG said the unrealized losses will "not be material."

MMC seeks annual director elections

Marsh & McLennan Cos. Inc. will elect its board of directors annually, rather than in

See **IN BRIEF** page 42

SPOTLIGHT

Railroads struggling with high hazard risk and low coverage limits; specialty insurance helps racehorse breeders down the stretch; underwriters tune in to exposures from reality TV shows; zoos more careful following attacks by animals.
Page 11

Finite risk trial heads to jury

Case rests after weeks of testimony

By **DOUGLAS McLEOD**

HARTFORD, Conn.—Following several weeks of complex testimony about the structure and purpose of an allegedly fraudulent finite risk transaction, a federal jury is now considering the fates of several executives charged over their roles in the deal.

Jurors in U.S. District Court in Hartford, Conn. began deliberating multiple counts of conspiracy and fraud last week against the five former officials of General Re Corp. and American International Group Inc. after prosecution and defense lawyers delivered closing arguments.

CORAL REDUX: Case brings out details on past activity at Barbados reinsurer. Page 41.

ONLINE: View all our reports, other resources on the trial at *www.businessinsurance.com/GenReTrial*

Prosecutors charge that the executives engineered a bogus loss portfolio reinsurance transaction that helped AIG inflate its loss reserves by $500 million in 2000 and 2001. The deal, aimed at countering stock analyst concerns about AIG's reserve levels, transferred no risk of loss to AIG and featured an unwritten side agreement that AIG would refund Gen Re's $10 million premium and pay it a $5 million fee, the government charges.

Defense lawyers countered that there was no such side agreement, that the defendants believed the deal to be a legiti-

See **GEN RE** page 40

Prosecutors set the stage

HARTFORD, Conn.—Five defendants, five roles.

Each of the five former General Re Corp. and American International Group Inc. executives on trial played a distinct part in developing an allegedly bogus reinsurance deal that allowed AIG to inflate its loss reserves, federal prosecutors charge. One got the deal rolling at Gen Re and kept tabs on it; others coordinated Gen Re's efforts, provided legal advice, helped conceal the movement of money or handled the deal on AIG's end, the government alleges.

Defense lawyers, meanwhile, argue their clients believed the loss portfolio deal to be legitimate and have accused prosecutors of misconstruing the defendants' comments in dozens of e-mails and recorded conversations that were introduced as evidence.

A summary of the government allegations and defense arguments for each defendant appears begins on page 40.

LANDOV

New York Attorney General Andrew Cuomo is investigating health insurers' reimbursement rates for out-of-network health care.

Payment rate probe raises concerns about health care cost hikes

N.Y. official faults out-of-network data used by many insurers

By **JOANNE WOJCIK**

NEW YORK—An investigation by New York Attorney General Andrew Cuomo into the reimbursement system used by most health insurers and self-funded employers for out-of-network services may ultimately lead to higher health care costs for employers, benefit experts warn.

Mr. Cuomo last week announced plans to sue Minnetonka, Minn.-based UnitedHealth Group Inc. and several of its subsidiaries for dramatically under-reimbursing out-of-network medical expenses using data provided by Eden Prairie, Minn.-based Ingenix, also a unit of UnitedHealth.

In addition, Mr. Cuomo has issued subpoenas to 16 other large health insurers—including Hartford, Conn.-based Aetna Inc.; New York-based Empire BlueCross BlueShield, a unit of Indianapolis-based WellPoint Inc.; and CIGNA Healthcare, a unit of Philadelphia-based CIGNA Corp.—to determine whether they, too, are underpaying providers by relying on the Ingenix's Prevailing Healthcare Charges System.

In a separate action, Aetna is facing a lawsuit filed by one of its plan members alleging that the insurer improperly reduced benefits for out-of-network services, also using the Ingenix usual, customary and reasonable rate database. In addition, UnitedHealth has been embroiled in litigation with the Chicago-based American Medical Assn. over its UCR practices since March 2000.

Ingenix's PHCS is used by the vast majority of the nation's health insurers and third-party administrators to calculate out-of-network reimbursements based on usual, customary and reasonable charges for medical expenses (see related story, page 39).

Mr. Cuomo charges that the UCRs produced by Ingenix were "remarkably lower" than the actual cost of typical medical expenses charged by doctors in New York state, leading to higher out-of-pocket charges to plan members. To make this determination, the New York Attorney General's office compared UnitedHealth's claims from providers in New York with Ingenix's UCR cost estimates for the state, a spokesman said.

Mr. Cuomo also criticized UnitedHealth's ownership of Ingenix, saying it is a conflict of interest because the insurer benefits financially from Ingenix's alleged suppression of UCR rates.

See **PROBE** page 39

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On the Web

GEN RE/AIG TRIAL

Complete Gen Re/AIG trial coverage online

The criminal fraud case against five former executives of Gen Re and American International Group has gone to the federal court jury in Hartford, Conn. The case centers on a finite reinsurance deal between Gen Re and AIG that prosecutors allege was a sham transaction. *Business Insurance* will report on the verdict when it is handed down. Complete coverage of the trial is available online at *www.BusinessInsurance.com/GenReTrial.*

THIS WEEK IN *BI*

Podcast takes you behind the *BI* headlines

"This Week in *Business Insurance*" is a new weekly podcast that reviews the headlines in each new issue of *Business Insurance* and interviews reporters for in-depth insights to the top stories of the week. Listen to these reports at *www.BusinessInsurance.com/thisweek* or subscribe to this free podcast on iTunes.

BI DIRECTORIES

Available online: *BI's* 2008 Market Sourcebook

The *Business Insurance* 2008 Market Sourcebook is a one-stop source for data on risk management and employee benefits vendors. Copies can be downloaded for $50 in digital format at *www.BusinessInsurance.com/BuyDigitalMSB.* Comprehensive data on all companies is at *www.BusinessInsurance.com/directories.*

Business Insurance®

REPORTING ON CORPORATE RISK AND EMPLOYEE BENEFIT MANAGEMENT NEWS

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Softening market slows growth for brokers

Revenues, profits up for most in 2007, but future gains likely harder to attain

By SALLY ROBERTS

The increasingly softening property/casualty marketplace held back revenue growth for many of the world's largest brokers in 2007, especially in the fourth quarter.

Competition for market share remains fierce, and many of the brokers are implementing cost-saving initiatives to try to offset the pricing declines and, in some cases, to make investments back into their companies. Acquisitions also remain a key growth strategy among the regional players.

But with no end in sight to the soft market, brokers are gearing up for what is likely to be a challenging 2008 for growth, analysts say.

Large regional public brokers, such as Arthur J. Gallagher & Co., Brown & Brown Inc. and Hilb Rogal & Hobbs Co., could be hit the hardest by market conditions, analysts say. Unlike their larger global counterparts, they don't have diversified businesses, such as international operations, to offset a drop in domestic revenues, nor do they have the resources for large expense saving initiatives, they say.

All of the world's largest publicly held brokers that have reported their 2007 figures reported higher 2007 brokerage revenues. Arthur J. Gallagher & Co. leads the pack with a 10.7% increase in revenues to $1.52 billion (see chart). Profits were up 8% for the year to $138.8

See **BROKERS** page 42

2007 BROKER RESULTS

Results for the world's five largest brokers (in millions)

Brokerage	Brokerage revenues*	% change from 2006	Net income	% change from 2006
Marsh & McLennan Cos. Inc.	$11,187.00	7.60%	$2,475.00	150.0
Aon Corp.	7,170.00	7.70	864.00	20.0
Willis Group Holdings Ltd.	2,482.00	6.00	409.00	-8.9
Arthur J. Gallagher & Co.	1,523.50	10.70	138.80	8.0
Brown & Brown Inc.	929.20	7.22	191.00	10.8

**Brokerage revenues comprise commissions and fees from insurance brokerage and consulting services and other income, and excludes investment or fiduciary income.*
Source: Company reports

AP PHOTOS

An explosion at Imperial Sugar Co.'s Port Wentworth, Ga., refinery killed at least eight and injured about 40.

Sugar refinery blast losses still unclear

Sugar dust a likely cause of explosion

By ROBERTO CENICEROS

PORT WENTWORTH, Ga.—The full extent of the insured losses from the Feb. 7 sugar refinery explosion in Port Wentworth, Ga., which killed and injured dozens of workers, is unclear.

Firefighters were finally able to extinguish the flames at the Imperial Sugar Co. refinery late last week. The explosion and fire killed at least eight employees and injured about 40 others.

While an exact cause of the explosion has not been determined, combustible sugar dust is a likely possibility, a spokesman for the U.S. Chemical Safety Board said.

The Washington-based CSB, which is charged with examining industrial chemical accidents, is among local, state and federal agencies investigating the incident.

According to Sugar Land, Texas-based Imperial Sugar reports, it is one of the nation's largest processors and marketers of refined sugars. In 2007, it reported $360 million in total assets.

The company says it conducts operations primarily at two refineries: the Georgia refinery and one in Gramercy, La. The Georgia refinery accounts for 65% of Imperial Sugar's production, Imperial Sugar reported.

"Damage to either of these refineries, or prolonged interruption in the operation of the facilities due to our dependence on ocean-going raw sugar deliveries, or for repairs or other reasons, would have a material effect on the company's business, financial condition, results of operations and cash flows," Imperial Sugar stated in its 2007 10-K report.

Richmond, Va.-based Hilb Rogal & Hobbs Co. places coverage for

See **BLAST** page 39

Court rules N.Y. must honor gay marriages

Employers advised to review benefit language

By JUDY GREENWALD

ROCHESTER, N.Y.—New York employers should review their employee benefit plan language in light of a recent appeals court ruling that same-sex marriages outside of New York must be recognized in the state, observers say.

The unanimous Feb. 1 decision by New York Supreme Court's appellate division in Rochester in *Martinez vs. County of Monroe*, if upheld by New York's highest court, could affect employers with insured plans, public employers and non-health care-related benefits that are not federally mandated.

However, self-insured employers would likely be exempt under the federal Employee Retirement Income Security Act, many observers say.

According to court records, Patricia Martinez married her same-sex partner, Lisa Ann Golden in Ontario, Canada, and then unsuccessfully applied for spousal health care benefits with her employer, Rochester-based Monroe Community College, in 2004.

Ms. Martinez sued, contending that her Canadian marriage should be recognized in New York. A lower court ruled in the community college's favor and dismissed the case.

The appellate court disagreed. "For well over a century, New York has recognized marriages solemnized outside of New York," unless they are either specifically prohibited, or involve incest or polygamy, says the opinion.

Ms. Martinez's marriage does not fall within either category, said the court, which noted that New York has not approved legislation explicitly prohibiting recognizing same-sex marriage.

"Thus, we conclude that plaintiff's marriage to Golden, valid in the Province of Ontario, Canada, is entitled to recognition in New York in the absence of express legislation to the contrary," the opinion states.

By refusing to recognize the marriage, the college violated New York Human Rights Law by discriminating against Ms. Martinez because of her sexual orientation, the opinion says.

The opinion states, however, that because of a change in the college's contract with its union, Ms. Golden is now covered under the health plan.

Rochester, N.Y.-based Monroe County Attorney Daniel M. DeLaus Jr. said he will appeal the decision. Ms. Martinez's attorney could not be reached for comment.

New York is one of just a handful of jurisdictions that neither adopted a state version of the federal Defense of Marriage Act, which forbids same-sex marriages, nor amended its constitution to prohibit same-sex marriage, observers note.

Massachusetts is the only state that permits same-sex marriage, although several other states issue civil union licenses or permit domestic partner registration of same-sex couples.

In a 2006 ruling, New York's highest court, the Court of Appeals, held in *Hernandez vs. Robles* that state marriage laws forbid same-sex marriage.

The appellate court's ruling "seems to be inconsistent" with that opinion, said Mr. DeLaus. "The Court of Appeals made it clear in there that same-sex marriages are not allowed in New York state."

The appeals court "in essence crafted a decision that allows people to get around that law by simply

See **SAME-SEX** page 38

Impact of subprime crisis becomes evident: Report

Despite earlier expectations, E&O insurers may only be "nicked" by the subprime mortgage crisis

By JUDY GREENWALD

Directors and officers liability insurers are likely to face as much as $3.6 billion in claims stemming from shareholder lawsuits over write-downs for subprime-related investments, a report concludes.

In addition, claims under errors and omissions liability coverage, which are more difficult to quantify, will be "significant, but not catastrophic," according to a report by New York-based Advisen Ltd.

"For the first time, we've been able to really quantify the expected impact as far as losses to the D&O marketplace," said Advisen Editor-in-Chief David Bradford, the report's author. Mr. Bradford said the report's information is based on information from various databases as well as a survey of financial institution risk managers.

According to the report, the $257 billion in write-downs recorded as of Feb. 8 by 130 companies could climb to $450 billion or more.

The "vast majority" of companies sued to date are either U.S. firms or firms that have securities traded on U.S. exchanges. As of Feb. 10, Advisen had identified 191 lawsuits related to the subprime mortgage market crisis, with the parties sued including mortgage brokers, lenders, underwriters, rating agencies and bond insurers.

The biggest category of subprime-related suits are securities class actions and those alleging securities law violations, totaling 66.

Furthermore, dozens of investigations have been launched by regulatory agencies, including at least 36 by the Securities and Exchange Commission and probes by attorneys general in New York, California, Illinois, Massachusetts, Connecticut and Ohio, says the report.

Despite the large number of lawsuits, "the overall financial impact on insurers is likely to be painful, but not cataclysmic," the report notes.

Earlier analyst forecasts concluded that E&O—rather than D&O—policies would bear the largest proportion of the losses, says the report.

"This may ultimately prove to be the case, but indications are at this point the E&O insurers may be nicked by the subprime bullet, but not grievously wounded."

The report says despite the concerns, so far no meaningful D&O or E&O premium hikes have been reported.

"There's just way too much capacity out there, and underwriters are really battling against this," said Mr. Bradford. "It looks like underwriters are starting to get some traction as far as pushing rate increases on financial institution D&O and E&O polices, but more broadly within the D&O markets, it's had virtually no impact whatsoever."

The 20-page report, "The Crisis in the Subprime Mortgage Market and its Impact on D&O and E&O Insurers," is available to Advisen subscribers for $200 and nonsubscribers for $500 by contacting the company at 212-897-4800, or *support@advisen.com*.

A SUBPRIME YEAR

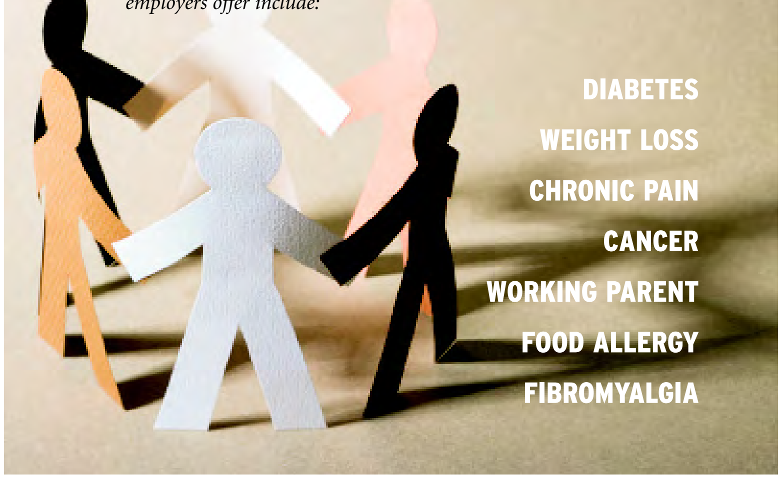
As of Feb. 10, Advisen identified 191 lawsuits related to the subprime mortgage crisis. Those lawsuits fall into the following categories:

Securities class action and securities fraud	66
Fraudulent trade practices	41
Underwriting malpractice	37
ERISA	14
Shareholder derivative suits	13
Breach of contract	6
Auditor malpractice	4
Breach of fiduciary duties	3
Banking malpractice	1
Legal malpractice	1
Other	5

Source: Advisen Ltd.

EMPLOYEE SUPPORT

Companies offer a wide variety of support groups for their employees struggling with different health or lifestyle issues. Some of the types of support groups employers offer include:



Support groups boost wellness initiatives

Programs help workers better manage health

By KRISTIN GUNDERSON HUNT

Some employers have formed worksite support groups for employees struggling with certain health conditions and lifestyle issues as a way to bolster their wellness programs and their bottom lines.

While support groups have yet to become widely accepted by employers, experts said such support systems have the potential to be the next big thing in wellness and disease management initiatives.

"Health care costs keep rising," said Barry Hall, a Boston-based principal with Buck Consultants L.L.C. "Employers are at a point of desperation on the health side. There is more and more interest in finding programs that work."

By bringing employees together in a supportive environment and providing them with the education needed to better manage their conditions, employers will likely see improvements to their bottom line, Mr. Hall said. The support group participants are typically more compliant with their health programs and experience better outcomes, he added.

"Certain diseases are manageable," he said. "If you don't manage them you can have huge repercussions, which result in high costs to both the company and individuals. By having people better deal with their conditions, employers spend less on medical treatment."

Additionally, offering support groups makes employees feel valued, bolstering employee morale and even improving employee retention, said Shelly Wolff, North America leader of health and productivity for Watson Wyatt World-

See **SUPPORT** page 9

State regulators oppose captive bill

Despite concerns, Michigan regulators willing to resolve differences

By JERRY GEISEL

LANSING, Mich.—Michigan insurance regulators say they will oppose legislation that would make the state a captive insurance domicile unless changes are made to the measure.

The bill, S.B. 1061, passed the Senate on a 36-0 vote last week and is now under consideration in the House.

Under the measure, introduced by Sen. Alan Sanborn, R-11th, captives would not be assessed premium taxes but instead would be charged an annual fee based on the amount of premiums generated by the captive. Those fees would range from $5,000 for captives with annual premiums of less than $10 million to $25,000 for captives with premium volume of at least $60 million.

Additionally, the bill would set the minimum capital and surplus requirements at $150,000 for a single-parent captive and at $400,000 for an association captive organized as a stock company or limited liability company and $300,00 for a risk retention group organized as a stock company.

Association captives organized as mutual insurers would need $750,000 in capital and surplus, while the minimum capital and surplus requirements for a sponsored captive providing coverage through protected cells would range from $150,000 to $500,000, with the amount depending on several variables, including the number of cells.

Like captive statutes in several other states, the Michigan legislation would allow employers to set up branch captives. That feature is aimed at employers that want to

See **CAPTIVE** page 6

MICHIGAN CAPTIVE PROPOSAL

ANNUAL FEE:
Fees would range from $5,000 for captives with premiums of less than $10 million to $25,000 for captives with $60 million or more.

CAPITAL AND SURPLUS:
Minimum $150,000 single parent captive; $400,000 for association captive organized as a stock company or limited liability company; $300,000 for RRG organized as a stock company; association captives organized as mutual insurers $750,000; sponsored captive with protected cells $150,000 to $500,000.

Source: Michigan bill S.B. 1061

Global legal trends fuel D&O risks

Local policies seen as answer to fill coverage gaps for U.S. companies

By GLORIA GONZALEZ

NEW YORK—Global D&O insurance policies are insufficient to protect directors and officers from increasing liability created by the worldwide evolution of corporate laws expanding their duties and shareholder rights, according to D&O experts.

Solutions do exist for addressing any coverage voids for local directors and officers and subsidiaries of U.S. parent companies, including purchasing local policies in countries that do not recognize U.S. policies or adding specific endorsements to U.S. D&O policies, they say.

D&O claims activity outside the United States against U.S. companies and their overseas subsidiaries is increasing, making international exposures an important area of focus for the D&O liability sector, Sarah Robson, managing director for Marsh Inc. in New York, told attendees of the Professional Liability Underwriting Society's D&O Symposium in New York on Feb. 6-7.

PLUS D&O: W.R. Berkley Corp. Chairman William Berkley discusses impact of the subprime crisis on the industry. **Page 30**

Several countries have amended their corporate laws to expressly permit derivative and shareholder lawsuits, codify the duties of directors and officers and impose additional duties or establish new doctrines of liability, said Carol Zacharias, senior vp, ACE USA in New York. "It's a train coming at you," she said. "Make sure you get ahead of it."

In 2006, for example, the United Kingdom revised its laws to codify the duties of directors and officers and create a new requirement that they consider the future success of the company in making decisions, she said. In addition, shareholders are now allowed to file derivative actions based on negligence rather than just fraud, she said. "It's…easier to file that complaint and sustain

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Captive: Michigan may allow captives

CONTINUED FROM PAGE 4

fund employee benefit risks through captives but want to continue to sponsor captives outside the United States. Department of Labor rules require that captives used to fund employee benefit risks of U.S. employees be licensed in a domestic state.

In its current form, the bill is opposed by the state's Office of Financial and Insurance Services. In an analysis completed last week, the OFIS raised several concerns about the bill.

One concern is whether the fees paid by captives would generate enough revenue to fund resources needed to regulate captives.

"There needs to be flexibility in setting the fees structure each year to ensure adequate funding for the program and prevent the potential for regulatory subsidization," the OFIS said in its analysis.

Another concern relates to provisions in the bill that would allow captives to write third-party business. "This adds an additional layer of regulatory concern and again, in light of the thin capitalization requirements, may not be a practice that promotes the best interests of the citizens of Michigan," according to the analysis.

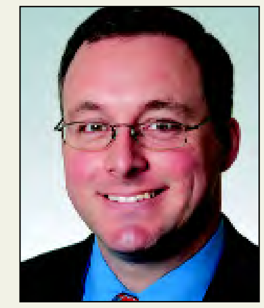
An OFIS spokesman, though, said the department is willing to discuss its concerns with the bill's proponents to try to resolve differences.

Sen. Sanborn has tried to address the OFIS's concerns at every opportunity, his spokesman said.

If the bill passes and is signed in to law, Michigan would become the second state in the Midwest to enact captive legislation in the past year. In July 2007, Missouri passed captive legislation and has since licensed two captives, said John Rehagen, captive program manager with the Missouri Department of Insurance in Jefferson City.

Commentary

No more rogue trading? I wouldn't bank on it



REGIS **COCCIA**

Editor Regis Coccia's commentary appears periodically. He can be reached at: rcoccia@businessinsurance.com

In an era of multibillion-dollar write-downs and losses on Wall Street, it takes a big number to raise eyebrows nowadays. A new record for losses from rogue trading was set late last month when France's Société Générale announced a single trader apparently racked up €5 billion ($7.4 billion) worth of losses.

By now, most of the world knows that Jerome Kerviel has been detained as part of an investigation into unauthorized derivatives trading at one of Europe's largest financial institutions. So far, Monsieur Kerviel has not bankrupted Société Générale. Last week the bank announced it will issue shares to raise about €5.5 billion ($8.0 billion) to offset the damage. In 1995, London-based Barings Bank was not so lucky. One of its futures traders, Nick Leeson, single-handedly brought down Barings with more than $1 billion in losses.

I first learned of the Barings debacle early one morning when my radio alarm roused me from sleep. Still groggy, I wasn't sure I'd heard that right, but the news report indicated a single trader had caused a billion dollars in losses and the bank's future was in doubt.

The question I asked then, and found myself asking again upon hearing the Société Générale news, was "How could this have happened?"

How, indeed. SocGen said that Mr. Kerviel used knowledge of the bank's controls to avoid detection. The implication is that SocGen's controls were not nearly as effective as it might have believed. Where was the contingency plan to protect the bank from catastrophic losses caused by one of its own employees?

While €5 billion is a big number, to be sure, Mr. Kerviel exposed SocGen to trades worth €50 billion ($73.9 billion). If all of those lost money, imagine the size of the economic repercussions. SocGen would have been ruined and Europe's banking system could have faced a major crisis. How could SocGen fail to notice its exposure, even if it was late in seeing the losses? By the way, SocGen said it will write-down about €1.7 billion ($2.5 billion) in losses from the subprime loan crisis, unrelated to Mr. Kerviel's trading activity. The bank is not out of the woods yet.

All the more puzzling is that the Basel II financial services accord requires international banks to put operational risk management plans in place. Rogue trading certainly falls into the operational risk category. Insurance coverage is available for rogue trading, but not in large quantities—definitely not enough to offset the size of SocGen's losses. And the cost of such coverage won't be going down anytime soon.

In the case of both Société Générale and Barings, it seems that their institutional views of risk were one-sided; they chose not to see the downside.

SocGen and Barings seem to have had one-sided views of risk; they chose not to see the downside.

Mr. Leeson attempted to hide his losses by placing more trades, trying to make money. It seems likely that Mr. Kerviel had the same idea. As long as the banks made money, the spiraling risk of loss could be ignored. This is not unlike a gambler who stays at the gaming table too long, rationalizing that a single jackpot will reverse a string of losses.

Messrs. Leeson and Kerviel's stories could have turned out differently. Indeed, early in his career Mr. Leeson was considered a star at Barings, which put him in a position to make large trades. With proper risk controls, Mr. Kerviel might have made a tremendous amount of money for Société Générale.

Whatever became of Mr. Leeson? After surviving four years in a Singapore jail, a divorce and colon cancer, he relocated to Ireland and now is a business speaker on...risk management. Time will tell what shape Mr. Kerviel's career will take.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Business Insurance OPINIONS

Cuomo should focus on provider behavior

IS THE REIMBURSEMENT SYSTEM used by most insurers to pay out-of-network claims flawed?

As we report on page 1, that is the allegation of New York Attorney General Andrew Cuomo, who last week announced plans to sue UnitedHealth Group Inc. and its subsidiaries for allegedly dramatically under-reimbursing out-of-network medical expenses using data provided by Ingenix, a UnitedHealth unit.

Mr. Cuomo charges that the usual and customary rates calculated by Ingenix were significantly lower than the actual cost of typical medical expenses, leading to higher out-of-pocket charges for health plan enrollees who receive services out of network and whose reimbursement is based on what is considered to be usual and customary.

UnitedHealth disagrees with those charges and—barring a settlement—the issue ultimately will be decided in court.

> *Mr. Cuomo would be well-advised to look into the way doctors and hospitals set and disclose rates.*

What disturbs us the most is the appearance of a conflict of interest. Should a unit of a gigantic health insurer, whose financial results are directly affected by the numbers the unit produces, be the one to determine what is usual and customary?

That said, we think Mr. Cuomo would be well-advised to look into the way doctors and hospitals set and disclose rates. How is it—despite all the talk about transparency—that patients typically have absolutely no idea prior to receiving medical services what the cost of those services will be?

And how is it that year after year, health care providers raise rates far more than the increase in the overall rate of inflation?

If Mr. Cuomo truly is concerned about how much health plan enrollees are paying for services, we hope he also sets his sights on provider behavior.

Lack of federal regulator hampers the industry

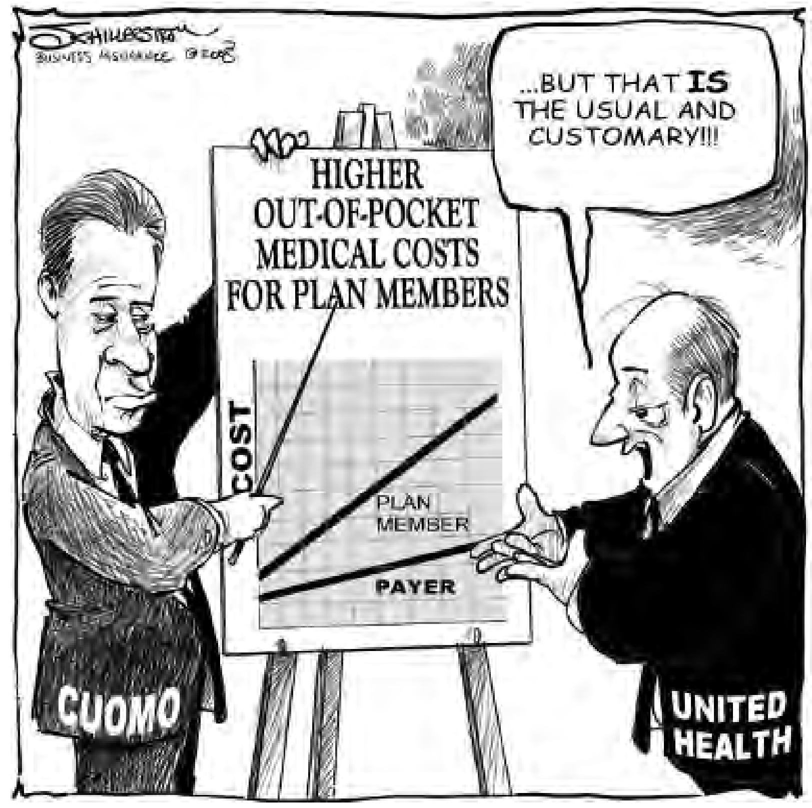
REP. ED ROYCE, R-Calif., rarely misses a chance to present the case for optional federal charters for insurers, a case that certainly needs to be made and heeded. Still, we were pleasantly surprised at his opening statement before a House Financial Services subcommittee hearing last week regarding the bond insurance industry.

Rep. Royce noted that the subcommittee wasn't hearing from "an expert on insurance matters from within the federal government—because no such position exists." While a representative of the Securities & Exchange Commission was on hand to provide the panel "with insight into the current bond insurance turmoil as it relates to the securities industry," there was no comparable federal representative to discuss the insurance implications, he said.

"The lack of a world-class regulator able to effectively comment on the broader insurance industry as it relates to the national economy and capital markets around the world will continue to hamper the industry and our nation until Congress acts," said Rep. Royce.

We couldn't agree more. Congress ought to use the opportunity presented by the bond insurance debacle to consider how federal regulation should be implemented.

While there's no guarantee that a federal insurance regulatory system would solve all of the problems associated with the current antiquated and often ineffective state system, we believe it would handle them more effectively and efficiently than a patchwork system of more than 50 regulators ever could.



BI beats list

In an effort to ensure continuing timely coverage of risk management, insurance and benefit-related news, Business Insurance has formalized a list of its reporters' assigned beats. This list is not intended to be exclusive but rather to represent core subject areas of importance to BI readers. BI welcomes ideas and tips from readers on these and other areas. Following is a list of the beats and the principal reporters for each:

Agents/brokers: Sally Roberts.

Benefits–health care and ancillary benefits: Joanne Wojcik.

Benefits–retirement savings/pensions: Jerry Geisel.

Canada–risk management and benefits: Gloria Gonzalez.

Commercial auto: Jeff Casale

Employment practices: Judy Greenwald.

Environmental risk management: Sally Roberts.

Federal regulation/ legislation–benefits: Jerry Geisel.

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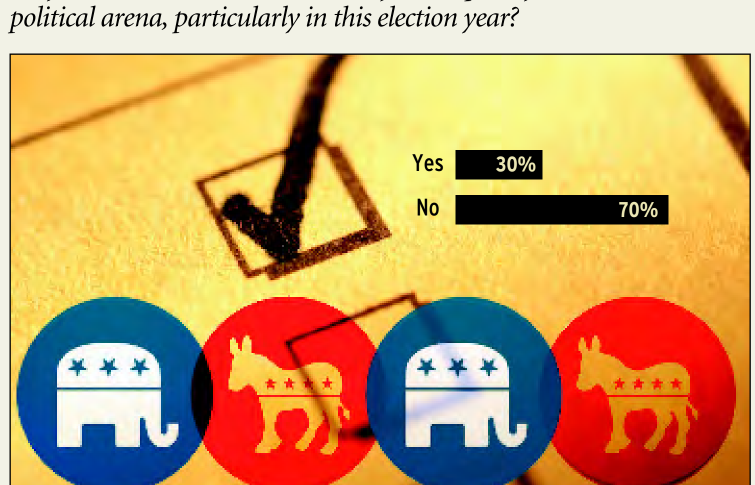
Online Poll at www.businessinsurance.com

Do you think the insurance industry is adequately involved in the political arena, particularly in this election year?



NEXT WEEK'S POLL: *How concerned are you that New York's probe of out-of-network reimbursement rates will raise costs for employers?*

***BI* Online Poll tool sponsored by Wausau Insurance Cos.**

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Support: Groups seen as the next big thing in wellness programs

CONTINUED FROM PAGE 4

wide in Stamford, Conn.

Employers "send a message to employees that they are more than just someone there to do a job, and they care about them as an individual," Ms. Wolff said. "Those things foster loyalty."

Worksite support groups can take a variety of forms and focus on numerous topics. Lands' End, a direct merchandiser in Dodgeville, Wis., has been offering onsite support groups to its employees for nearly 10 years, said Jen Feltz, the company's health and fitness specialist.

The company has groups aimed at diabetics, women going though menopause, family members of military officers, those diagnosed with breast cancer and working parents. The company is also considering facilitating support groups for those on gluten-free diets and those suffering from fibromyalgia.

Meeting formats and schedules can vary as much as the topics covered. For the most part, however, materials and resources are provided for attendees; a guest speaker or expert, such as a physician specializing in diabetes or a breast cancer survivor, will present pertinent information; and attendees will discuss their own personal experiences. The participants ultimately determine the direction of the meeting, Ms. Feltz said.

Lands' End is not unique. Trane Inc., a heating, ventilation and air conditioning company in Piscataway, N.J., focuses its support groups on diabetes, weight loss management and smoking cessation at several of the company's locations. It has been offering support groups since 2006.

> **Support groups show that 'we care about our employees and that we care about their overall well-being. Healthy, happy employees make healthy, happy individuals. People who are feeling well make better workers.'**
>
> Jen Feltz, Lands' End

Additionally, Northwestern Mutual Life Insurance Co., in Milwaukee, Wis., has provided support groups to employees for 10 years. It began with a diabetes program and added a cancer group about four years ago.

At Lands' End, groups commonly form when the health and wellness staff notices numerous employees posing questions about similar conditions or indicating they need support on similar topics. A health educator on staff then organizes the group.

Trane's third-party administrator typically identifies candidates for its diabetes support group by reviewing claims data and sending out invitations to those individuals to join the group. Trane stresses to its employees that it doesn't have access to their health data, said Heidi Lattig, the director of health and productivity programs.

"Support groups are about giving people time to talk and touch base with one another and find out how others are dealing with the same situation," she said.

All three companies offer support group meetings onsite for the sake of convenience. Onsite meetings, Ms. Lattig said, promote participation because they are accessible, and employees feel more comfortable knowing other co-workers will be there, as opposed to unfamiliar faces.

At the same time, however, employee privacy must be protected. Lands' End's Ms. Feltz said it's made clear to participants that the support group is a safe environment to discuss their problems and concerns, and discussions at the meetings must not leave the room.

Trane often has a meeting facilitator unaffiliated with the company to further protect participants' privacy.

Time is the biggest resource that goes into planning support group meetings, said all three professionals at these three companies. They said support groups are inexpensive ventures that create valuable experiences for employees.

They could not quantify their returns on offering the groups, though—one reason Ms. Wolff of Watson Wyatt said vast amounts of employers haven't adopted support groups.

"It's not readily evident the value it brings to the workplace," Ms. Wolff said. "Once it's more apparent, it might become more widespread."

Ms. Feltz said launching support groups builds good will and results in a more productive workforce, which she said is reason enough to continue the service.

"It shows we care about our employees and that we care about their overall well-being," Ms. Feltz said. "Healthy, happy employees make healthy, happy individuals. People who are feeling well make better workers."

The support groups are a smart business decision, Ms. Lattig said, and they allow employees to aid one another in their pursuit for healthier lifestyles, which in the end, benefits the company and has a positive impact on the bottom line.

"We focus on wellness because we believe it's the right thing to do for our people," Ms. Lattig said. "At the same time it's the smart thing to do for our business."

OFFERING SUPPORT

The Society for Human Resource Management 2007 Benefits survey reported that of the employers that provide support groups, large employers were more likely to offer them.

- Of the 153 **SMALL EMPLOYERS** (1-99 employees) that responded, **5% OFFER SUPPORT GROUPS**
- Of the 219 **MIDSIZE EMPLOYERS** (100-499 employees) that responded, **6% OFFER SUPPORT GROUPS**
- Of the 153 **LARGE EMPLOYERS** (500 or more) that responded, **19% OFFER SUPPORT GROUPS**

Source: Society for Human Resource Management




SPOTLIGHT

Toxic spills seen as major risk for railroads

Chemical cargo a small fraction of rail freight, but constitute bulk of liability exposure

By SALLY ROBERTS

Toxic chemical releases due to a train derailment, such as the one that occurred in Graniteville, S.C., in 2005, are rare, but still worry railroads, which transport about 100,000 carloads of toxic inhalation hazards throughout the United States every year.

Losses from the Graniteville incident are in the hundreds of millions of dollars and litigation is still pending. The incident involved two Norfolk Southern Railway Co. trains and killed nine people who inhaled chlorine gas from a breached tank car.

Had the accident occurred at 2:30 p.m. rather than 2:30 a.m., or had it happened in an urban setting rather than rural Graniteville, losses could possibly have topped $1 billion.

It is that type of catastrophic scenario that keeps risk managers for railroads awake at night. Under federal law, railroads are required to transport toxic inhalation hazards.

In addition to rigorous safety measures, Class 1 railroads—the seven largest railroads in North America based on revenues, including Norfolk Southern—purchase between $750 million and $1 billion in excess liability limits, above retentions in the $25 million range, to cover losses from a potential catastrophic TIH release, railroad experts say.

Not only is the insurance costly—anywhere from $18 million to $25 million for $1 billion in coverage, according to one broker—the $1 billion in available capacity may not be enough to cover a given TIH catastrophic scenario, they note.

It's a huge risk for a small fraction of a railroad's overall business, Class 1 railroad experts say.

"They obviously haul a great deal of commodities (on) their rail lines across the country," said Mark O'Neill, product line manager for railroads at Lexington Insurance Co. in Boston, one of U.S. insurers that underwrite liability exposures for Class 1 railroads.

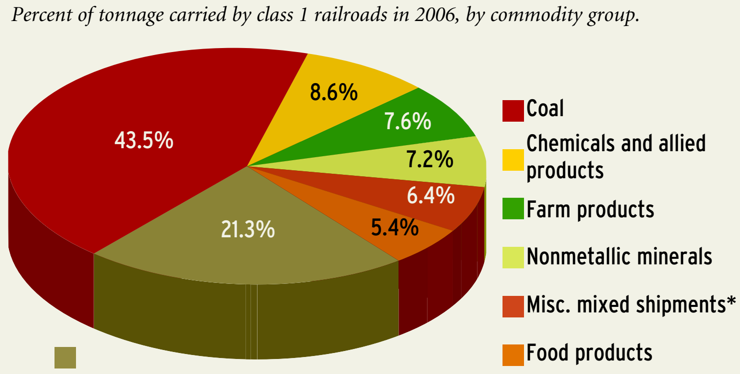
TIH materials represent about 1% of their total cartage, "but that's absolutely the exposure," he said.

A TIH spill or release is "the real catastrophic fear," said Eckart Russell, managing director of Marsh Inc.'s global railroad practice in Montreal. "If that wasn't there, the Class 1 railroads might only buy

See **RAIL** next page

TYPES OF RAIL FREIGHT CARRIED

Percent of tonnage carried by class 1 railroads in 2006, by commodity group.



Other commodities; including metals and products; metallic ores; petroleum and coke; stone, clay and glass products; waste and scrap materials; lumber and wood products; pulp, paper and allied products; motor vehicles and equipment

**Miscellaneous mixed shipments is mostly intermodal traffic.*
Source: Assn. of American Railroads.

AP

Contract workers for Norfolk Southern Railway Co. are surrounded by wreckage from a 2005 derailment that released deadly chlorine gas, killing nine people.

Rail: Toxic spills a major exposure

CONTINUED FROM PREVIOUS PAGE

$250 million to $300 million in limits. The rest is for the inhalation exposure."

A spokesman for the Washington-based Assn. of American Railroads, which represents the Class 1 railroads and others, described the transportation of TIH materials as a "bet the company" type of risk.

"When you're dealing with something like chlorine and anhydrous ammonia, it could result in…liability beyond what railroads are capable of handling," he said.

The AAR strongly supports the use of safer alternatives to chlorine and anhydrous ammonia, which make up the bulk of TIH transported by rail. Among other uses, chlorine is used by water treatment facilities to purify drinking water and anhydrous ammonia is used by the agricultural industry as a fertilizer.

Also, the AAR is urging Congress to pass legislation that would cap a railroad's liability in such hazmat accidents. Short of that, the AAR wants Congress to relieve railroads of their "common carrier obligation" to haul TIH and other highly hazardous materials.

As a common carrier, railroads are required to transport any goods for the public as long as the customer is willing to pay.

"If you look at it from our perspective, we don't have any choice in the matter," the AAR spokesman said. "The manufacturers can choose to manufacture it or not. Those who buy it can choose to buy another product, but we don't have a choice in the matter," the spokesman said, noting that he believes some of the Class 1 railroads, if given the choice, would choose not to transport TIH materials. "We're the only part of this whole chain that doesn't have a choice and we think that's…inherently untenable."

Railroad market sources say that the $1 billion in available limits is not only very expensive, it may not be enough to cover losses from a large catastrophic event.

"The Graniteville loss in South Carolina was a real wake-up call to everyone as to what can happen," said James R. Beardsley, managing director of Aon Risk Services' national rail transportation practice in Baltimore.

"This loss is in the several hundreds of millions of dollars already with only nine fatalities. What happens if something like this happens in an urban area where you have multiples of that? Is there enough insurance to cover that? If I were a betting guy, I would say that $1 billion may not" be enough, he said.

"So the railroads are in between a rock and a hard place. They have to carry this stuff, but there's really not enough affordable insurance to protect" the company and its shareholders should a large catastrophic event occur, he said.

Rail market sources are quick to point out, though, that while accidents do happen, the industry's safety record in transporting TIH and other hazardous materials is excellent.

On its Web site, Jacksonville, Fla.-based CSX Transportation Inc., a Class 1 railroad, says "Railroads continue to be the safest mode of ground transportation for transporting hazardous materials. For every billion ton-miles of hazardous materials transported, trucks are involved in more than 10 times as many accidents as the railroads."

CSX says that it has "developed some of the most effective programs in the rail industry, aimed at moving these materials safely from ship-

See RAIL page 14

'They have to carry this stuff, but there's really not enough affordable insurance to protect the company and its shareholders should a large catastrophic event occur.'

James R. Beardsley,
Aon Risk Services

TRAIN ACCIDENTS IN LAST SIX YEARS

A train accident is an event involving ontrack rail equipment that results in monetary damage to the equipment and track above a certain threshold. Lading, clearing cost and environmental damage is not included.

** 2007 ends with November numbers*
Source: Federal Railroad Administration

Rail: Toxic spill a top risk

CONTINUED FROM PAGE 12

per to destination."

CSX, for example, provides emergency planning assistance and training to local fire, police and emergency response personnel in communities serviced by its rail network, it says.

Among its other safety programs, CSX says it spends $1 billion annually on track and structural improvements; employs roughly 4,800 people who work full-time on track and bridge maintenance; and annually certifies train crewmembers in safety.

And it's not just the railroads that are focused on reducing the potential for a hazmat rail accident.

The Federal Railroad Administration last year announced it was joining forces with the rail and chemical industries to create new and safer tank cars that carry hazardous materials. It also plans soon to issue new, more robust federal design standards for hazardous materials tank cars, according to an FRA spokesman.

"We have very strong safety measures and in fact, we have an extremely good safety record when it comes to moving hazardous materials," the AAR spokesman said. In 2005—the latest figures available—99.997% of rail hazmat shipments reached their final destination without a release caused by an accident, he said.

But 2005 was also the year of the Graniteville accident. According to the National Transportation Safety Board, the probable cause of the accident was human error on the part of the crew of one of the Norfolk trains.

A spokeswoman for the Norfolk, Va.-based railroad said the company is insured for "substantially all" of the expenses related to the derailment, including its response costs and legal fees. Norfolk Southern did record a $41 million expense in 2005 related to the derailment, which the spokeswoman said covered the railroad's self-insured retention and other uninsured costs.

> **'The only way you eliminate the risk altogether is by eliminating the use of some of these most hazardous materials.'**
>
> Assn. of American Railroads spokesman

Robert B. Eckart, senior vp of Kansas City, Mo.-based Lockton Cos. L.L.C., said incidents like Graniteville remind railroads of the importance of safety.

"The railroads are in the business of transporting these materials, which are really essential in the ongoing viability of communities. They know that the exposure exists; they are very concern about it," he said. "I think when you have incidents like Graniteville and others, it…creates a heightened awareness that it's important not only…to buy the appropriate limits, but to really concentrate on the safety piece of it as well. And that's what the railroads have done. They learn from that experience."

"We'd love to be 100% perfect and we try hard to be 100% perfect, but accidents do happen," the AAR spokesman said. "The only way you eliminate the risk altogether is by eliminating the use of some of these most hazardous materials. That's why we so strongly support the use of safer alternatives."

Smaller regional and short-line railroads transport hazardous materials, similar to larger Class I railroads, but because they carry less of it and travel at slower speeds, the risk becomes easier to manage.

Small railroads buy less coverage than larger railroads despite risks

By SALLY ROBERTS

Although Class 1 railroads transport the bulk of highly hazardous materials across the country, they are not the only freight railroads that do so.

Smaller regional and short-line railroads, known as Class II and Class III railroads, also carry hazardous materials, including toxic inhalation hazards such as chlorine and anhydrous ammonia, rail experts say.

But while larger railroads purchase up to $1 billion in liability limits to cover them in the event of a train accident or derailment resulting in a TIH release, smaller railroads purchase only a fraction of that—anywhere between $10 million and $100 million in liability coverage, market sources say.

"You could say in terms of exposure that the base exposure is the same—if you have a hazardous material in a car and you're moving it—the bad things that could happen could happen with anybody," said Bill Sullivan, managing principal and railroad resource at Integro Ltd. in Chicago. But the risk is mitigated "quite a bit" for the smaller railroads due to the fact that they carry less of it, travel in less populated areas and travel at slower speeds, he said. Short-lines, for example, travel very few miles and at very slow speeds "so when they do derail, the wheels fall off, they don't necessarily pile up," he said.

> 'If (a smaller railroad) had a massive chlorine spill in a populated area, it would create the same damages, but they do not buy those limits. They can't afford it.'
>
> Eckart Russell, Marsh Inc.

But even if the smaller railroads wanted to purchase more liability coverage, most could not afford to do so, market experts say.

"If (a smaller railroad) had a massive chlorine spill in a populated area, it would create the same damages, but they do not buy those limits. They can't afford it," said Eckart Russell, managing director and global railroad practice leader for Marsh Inc. in Montreal. It costs between $18 million and $25 million to buy $1 billion in rail liability limits, he said. Some of these smaller railroads generate only $1 million in total revenues.

"Presumably, if they get caught in a bad disaster, they'd be Chapter 11," he said.


Risk can be contained.
It takes a specialist to know how.

REUTERS/LANDOV

2006 Kentucky Derby winner Barbaro was insured for an estimated $15 million. He was euthanized after fracturing several bones in the Preakness.

Buying coverage for thoroughbreds often a matter of playing the odds

By KRISTIN GUNDERSON HUNT

"The greatest two minutes in sports," as the Kentucky Derby is called by horse racing enthusiasts, can damage a thoroughbred owner's business for years if the horse is not properly insured.

Racing and breeding thoroughbreds carries substantial risk, especially for top-tier horses competing in stakes such as the Derby. The most sought-after horses can be valued at nearly $100 million. Factor in the dangers attached to the sport and the need for insurance becomes apparent.

"One bad step can destroy one or multiple horses," said Nick Strong, vp of Old Colony Insurance Services in Lexington, Ky. "It could be a multimillion-dollar bad step. One second you're on top of the world with a potential Derby horse and the next you're without."

Richard Wilcke, director of the equine industry program at the University of Louisville in Louisville, Ky., said while many race horses go without coverage, the top horses are typically insured because their value is so great and the risks are so high.

Broken bones, various diseases and infertility are major concerns for most owners. If a thoroughbred can no longer race because of injury or breed because of fertility issues, its value plummets and then the owners must determining its fate.

The owners of 2006 Triple Crown hopeful Barbaro found themselves in such a position after the horse fractured several bones while racing during the 2006 Preakness Stakes, just weeks after winning the Kentucky Derby. After attempting to save Barbaro through several surgeries and intensive medical care, the owners decided to euthanize the horse in January 2007 after he contracted laminitis, an inflammation of the leg tissues. Market sources estimated, but could not confirm, that Barbaro was insured for at least $15 million in the event of death.

Bill Landes, general manager of Hermitage Farm in Goshen, Ky., said only the farm's most valuable thoroughbreds are insured for animal mortality. To insure anything beyond the essentially irreplaceable horses would be cost prohibitive, he said.

In addition to its breeding stock, the farm houses between 10 and 12 horses that actually race. Currently, just two race horses that have enough earning potential to pay for the coverage are insured for mortality, he said.

At Hermitage, once a horse is valued at $500,000, animal mortality insurance becomes a necessity, Mr. Landes said. Still, he only insures a portion of a horse's value, to keep costs down. That portion varies from horse to horse.

Craig Bandoroff, owner and president of Denali Stud in Paris, Ky., said of the breeding stock boarded at his farm, which includes between 250 and 300 mares and their foals, as well as young horses that will eventually be racing stock, about 30% to 40% are insured with animal mortality coverage.

Animal mortality coverage is by far the most common coverage thoroughbred owners invest in, said Julian Lloyd, a bloodstock underwriter at Hiscox Ltd. in London. Additionally, there are other coverages available for a variety of risks relating to horse racing and breeding (see story, page 20).

Annual premiums are based on a percentage of the value of a horse. Mr. Lloyd said premiums are typically between 3.5% and 6% of a thoroughbred's value. Premiums for a $500,000 horse, then, start at $17,500. Those rates have remained relatively stable for years, experts said.

"The rates fluctuate within a much narrower band compared to the property and casualty classes where you get much bigger swings," said Julian Bowen-Rees, the Lon-

See EQUINE page 20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Equine: Coverage sees tighter capacity as insurers exit the marketplace

CONTINUED FROM PAGE 18

don-based chief underwriter for global equine at XL Insurance.

Mr. Lloyd said premiums are typically based on the horse's function and age. Premiums are usually high for foals, horses under a year old. Prices drop for yearlings then jump at age two when a horse hits racing age. From there, prices hinge on age and whether a horse will go on to breed after it retires from racing.

Geography can also influence premiums. Established horse farms in Kentucky with a reputation for excellent care and knowledge of thoroughbreds will likely see better rates than less notable horse farms in areas foreign to the industry, which might have less advanced veterinary care for the animals or have more exposure to unique diseases, Mr. Lloyd said.

A horse's health history impacts coverage as well. Mr. Bowen-Rees said because colic is one of the biggest killers of horses, insurers will occasionally write an exclusion into the policy if a horse has had several colic experiences. Colic is abdominal pain in a horse that can lead to fatal intestinal blockage.

Capacity for animal mortality coverage has tightened in recent years, Old Colony's Mr. Strong said. Ten to 15 years ago, accumulating $100 million in coverage through multiple insurers was possible, he said.

Now, capacity maxes out at between $60 million and $70 million, Mr. Bowen-Rees said. Those amounts still require the cooperation of numerous insurers, he said. No single insurer could provide all that coverage.

Mr. Strong said the restricted capacity is the result of fewer insurers offering equine coverage. He said several insurers exited the market about three or four years ago because of bad results. Insurers may have experienced losses because horses were injured or contracted diseases, or because they offered policies at rates below what was needed to cover their future losses. They may have found lines they were more comfortable covering, he said.

"When things are going good, when insurance companies are making money on their investments, they're willing to go into markets they don't know much about," Mr. Wilcke said. "When things go in the other direction—when they're not making much money on their portfolios—the first things they drop are these niche markets like the horse industry."

Mr. Landes of Hermitage Farm said he hasn't had any trouble getting mortality coverage. He said being part of an established farm that produces and cares for quality horses also makes a difference when it comes to capacity. He added that he hasn't fully tested the market since he doesn't typically insure a thoroughbred for its full value.

Insurance at any level is important in the expensive business of breeding and racing thoroughbreds, said Mr. Bandoroff of Denali Stud.

"These horses cost a lot of money," he said. Insurance is "there to cover you for the financial hit you don't want to absorb, should it come. You're covering risks and avoiding calamity."

Equine coverage essential for thoroughbred businesses

While animal mortality coverage is the most popular coverage for thoroughbreds, other coverages exist for the variety of risks that come with horse racing and breeding.

Limited peril coverage is one of the most popular coverages outside of animal mortality. It is not as broad as animal mortality coverage and is limited to specific perils. It insures against accidental death from events such as fire and lightning strikes and theft.

In certain instances, owners might choose limited peril coverage in lieu of animal mortality coverage because it is up to 80% less expensive, said Nick Strong, vp of Old Colony Insurance Services Inc. in Lexington, Ky.

Insuring against breeding losses is also common within the thoroughbred industry. Such policies are costly, though, which keeps some owners from purchasing them.

Barrenness coverage is purchased before a horse is even bred. It is purchased annually to guarantee a mare will conceive and produce a foal with a specific stallion during the breeding season. Horse owners electing this coverage protect themselves from the loss of a stud fee should one of their mares be unable to conceive after a limited number of breeding sessions during the season.

Historical losses and the wide variance in horses' abilities to conceive and produce live foals from year to year drives the rates to be higher than other coverages. Rates run in the mid to upper 20% of a mare's projected value, Mr. Strong said.

Prospective foal coverage can be included in barrenness coverage or purchased separately. It insures against a loss incurred in the event that a broodmare's fetus is not born alive. Coverage starts 42 days after breeding occurs, depending on the age and production of the mare, and lasts up to 30 days after birth. Mr. Strong estimated rates range between 8% and 15% of a horse's value.

Stallion first season infertility is another breeding coverage offered by most equine insurers. It guarantees that a new stallion will achieve a pre-agreed conception rate during its first season as a stud. Mr. Strong said the agreement typically guarantees a stallion will impregnate at least 60% of the mares he's booked to breed, as long as the mares are of a reasonable age and have a legitimate breeding history.

Julian Bowen-Rees, chief underwriter for global equine at XL Insurance in London, said it is popular coverage because of the potential for poor conception rates and money at stake.

Stallion owners might also invest in stallion loss of income coverage. It protects the owner should a stallion get injured or be affected by disease and is therefore unable to breed with the number of mares he was slated to stud. For example, if a stallion is booked to breed with 100 mares at $100,000 each, the policy would cover the stud fees from each unbred mare.

Mr. Strong said a limited amount of major medical and surgery insurance is available for breeding horses, but he is unaware of any companies offering such coverage for race horses because of the risk involved. Injuries to race horses are frequent and many.

Mr. Strong said the varied types of insurance available to thoroughbred owners and breeders are critical to their business.

"These are business-leveling devices to keep people from having devastating years," Mr. Strong said. "These types of covers keep owners from having disastrous years that would ultimately put the farm out of business."

—By Kristin Gunderson Hunt


Strong
Stable
Exceptional

Insurers more likely to offer coverage for reality television

Coverage costs remain high due to shows' unpredictability

By LOUISE ESOLA

As America's love affair with reality television continues to grow, more insurers are offering coverage for the programs that aim to wow audiences with risky stunts and unpredictable plots.

Unlike earlier notions that insurers would steer clear of the unique risks associated with reality TV, when shows depicting dangerous feats and unpleasant scenarios began dominating television programming, insuring such programs is no longer a fear factor for insurers, experts say.

'In the beginning, insurance companies looked at (reality shows) conservatively; we wondered how would they be handled in the courts.'

Joe Finnegan,
Fireman's Fund Insurance Co.

"Insurers aren't afraid of the market anymore," said a spokesman for the Concord, Calif.-based Insurance Information Network of California.

Kevin Topper, Glendale, Calif.-based chief underwriting officer with the Encore Entertainment Group, a unit of Travelers Cos. Inc., said the demand for reality shows is high given the three-month long writers' strike.

"The demand is high and the insurance market is soft," Mr. Topper said.

Reality television has been around for decades, with the show "Candid Camera" named as the first to hit home audiences with "real people" entertainment when it first aired in the 1940s.

Reality television gained popularity in the 1990s with such shows as "COPS" and MTV's "The Real World." Its popularity has soared over the past decade with highly watched shows such as "Survivor" and "Fear Factor."

Nowadays, one can't channel surf without spotting a reality show: women undergoing liposuction in Beverly Hills, Calif.; housemates bickering over who left dishes in the sink; neighbors temporarily swapping homes and painting a living room lime green, among others.

"In the beginning, insurance companies looked at (reality shows) conservatively; we wondered how would they be handled in the courts," said Joe Finnegan, Los-Angeles-based vp of the entertainment division for Fireman's Fund Insurance Co., which initially avoided the reality television market but has since become a major player.

Some experts say lawsuits arising from reality TV shows are uncommon—as measured by the number of such shows vs. actual cases filed—but are nevertheless unavoidable.

Among recent lawsuits, mentioned by Brian Kingman, Los Angeles-based director of business development and strategic account management with Aon/Albert G. Ruben Insurance Services Inc., one of the most notorious allegations was filed against the producers of "Extreme Makeover: Home Edition." In 2005, five orphans claimed they were taken in by neighbors who allegedly used the orphans' tragic story in their application to have their home redone, their mortgage paid off, among other things. The suit, which was thrown out by a Los Angeles judge in 2007, claimed that the family eventually forced the orphans from the home once the show aired.

In a 2001 incident, a traveler at the Mohave County Airport in Arizona was asked to go through an X-ray machine unknowingly as part of a "Candid Camera" segment and suffered injuries to his thigh while on the conveyer belt as he was recorded with a hidden camera. He later sued the show and was awarded $300,000, along with other damages in related suits filed against the airport.

"When (lawsuits) happen they're in the news and they're very expensive," said Mr. Kingman. "We see it as part of the business."

Risky business

Unpredictability is what makes insuring reality television and gauging risks tricky and expensive, he said.

Policies typically mirror coverage for regular, scripted entertainment: general liability; production insurance to cover such liabilities as sets, wardrobe, and props; and errors and omissions insurance to cover the risks associated with character defamation, invasion of privacy and copyright infringement. Yet insurance for reality shows often include extra layers of coverage, such as liability and bodily harm, to handle the increased risks, experts say.

"There are a lot of unique exposures in reality television," said Mr. Topper. "There's an unknown aspect of reality television that adds to the risk. You don't always have

Continued on next page

GETTY

Despite its unique exposures, insurers are now more eager to offer coverage for reality television shows, such as CBS' "Survivor: Cook Islands."

CONTINUED FROM PREVIOUS PAGE

the ability to map these things out in advance (like you can with regular television shows)."

Mr. Kingman adds that reality television's hallmark of featuring real-life people and not professional actors—whose ethics and work are guarded by professional organizations such as the Screen Actors Guild—adds to the risk.

"(Reality show participants) are people who sometimes don't act professionally," Mr. Kingman said. "When dealing with nonprofessionals, there's no way to predict how these people are going to act."

Of course there are the obvious risks associated with daredevil stunts, among the most alluring aspects of reality television and among the major cost-drivers for insurance.

That's why insurance for reality television often eats up more of a production company's budget, according to experts who say insurance coverage for such shows can cost between five and 10 times more than for a policy for a regular television program.

An IINC spokesman estimated that between 3% and 5% of a regular, scripted program's production costs go towards insurance, whereas insurance for a reality show starts at 5% of a productions' budget and can skyrocket from there.

Insurers hands-on

Along with the higher price tag on insurance for reality shows, insurers often place underwriters on-set everyday with producers to manage and calculate risks, insurers said.

"This is very hands-on for us," said Mr. Topper of Travelers.

Fireman's Fund maintains an office at Universal Studios, said Mr. Finnegan, and employs at least one underwriter who previously worked as a risk manager on a television set.

"We ask a lot of questions and take in as much information as possible," said Mr. Finnegan. "We need to know how dangerous the stunts are going to be, who's doing them, all of that goes into this."

Mr. Finnegan noted that some stunts, even those that seem death defying on television, are often the result of camera tricks. "Otherwise some things wouldn't be insurable," he said.

One example, according to Mr. Finnegan, is when a contestant is engaging in a stunt that is supposedly set high above ground, but the producers utilize camera angles to make the stunt seem riskier.

'We are rejecting the shows that aim to make people look bad.'

Kevin Topper
Travelers Cos. Inc.

Aside from the actual production risks, one reality show risk is gaining momentum in the courts and among insurers. According to Mr. Kingman, the industry is "very" concerned about copyright protection and unfair business practices associated with show ideas and concepts.

Show "concepts are pitched all the time, all over Hollywood there's a lot of pitching going on," said Mr. Kingman.

In 2003, radio shock jock Howard Stern sued ABC and the producers of the show "Are you Hot? The Search for America's Sexiest People," which he said copied a popular segment on his radio show. Originally asking for $100 million, the suit was settled for an undisclosed amount.

Popular shows, "The Apprentice," "America's Next Top Model," and "Trading Spouses," have all been named in separate suits, accusing producers of stolen ideas, among other complaints.

Mr. Kingman said those risks are being mitigated with pre- and post-pitch releases, which help safeguard show ideas and concepts.

Insurers are also treading carefully when it comes to the shows' concepts themselves. Humiliation may sell when it comes to viewers and ratings, but underwriters are avoiding writing coverage for shows that aim to pose emotional harm, and could result in high claims, according to insurers.

"We are rejecting the shows that aim to make people look bad," said Mr. Topper. "There are these mean-spirited shows and we are choosing to instead focus on the socially responsible, positive shows."

Fatal zoo attack may increase underwriter scrutiny

Incident unlikely to decrease coverage or raise rates

By TINA EICHNER

Zoo animal attacks are as rare and unusual as the animals involved, however several recent occurrences have placed zoos under the microscope, which may not affect insurance rates, but it may create tighter underwriting scrutiny.

One recent incident occurred last December, in which a tiger escaped its exhibit at the San Francisco Zoo, killing one man and injuring two others. It has been determined that the wall surrounding the habitat was shorter than the required industry standard but several other possible contributing factors also remain under investigation.

The zoo would not comment on its insurance coverage.

Other recent incidents include a Denver Zoo employee killed by a jaguar in February 2007 and a tiger attack on a keeper at the San Antonio Zoo in July 2007. In that attack, the employee suffered head wounds but survived.

"The incident in the San Francisco Zoo is going to put a lot more exposure on having controls in place at zoos," said Mary Keenan, a product manager for zoo-focused insurance products at Philadelphia Insurance Cos. in Bala Cynwyd, Pa. "You will see more loss control and inspection of property to make sure that everything is in place that should be. I think we will see some good coming out of it."

Philadelphia Insurance introduced its zoo-focused insurance products in the second half of 2006 and so far has written policies for eight zoos.

In general, insurers that serve the market require that a zoo be a member of the Silver Spring, Md.-based Assn. of Zoos and Aquariums, a nonprofit organization dedicated to the advancement of zoos and aquariums in the areas of conservation, education, science and recreation. AZA also provides accreditation ensuring that properties meet minimum standards for overall safety and proper care of animals.

"We only write for zoos that have gone through the AZA accreditation process," said Ms. Keenan.

"There is an inherent risk in insuring zoos. Animal incidents are infrequent but can be…severe," said Mark Beck, Fort Wayne, Ind.-based vp of marketing at K&K Insurance Group Inc., a subsidiary of Aon Corp. "K&K works only with AZA certified zoos because AZA is a long-standing organization with a great deal of credibility. AZA understands the risk associated with this industry perhaps better then the insurance companies themselves."

K&K Insurance, a managing general underwriter, serves the sports, leisure and entertainment markets and has provided coverage in the zoo category for 20 years.

K&K's Chief Marketing Officer Lou Valentik said that there are multiple types of coverage to consider when insuring zoo property. First there is traditional property/casualty insurance on the venue, its structures and all of the contents of the venue and structures.

Second, general liability insurance covers allegations of negligence brought against the property by a third party, including patrons.

See ZOO page 26

UPI/NEWSCOM

ZUMAPRESS

At left, the tiger habitat at the San Francisco Zoo gets some rehab after a tiger escaped in December 2007, killing one zoo patron and injuring two others. Above, Berani, a Sumatran tiger, attacked a zoo keeper in San Antonio in July 2007, biting the keeper's head several times. The zoo employee survived the attack.

Zoo: Fatal attack may increase scrutiny from underwriters

CONTINUED FROM PAGE 24

The liability policy provides for investigation of the incident, defense for the policyholder and possible indemnity to the third party.

"Allegations of negligence can run the gamut from slip and falls to food issues to problems with animals," said Mr. Valentik. "We are looking at five basic safety areas: parking, concessions, security, first aid and maintenance and housekeeping. Ninety-nine percent of all claims fall in one of these areas."

Zoo policies also will include workers compensation, automobile coverage for vehicles owned by the property including golf carts and trams, excess limits coverage and professional liability coverage for the property's directors and officers.

Although zoos deal primarily with wild animals, that does not necessarily make them more difficult to insure. "Zoos are like living museums. Patrons walk through casually and nonchalantly and the experience is relatively safe compared to patrons attending a youth hockey game or a motocross event. The risk to a patron walking through a zoo is relatively minor," he said. "On the other side you have the animals, some of which are wild. Some zoos have petting zoos and there are risks there, including minor bites and disease."

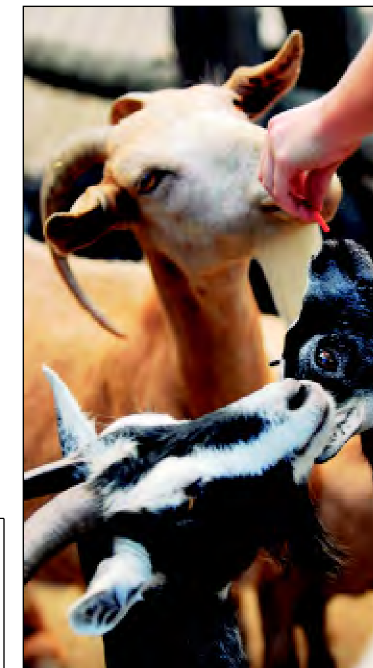
Mr. Valentik added that if a zoo meets AZA accreditation standards, then the risk of animal exposure is highly unlikely. Patron exposure to an animal and any resulting damages would fall under the liability portion of coverage.

He does not anticipate that the San Francisco tiger attack will have an impact on coverage or rates.

"I don't think it will cause insurers of zoos to raise their rates. It may cause them to ask more questions than they have asked previously and they may be more proactive from a loss control inspection perspective," said Mr. Valentik.

In most cases, coverage for the animals is handled in a separate policy and often by a separate insurer.

For instance, Lester Kalmanson Agency Inc. in Orlando, Fla., is one of a handful of companies that provides animal mortality insurance in addition to a full-range of property, casualty and general liability coverage. Mitchell Kalmanson, risk manager, said the company specializes in insuring rare and unusual risks, providing liability and mortality insurance policies on animals, from alligators to zebras.



Patrons of petting zoos are at risk of minor bites and disease.

Mr. Kalmanson said that coverage amounts on animal-oriented policies at a property depend on the size and accreditation of the institution. He explained that some zoos will insure their entire inventory of animals while others will only insure the most rare and expensive specimens.

"We want to understand what is happening at the institution overall so that we can insure it properly. Each animal has certain requirements for safety and we make sure that they are being met," said Mr. Kalmanson.

Zoo: Fatal attack may increase scrutiny from underwriters

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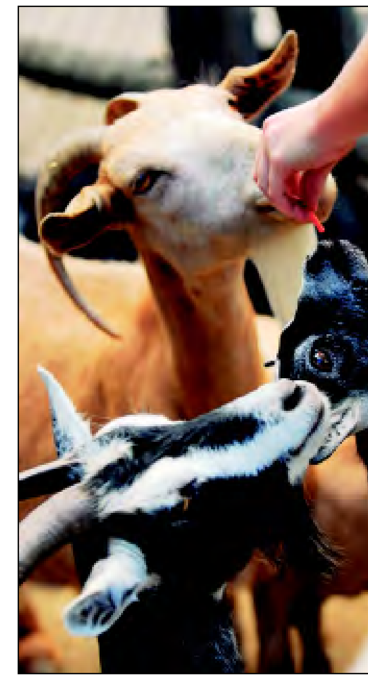

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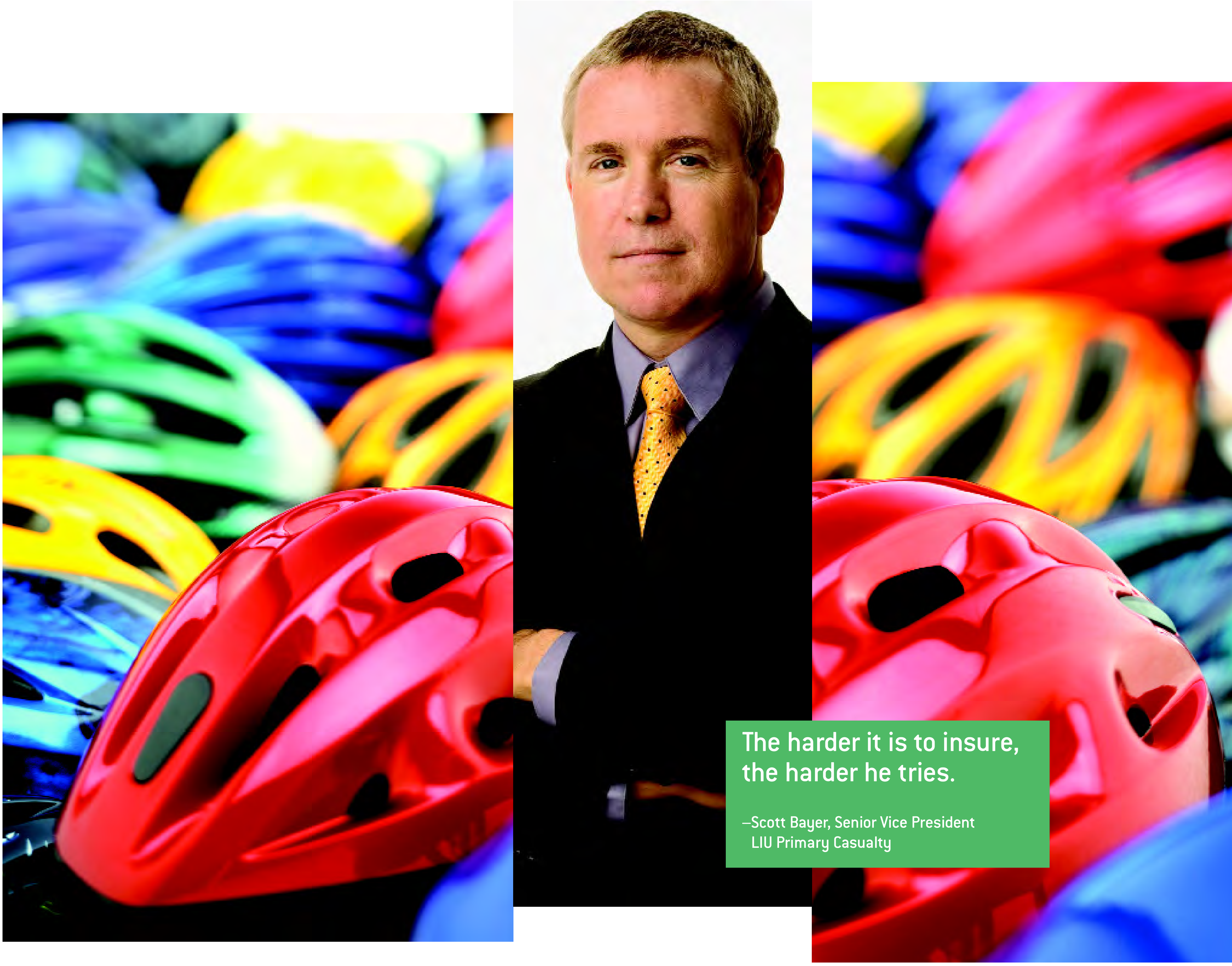

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Market Moves

Brown & Brown adds five to fold

DAYTONA BEACH, Fla.—Daytona Beach, Fla.-based Brown & Brown Inc. has completed business acquisitions in Florida, Georgia, Indiana, Michigan and New Jersey with combined annualized revenue of about $22 million.

The purchases include LDP Consulting Group Inc., which will remain in Lambertville, Livingston and Shrewsbury, N.J., as a free-standing Brown & Brown employee benefits unit led by Chief Executive Officer Louis E. Della Penna Sr., the brokerage said in a statement.

Other purchases include: Smith-Peabody-Stiles Insurance Agency Inc. in Fenton and Brighton, Mich.; AGA Insurance based in Alpharetta, Ga.; MEW Custom Staffing L.L.C., which does business as Custom Outsourcing, based in Tampa, Fla.; and Diversified Insurance Brokerage Group Inc. based in Indianapolis.

Gallagher buys brokers, consultant

ITASCA, Ill.—Arthur J. Gallagher & Co., which said it completed a record 21 acquisitions last year, has added two retail brokerages and an institutional investment consulting firm so far this year.

The broker purchases by the Itasca, Ill.-based Gallagher include Petty Burton Associates Inc. of Montclair, N.J., and Crist Elliott Machette Insurance Services Inc. of Oakland, Calif. Gallagher also said it completed the purchase of consultant Yanni Partners Inc. of Pittsburgh.

BB&T unit to purchase MGU

STAMFORD, Conn.—Houston-based managing general underwriter AmRisc L.P., a subsidiary of BB&T Corp., said it plans to purchase reinsurance brokerage Savannah Reinsurance Underwriting Management L.L.C. of Stamford, Conn.

Price of the purchase from Glencoe U.S. Holdings Inc., a subsidiary of RenaissanceRe Holding Ltd., was not disclosed. AmRisc said the acquisition is expected to close sometime this month.

MetLife completes SafeGuard purchase

LAGUNA HILLS, Calif.—New York-based Metropolitan Life Insurance Co. said it has completed the purchase of SafeGuard Health Enterprises Inc., a Laguna Hills, Calif.-based dental and vision plan provider with about 1.8 million members serving primarily California, Florida, Nevada and Texas.

Hanover agrees to buy Verlan Holdings

SILVER SPRING, Md.—Hanover Insurance Group Inc. of Worcester, Mass., has reached a definitive agreement to buy Silver Spring, Md.-based Verlan Holdings Inc., which provides insurance and other services to chemical product manufacturers and distributors.

In a statement, Hanover said the purchase, which is expected to close by the end of the first quarter, is subject to regulatory reviews and approval of Verlan Holdings' shareholders.

HRH office to house three acquisitions

GREENWOOD VILLAGE, Colo.—Hilb Rogal & Hobbs Co. has completed the acquisition of substantially all the assets of Denver-based Talty Insurance Agency Inc., which will move to a new HRH office in Greenwood Village, Colo.

HRH said the new office, which is expected to be completed by April 1 and be led by Vp and West Region Director William Creedon, also would house two other recent Colorado acquisitions: Urman Co. and Brown/Raynor Corp.

Law firm moves Philly office

BLUE BELL, Pa.—Nelson Levine de Luca & Horst L.L.C., a law firm that works primarily with insurers, has moved its Philadelphia-area office to 518 Township Line Road, Suite 300, Blue Bell, Pa. 19422. Phone: 215-358-5100.

USI adds broker, marketing accord

MERIDEN, Conn.—USI Holdings Corp. said it has completed the acquisition of Meriden, Conn.-based Webster Insurance Inc. from Webster Financial Corp. Briarcliff Manor, N.Y.-based USI said the brokerage is expected to contribute about $26 million in annualized revenue.

USI also said it had reached a product and service marketing agreement with Webster Financial.

Engle Martin moves Midwest offices

CHICAGO—Atlanta-based adjuster and claims administrator Engle Martin & Associates Inc. has opened new offices in the Chicago and Minneapolis areas.

The Chicago-area office now is at 1211 W. 22nd St., Suite 102, Oak Brook, Ill. 60523. Phone: 630-368-3710.

The Minneapolis-area office is at 7100 Northland Circle, Suite 108, Brooklyn Park, Minn. 55428. Phone: 763-230-7300.

Lockton opens 20th U.S. office

PHOENIX—Kansas City, Mo.-based brokerage Lockton Cos. L.L.C. has opened its 20th U.S. office, a Phoenix site focusing on employee benefits.

The office led by Senior Vp Todd Newton is at 2375 E. Camelback Road, Suite 500, Phoenix, Ariz. 85016. Phone: 602-957-1966.

Preventive care network expanding

JACKSONVILLE, Fla.—Dallas-based U.S. Preventive Medicine, which offers wellness, chronic care and early disease detection programs, said it plans to open an international operations center in Jacksonville, Fla.

The new office, which is to open by midyear, will incorporate current operations and allow for expansion of up to 100 positions in the next year, the company said.

Law firm unit targets subprime woes

NEW YORK—Reacting to more than 200 lawsuits nationwide as a result of the subprime crisis, New York-based law firm Locke Lord Bissell & Liddell L.L.P. said it has formed a Financial Guaranty Insurers Section.

"The housing downturn is threatening to cripple some bond insurers that wrote billions of dollars of guarantees in the past few years on securities backed by risky subprime-mortgage debt because they entered into contracts know as credit-default swaps," said Brian Casey, a partner with the firm and a leader of the new section.

BIMA backs captive designation

HAMILTON, Bermuda—The Bermuda Insurance Management Assn. has endorsed the Associate in Captive Insurance professional designation—the only captive insurance professional designation—offered by the International Center for Captive Insurance Education.

In addition, BIMA and the Bermuda Captive Conference have established a fund to pay the complete tuition of two Bermuda students going through the ACI program and scholarships to help two other Bermuda students seeking a captive insurance career.

Dovetail chooses South Carolina

COLUMBIA, S.C.—Dovetail Insurance Corp., an insurance technology and services company founded recently by New York venture capital firm Pequot Ventures, has chosen Columbia, S.C., as its headquarters.

Dovetail's office is at 1901 Assembly St., Suite 360, Columbia, S.C. 29201. Phone: 803-255-8891.

TO SUBMIT ITEMS

BI's new Market Moves column reports on activities by insurance industry companies and related entities. Personnel changes appear in Comings & Goings, while new product offerings appear in Products & Services.

Please send Market Moves news to: Charmain Benton, *Business Insurance*, 360 N. Michigan Ave., Chicago, Ill. 60601-3806; *cbenton@businessinsurance.com*.

Items for the Products & Services and the Comings & Goings reports should be e-mailed to Joe Walker at *jwalker@businessinsurance.com*.

Global: D&O policies may fail to protect

CONTINUED FROM PAGE 4

that action," Ms. Zacharias said.

Spain, meanwhile, not only codified the duties of directors, but established joint and several liability for directors and mandated the appointment of independent directors.

In addition, Spain requires publicly listed companies to explain whether, and to what degree, they are complying with the recommendations of a white paper on corporate governance, an explanation that could be used by plaintiffs' lawyers when filing complaints, Ms. Zacharias said.

In cases launched overseas, directors and officers of both the U.S. parent companies and the local subsidiaries are often named, said Suzan Friedberg, assistant vp, American International Underwriters in New York, a unit of American International Group Inc.

Historically, North American companies have purchased global policies protecting all directors and officers working in their worldwide operations with very few companies purchasing locally admitted policies, Ms. Robson said.

When local directors and officers end up in court, though, they often find that their company's global D&O policy does not protect them because it is not admitted on local paper, said Vincent Vandendael, global practice leader, financial lines, for Zurich Insurance Co. in Zurich, a unit of Zurich Financial Services Group.

'You have to make sure your policy is compliant with all local laws and regulations.'

Vincent Vandendael,
Zurich Insurance Co. Company

He cited one case where a local director of a Latin American subsidiary spent three weeks in jail because the D&O policy was on nonadmitted paper. "Really this could have been avoided if this person had a local admitted policy," he said.

Global D&O policies issued in the United States only cover directors and officers in countries that allow nonadmitted paper, Mr. Vandendael said. About one third of countries worldwide, including Russia, China, Japan and Germany, do not allow nonadmitted policies, he said. "You have to make sure your policy is compliant with all local laws and regulations," he said.

In addition, typical aspects of D&O policies may be problematic for policyholders with global subsidiaries, he said.

For example, insured vs. insured exclusions are common in U.S. policies, but the coverage is important for overseas claims because several European countries impose a duty on a company to bring an action against officials if their actions have an adverse impact on the company. If insurers do not provide coverage for employees who are legally required to sue their colleagues, they risk not selling many policies, Mr. Vandendael said.

In addition, several countries do not provide clear guidance on the ability to provide indemnification for directors and officers, said Edward Smerdon, partner with Reynolds, Porter Chamberlain L.L.P. in London.

For instance, local laws may stipulate that an exonerated director may be indemnified, but do not specify if the company can advance fees, creating a cash flow issue for directors and officers defending themselves against claims, he said.

Structuring a plan

When structuring a global D&O program, risk managers need to examine whether any of their company's subsidiaries are located in restricted countries and what the legal requirements are in those countries. "Looking territory by territory is absolutely critical," Mr. Vandendael said.

Companies that have operations in local countries that do not recognize U.S. policies may decide not to purchase local coverage because they have limited operations in the country or they feel the risk of litigation is fairly small, the panelists said.

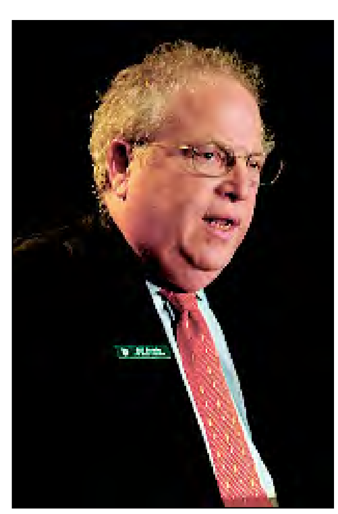
Parent companies may want to consider establishing a master D&O program with local policies in relevant jurisdictions and tie it in with the limits of their regular policies, Mr. Smerdon said. In theory, though, this could erode the limits of the main program, creating a significant coverage issue if a large claim emerges. "As far as I'm concerned, the full limit applies to that local policy," he said.

Purchasing basic local policies in countries that do not recognize U.S. policies is an option that could make sense from a financial and logistical perspective, although those policies would not have access to the higher U.S. limits or coverage under U.S. endorsements, ACE USA's Ms. Zacharias said. "That could be a problem if you have a significant claim," she said.

In response, some policyholders are purchasing endorsements to their U.S. D&O policies that would reimburse them for indemnifying a local subsidiary that experiences a loss related to its indemnification of a local director who experiences a claim, she said.

Impact of subprime crisis not expected to be severe

NEW YORK—The insurance industry will suffer substantial losses related to the subprime mortgage crisis, although it will not be as dire an event for the industry as some parties predict, according to William R. Berkley, chairman and chief executive office of W.R. Berkley Corp.



PLUS

Mr. Berkley

"I think the industry is going to pay, probably less than you would imagine," Mr. Berkley said during the keynote address of the Professional Liability Underwriting Society's D&O Symposium in New York on Feb. 6-7.

Although subprime litigation is in its early stages, all financial institutions will have exposure to the subprime crisis, he said.

Various analyst estimates have predicted liability insurance losses above $1 billion, while a Bear Stearns report last month estimated that insurance industry losses from the subprime crisis could top $9 billion, a number that D&O experts have referred to as extremely high.

Meanwhile, the subprime and housing market crisis will worsen, contributing to the economic challenges that will extend the soft market cycle for the insurance industry for several more years, Mr. Berkley said.

"I think the cycle is not over yet. I think '09 will be a substantial loss year for most of the industry," he said. "I think the cycle will turn around in 2010."

Although sophisticated tools have increased insurers' ability to ameliorate risk, Mr. Berkley questioned whether their ability to understand risk has really changed. He cited the situation at Société Générale where a trader is being blamed for $7 billion in losses, wondering how company officials failed to uncover the trader's activity. "Whoever wrote that business made a bet on the control systems that failed," Mr. Berkley said.

—By Gloria Gonzalez

SEC to remain focused on backdating, subprime investigations

Agency can still bring third-party cases despite court decision

By GLORIA GONZALEZ

NEW YORK—Options backdating and subprime investigations are a major priority for the U.S. Securities and Exchange Commission, an SEC official said during a recent conference on directors and officers liability.

The SEC will also continue to have a broad focus in pursuing third parties that aid and abet securities fraud despite a recent Supreme Court decision, Mark Schonfeld, director of the Northeast Regional Office of the SEC in New York, told attendees of the Professional Liability Underwriting Society's D&O Symposium in New York on Feb. 6-7.

Options backdating has been a "big priority" for the SEC, with the agency past the midpoint in bringing those cases, he said. The SEC has filed nearly 30 cases and a little less than half involve parallel criminal cases, Mr. Schonfeld said.

One notable aspect of backdating cases is the number of in-house general counsels involved, because they have a role in the compensation process, he said. The involvement of general counsels in SEC cases is rare, but about seven backdating cases have included general counsels, some of whom have pleaded guilty, Mr. Schonfeld said.

The subprime mortgage meltdown has generated another major area of activity for the SEC, which currently is conducting about three dozen investigations involving a wide range of organizations, making it a significant area of focus for the agency, he said.

The SEC still experiences a "steady diet" of accounting fraud cases, but they tend to be smaller than the cases brought against Enron Corp. and WorldCom Inc., he said. The agency has uncovered a number of accounting problems, but they were not necessarily severe enough that the companies could not survive them, he said.

The Sarbanes-Oxley Act, which requires certification of financial statements, has become a "powerful device" in deterring fraud. The SEC has seen cases in which employees refused to certify statements and brought issues to the attention of senior management and auditors that might have gone unnoticed.

And despite last month's Supreme Court decision in *Stoneridge Investment Partners L.L.C. vs. Scientific-Atlanta Inc; Motorola Inc.*, the SEC can bring cases against parties that aid and abet securities fraud, including auditors, managers and counterparties participating in transactions "if done with sufficient level of intent to cook the books of the public company," he said.

In its Jan. 15 decision in *Stoneridge*, the high court limited the cases when defrauded investors can recover from third parties—even those that knowingly facilitated another company's fraud—to those in which the investors relied on the defendants' actions (*BI*, Jan. 21).

The SEC plans to continue to focus on a broad array of parties involved in fraud as it did in a case involving Adelphia Communications Corp. In April 2005, the SEC announced that Deloitte & Touche L.L.P. agreed to pay $50 million to settle charges stemming from its audit of Adelphia's 2000 financial statements.

An unanswered question is whether the *Stoneridge* decision places the onus on the government to bring cases against third parties if the door is clearly closed on the plaintiff's ability to file such claims, he said.

The plaintiffs bar will have to rely on the SEC to bring cases against these third parties and the agency may not have the resources to pursue all cases, said panel member John Coffey, a partner with Bernstein Litowitz Berger & Grossmann L.L.P. in New York, which prosecutes class and private actions on behalf of individual and institutional clients. "It's going to put a lot of pressure on the SEC," he said.

Meanwhile, other parties such as audit committees still involved in lawsuits will face larger potential losses than they would if third parties were still involved in the cases, he said.

1,345 attend conference

NEW YORK—A total of 1,345 people attended the Professional Liability Underwriting Society's D&O Symposium in New York on Feb. 6-7.

The symposium featured sessions on international director and officers exposures, the impact of the subprime mortgage crisis on the D&O sector, securities litigation and coverage issues related to both primary and excess insurance policies.

Next year's symposium will take place Feb. 25-26 in New York.

—By Gloria Gonzalez

Business Insurance
PERSPECTIVE

Nanotechnology poses no minuscule risk

Louise E. Vallee is a vp for Chubb & Son and a research and development specialist for Chubb Commercial Insurance in Whitehouse Station, N.J.

Risk managers face new challenges in evaluating exposures

By Louise E. Vallee

Research and commercial applications of nanotechnology are advancing rapidly. In the future, we can expect to see nanotechnology applications in numerous industries including electronics, cosmetics, pharmaceuticals and biomedicals.

While nanotechnology offers opportunities for many industries, it also comes with questions. The advances in nanotechnology applications are outpacing research into possible adverse effects, as well as regulations that might govern the use of these products. This information gap makes it imperative that risk managers understand the new dimensions that nanotechnology will likely bring to workers compensation, product liability, environmental liability and property and general liability.

The size of nanoparticles makes them highly reactive, increasing the risk of fire or explosion. These particles also may behave differently, from a pollution or remediation perspective, than larger particles. And in product development, companies need to assess the effects of inhaled or absorbed nanoparticles. Most nanotechnology research and development currently focuses on workers compensation-type exposures, because those are believed to present the greatest potential risk.

Experimental studies have shown that nanoparticles can affect lung tissue or cross the blood-brain barrier. While there is concern about workers exposed to nanoparticles, the research is not yet complete, so no definitive judgments can be made.

All of these unanswered questions make it imperative that businesses develop their own nanotechnology risk management plan to consider materials in terms of expected applications, potential exposures, toxicity and appropriate control measures. Risk managers must identify and mitigate points of possible employee exposures in the production process.

For many years, the primary health and safety concern for workers was chemical exposure. Risk managers typically focus on the amount of employee chemical exposure based on the U.S. National Institute of Occupational Safety and Health and the Occupational Safety and Health Administration standards for air contaminants, with the assumption that elevated levels may cause illness or injury.

However, the emergence of nanotechnology exposure is deepening the risk picture. The highly reactive nature of nanoparticles means that size and count now are just as important as the traditional concern about quantity.

With this shift, companies face different ways of evaluating workplace contaminants.

Traditional industrial air sampling methods may not adequately gauge employee exposure to nanoparticles. Consequently, monitoring methodology will have to become more complex.

If nanotechnology processes could lead to release of materials into the air, control practices should potentially involve enclosure, isolation and ventilation. Protective equipment and good hygiene practices, such as facilities for showering, are also essential. Employees should be prohibited from consuming food and drink in the workplace to avoid accidental ingestion of nanoparticles. And in the event of surface particle accumulation, the cleanup procedure must include vacuuming with a HEPA filter to trap the nanoparticles. Best practices also call for ventilation systems that capture nanoparticle contaminants.

Companies should follow special procedures for cleaning up spills, addressing fire risk and containing materials. Also, fire suppression and extinguishing systems and explosion venting must be in place.

In 2003, President Bush signed the 21st Century Nanotechnology Research and Development Act, which authorized funding for nanotechnology research and development for four years beginning in 2005. The legislation put into law programs and activities supported by the National Nanotechnology Initiative, a multiagency research and development priority of the Bush administration.

The NNI aims to ensure that nanotechnology research leads to "the responsible development of beneficial applications by giving high priority to research on societal implications, human health, and environmental issues related to nanotechnology."

Based on the limited research on nanoparticles, nanotech products must undergo rigorous scrutiny to assure their safest use. Funding of nanotech product research continues to grow globally, with estimates that more than $3 billion was spent in 2003 for public research alone, according to Swiss Reinsurance Co.

Nanotechnology is here to stay. According to NIOSH, nanotechnology has potential applications for integrated sensors, semiconductors, medical imaging and drug delivery systems. In the medical world, this technology could improve detection and treatment of diseases, such as cancer and HIV/AIDS.

U.S. officials expect that by 2015, the global market for nanotechnology-related products will reach $1 trillion and employ 1 million workers in the United States alone. The prospect of nanotechnology applications affecting nearly every industry makes it all the more important for risk managers to understand all aspects of nanotechnology.

Many of these control measures aren't new. Containment technologies for hazardous materials already exist. What's new is the ability to manipulate individual atoms to create particles and structures having specific properties.

Developments in this field promise to occur at lightning speed. Many nanotech firms are in the research and development phase, with production expected to take off within two to five years.

Rapid growth and changes, coupled with the knowledge gaps that confront us on the possible impact of nanoparticles, make it imperative for risk managers to learn the potential risks as well as assess their potential exposure and ways to control the technology.

Business Insurance
PERSPECTIVE

Rating disease management programs

Alfred Lewis is founder and president of the Disease Management Purchasing Consortium International Inc. in Wellesley, Mass.

Simple assessments can show employers true value of plans

By Alfred Lewis

Even though it has existed for more than a decade, the disease management field is still in its infancy when it comes to providing valid metrics for measuring its value for the managed care industry and large employers that pay for the programs. Standards of measurement have varied widely among vendors, often giving rise to assertions that sound impressive, but on closer inspection prove to be flawed.

For years, major payers have embraced disease management programs as a way to manage high costs and debilitating health conditions. The return on investment from disease management has been associated with both improved health outcomes and measurable cost savings. But inconsistent and invalid application of measurement tools have forced large payers of health care dollars to implement programs without valid tools, approve programs on good faith or inaccurately estimate savings from disease management programs.

So, is it possible for employers and consultants to avoid being fooled by these optimistic claims? And, can results from disease management programs be realistically and accurately reported?

It turns out that there are two easy ways to avoid getting fooled and to get valid results.

First, create a "dummy program" using claims data from years prior to the program year. Pretend a program was in place, and measure its "impact" by trending the claims costs of members with the condition against the members without, using the vendor's exact measurement methodology. What you may find is that the simple act of splitting the population and trending them forward creates a phantom percentage of "savings" in the group with the disease. If you can do this calculation on multiple years prior to the program, all the better. Then apply the average phantom savings number to the real baseline, so that vendors don't get credit for them but rather only for the savings in excess of that phantom number.

Second, run "plausibility checks" on vendor reports. If, for instance, a vendor says it saved you 15% of what you spend on asthma, see if your emergency room and inpatient costs for asthma—the only costs which are theoretically reducible—even exceed 15% of total asthma patient spending—chances are, they don't. If your outcomes report cites 10% savings in heart disease, see if your total heart attacks and angina attacks fell 10%. No chance of a vendor fooling you here. This is your data and your analysis.

The only caveat: an employer needs at least 20,000 total covered lives to make either of these analyses valid. However, doing both analyses together provides supporting insight even among much smaller employers.

When you do these analyses you will find that savings are much reduced, perhaps even to zero. The uncomfortable conclusion is, when you measure correctly, you may not be saving money. You might think, "Well, our reported ROI is high enough that even if the methodology is flawed, we will still be above

See **DISEASE** next page

Business Insurance

PERSPECTIVE

Dig deep to win pollution claims fights

By Jerry Oshinsky and Barry Buchman

Last June, the New Jersey Department of Environmental Protection filed a group of lawsuits against numerous petrochemical, manufacturing and other types of companies seeking substantial compensation for alleged environmental damage.

These lawsuits are the latest in a series that New Jersey began filing in 2002, primarily under the state's Spill Compensation and Control Act. In total, there are approximately 120 lawsuits, which collectively name hundreds of companies as defendants and seek hundreds of millions of dollars in damages.

The potential damages are significant because the lawsuits seek compensation beyond traditional cleanup costs and fines. The lawsuits also seek recovery of "natural resource damages," including the "loss of use" of allegedly contaminated natural resources.

On June 6, 2007, in the case of *New Jersey Department of Environmental Protection vs. Exxon Mobil Corp.*, the Appellate Division of the New Jersey Superior Court held that companies can be held strictly liable under the Spill Act for these types of "loss of use" damages. Also, in August, New Jersey Gov. Jon Corzine signed a bill that eliminates statutes of limitations for claims brought under several environmental statutes, including certain statutes relied upon in the recent NRD lawsuits.

Although NRD litigation has received significant attention recently in New Jersey, as many as 29 states have authority under state law to bring NRD claims, and additional states may claim authority under federal law to bring these claims. Moreover, companies that do not face state-initiated lawsuits may still face indemnification or contribution lawsuits by companies that are sued by states.

Due to the large sums of damages that they seek, NRD lawsuits raise important insurance coverage considerations for companies named as defendants. These companies, for example, may be able to recover insurance proceeds under their comprehensive general liability insurance policies for defense costs and any ultimate liabilities associated with the lawsuits. Many NRD lawsuits allege environmental damage going back several decades, so the lawsuits may implicate numerous policies in a company's insurance program, including older policies.

Insurance companies, however, may raise their usual, and often rejected, litany of defenses in an effort to preclude or limit coverage. Some of the issues include: whether the costs of cleaning up sites constitute insured "damages" within the meaning of CGL policies; whether, and to what extent, pollution exclusions in policies may bar coverage; and whether, and to what extent, prior insurance coverage settlements between companies and their insurers may have released coverage for more recent NRD lawsuits.

Companies should not assume that these or other insurance company defenses will defeat coverage. For example, there is favorable case law in New Jersey and other jurisdictions holding that cleanup costs constitute insured "damages" within the meaning of CGL policies. There also is favorable case law in New Jersey and other jurisdictions regarding the scope of pollution exclusions in CGL policies. And, as noted earlier, NRD lawsuits may implicate older policies that do not even contain pollution exclusions.

Further, many prior environmental coverage settlements carve out coverage for NRD claims from the liability releases provided to the insurance companies in the settlements. Thus, these settlements do not preclude companies from pursuing such coverage now. Accordingly, companies should not assume that they do not have any coverage for NRD claims simply because they have entered into prior environmental coverage settlements.

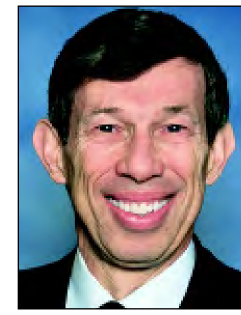
Regardless of whether a company has been named in an NRD lawsuit, there are steps that all risk management and legal departments can take to put their companies in the best possible position to secure insurance coverage if and when the need arises.

First, collect, organize and safeguard all of your company's CGL policies going as far back in time as possible. This process should include an effort to identify, and obtain, if possible, policies issued to other pertinent companies, such as predecessors and current or former affiliates of your company, and companies that previously owned any environmental sites that your company now owns. Policyholder attorneys and consultants can assist with this process by utilizing sophisticated "policy archaeology" techniques to locate historical policies and secondary evidence of any missing policies.

Second, collect, review, and analyze any prior insurance coverage settlements encompassing these policies to determine whether any of those agreements may have released coverage for NRD claims. Companies similarly should analyze whether the payment of any prior insurance claims may have exhausted any policies.

Third, if served with any NRD lawsuits, the company should give notice promptly to its insurers, absent relatively rare, case-specific circumstances that may justify refraining from giving such notice. Companies also should take reasonable steps to keep their insurers apprised of the status of NRD lawsuits.

The coverage provided by historical insurance policies for NRD lawsuits and other types of environmental and toxic tort litigation can be an extremely valuable corporate asset. Companies can maximize the benefits of that asset by acting proactively now to analyze it, and by refusing to take coverage denials from their insurers at face value.



Jerry Oshinsky and Barry Buchman are attorneys with the Washington-based law firm Dickstein Shapiro L.L.P. The opinions expressed in this article are solely those of the authors, and do not necessarily reflect the views of Dickstein Shapiro or any of its clients.

Disease: Measuring success

CONTINUED FROM PAGE 33

1:1." Unfortunately, history has shown that there is actually an inverse correlation between reported and true ROIs—the higher the reported ROI, the less money was actually saved, perhaps because companies which don't know how to measure, don't know how to manage either.

Some vendors and health plans have noticed this too. They've traced the industry's failure to earn a true economic ROI to its limited scope, costly and ineffective outreach, and, most importantly, lack of integration with the remainder of the health plan.

As a result, these leading-edge vendors and health plans have created a new model for disease management programs, far more integrated than the old, which with all its carve-outs and special programs has become shockingly fragmented.

Clearly, a single point of contact for members would be helpful in reducing fragmentation, but a single point of contact is only the start of integration. What happens next is where true integration takes place. Is a caller to a referral line seeking a cardiologist prompted for his/her interest in a heart risk reduction program, and then transferred? Is someone calling for diabetic supplies given the option of joining a diabetes program? Does the diabetic supplies vendor even share names with the disease management vendor?

The list of potential linkages actuated in these new programs could continue for pages and includes coverage questions, nurseline inquiries, health risk assessments and almost every other health plan administrative function for providers as well as members. Even something as basic as direct communication between utilization management and disease management takes place so rarely that the average lag time between a patient's diagnosis and first completed contact with a disease management program exceeds three months.

Replacing reams of outgoing cold calls with much smarter use of existing touch points appears to make a huge difference in disease management participation and outcomes. But this time, unlike in disease management, don't take the vendor's word for it. Divide your total population, not just disease population, into two groups and contract with one vendor to provide one group with comprehensive, integrated services. Put that vendor at full risk for beating the overall performance of the other group for claims plus program fees. It's that simple. Either the "study group" as a whole beats the control group in overall trend, or you get money back. No fancy algorithms for finding "eligibles." No pre-post sleight-of-hand. No questionable "trend" calculations. No fooling.

Group seeks stay of health care spending law from high court

By JERRY GEISEL

SAN FRANCISCO—A California restaurant association is asking the U.S. Supreme Court for an order to prevent the city of San Francisco from enforcing a health care spending law while an appeals court decides whether the requirement is pre-empted by federal law.

The request by the Golden Gate Restaurant Assn. involves a 2006 San Francisco law that requires employers to either spend a certain amount of money on employee health care coverage or pay a fee to help fund coverage for uninsured city residents.

Late last year, a federal judge ruled that the law ran afoul of a provision in the Employee Retirement Income Security Act that pre-empts state and local laws that relate to employee benefit plans.

But last month, a three-judge panel of the U.S. 9th Circuit Court of Appeals said San Francisco can enforce the law while the case is decided by the full appeals court.

In its request for a Supreme Court order to stay enforcement of the law, the Golden State Restaurant Assn. said implementation of the law has ended three decades of uniform federal benefit plan regulation.

> **'Employee benefit plans and plan sponsors must now...immediately conform their conduct to inconsistent local requirements.'**
>
> Golden Gate Restaurant Assn.

"Employee benefit plans and plan sponsors must now…immediately conform their conduct to inconsistent local requirements," according to the application filed by the law firm Dickenson, Peatman & Fogarty in Napa, Calif.

Since the appeals court order was published, "its language will cause confusion far beyond San Francisco, requiring employers throughout the nation to closely monitor and plan for dozens of similar state and local proposals," according to the application.

By stopping enforcement of the law, the Supreme Court can "restore uniformity, avoid immediate disruption of the national interests Congress intended to protect and preserve ERISA's structure and balance," the application said.

Supreme Court Associate Justice Anthony Kennedy last week asked San Francisco to respond. The city's response is due Feb. 20.

International NEWS

U.K. corporate manslaughter law prompts liability cover concerns

Increase expected in prosecutions alleging negligence in worker deaths

By STUART COLLINS

LONDON—Buyers seeking clarity over coverage for liabilities brought about by upcoming corporate manslaughter legislation in the United Kingdom have met with a far from cohesive response from insurers.

Some employers and public liability insurers have indicated that they will provide coverage—such as legal expenses—for corporate manslaughter charges, but several have restricted coverage and introduced sublimits, brokers and insurers say. Directors and officers liability insurers have not made significant changes to their policywordings, although buyers should ensure they have appropriate cover for directors' defense costs, one broker noted.

Changes to the law on corporate manslaughter—known as corporate homicide under Scottish law—will come into force in April this year as part of the phased implementation of the Companies Act 2006. The new law, The Corporate Manslaughter and Homicide Act 2007, is aimed at making it easier to prosecute companies for deaths caused by gross negligence and breaches of duty of care.

But until the legislation is tested and prosecutions are brought under the Act, it is uncertain to what degree companies—and their directors—face higher exposures, experts say. As a result, there has been a mixed response from providers of employers liability, public liability, commercial auto and D&O insurance to the act.

Where a criminal prosecution is brought against a company or employee in cases of a fatal accident, insurers will only cover legal costs, and in some cases bodily injury awards, experts say. Even then, legal costs are usually recoverable, if a company or individual is found guilty of a criminal act, they add.

Employers liability and public liability policies cover legal costs for offenses committed under the Heath and Safety at Work Act 1974, but this coverage will not automatically extend to prosecutions brought under the new law.

Buyers should check whether their liability coverages provide cover for legal costs and bodily injury awards incurred under corporate manslaughter prosecutions, experts advise.

But this is the least cohesive response by U.K. liability insurers to new legislation in several years, according to Simon Collings, employers liability practice leader and senior vp in the property/casualty practice at brokerage Marsh Ltd. in London.

"Some insurers say this is not an employers liability, public liability or commercial auto insurance issue, it is a legal expenses issue. At the other extreme some insurers say that this is covered under existing wordings," Mr. Collings said.

In between these two extremes, several insurers have issued wordings to endorse or restrict (legal costs associated with corporate manslaughter prosecutions) through sublimits or give defense cover only where there is a bodily injury claim," he added.

Concern

Mr. Collings said he wants clarity from insurers over the coverage they plan to offer in the near future.

"Our concern is that we have clients with policies that run over April 6 (when the Act comes into force), that will need endorsements to get cover. And we have clients that need coverage after April 6, and this issue could be material when comparing coverage" offered by different insurers, he said.

"Ideally we would like to see a unified response from insurers, and it would be ideal if insurers all agreed to deal with corporate manslaughter" in the coverage, he added.

QBE Europe, a unit of Sydney, Australia-based QBE Insurance Group Ltd., has introduced a sublimit for corporate manslaughter in its liability policies, said Mike Noonan, head of strategic claims for the company's operations in London.

See MANSLAUGHTER next page

ZUMA PRESS

Several buildings collapsed in Yichun, China, after their roofs caved-in under the weight of snow. The worst winter weather to hit China in 50 years caused significant insurance losses in many parts of the country.

Insurers see China storm losses

BEIJING—Chinese insurers have so far paid out more than one billion yuan ($138.9 million) for snow-related claims in the country's southern provinces, according to the China Insurance Regulatory Commission. Property losses accounted for nearly 90% or 855 million yuan ($118.77 million), the country's insurance regulator said in a special report on the snow storms that hit China late last month. Earlier this month, China's Ministry of Civil Affairs estimated that the country's worst winter weather in 50 years has caused an estimated $7.5 billion in economic losses.

—By Stuart Collins

European runoff liabilities decrease, but long-tail losses remain an issue

Survey finds differing trends as markets throughout continent vary

By STUART COLLINS

European insurance liabilities in runoff have shrunk slightly to €202 billion ($295.3 billion) in 2008, €2 billion ($2.9 billion) lower than in 2007, according to a survey published last week.

The overall reduction was caused by a €7 billion ($10.2 billion) fall in the United Kingdom and Ireland, although liabilities in continental Europe increased by €5 billion ($7.3 billion), according to "Unlocking value in Run-Off: A Survey of Discontinued Insurance Business in Europe," published by accountancy firm PricewaterhouseCoopers L.L.P. in London.

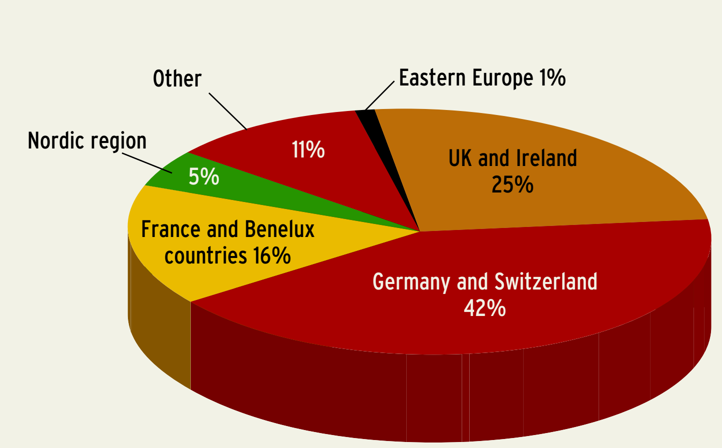
The increase in mainland European runoff liabilities reflected the absence of any significant runoff closures at a time when the European insurance market continues to grow, according to the report.

In other findings in the survey of 135 insurers and reinsurers, 70% of respondents estimated it would take more than 10 years to run off their books of business.

Runoff business in the United

See RUNOFF next page

DISTRIBUTION OF EUROPEAN RUNOFF LIABILITIES



Source: PricewaterhouseCoopers L.L.P.

Same-sex: New York must recognize gay marriages, appeal court says

CONTINUED FROM PAGE 3

crossing the border and bringing that marriage into New York's jurisdiction," said Mr. DeLaus.

Some observers believe, nonetheless, that the appellate court's ruling is likely to be upheld by the higher court.

"I would say there's a good chance that it will be upheld" because the marriage does not fall under the two categories not permitted under state law, said Joe Lazzorotti, an employer attorney for Jackson Lewis L.L.P. in White Plains, N.Y.

With few exceptions, it has long been established that marriage in other jurisdictions are recognized by states, said Joanne Hustead, Washington-based senior health compliance specialist, national compliance practice, with the Segal Co. "Otherwise, every time you moved, you'd have to get remarried," she said.

However, even if the Court of Appeals upholds the decision, there will be pressure on the state to change the relevant statute's language, said Scott Macey, Somerset, N.J.-based senior vp, and director of government affairs for Aon Consulting.

Employers should review their benefit plan language, observers say, to see, for instance, if spouse is clearly defined as someone of the opposite sex. "The conservative employer will take a look at their policies now," said Dorian Smith, an attorney with Valhalla, New York-based Towers Perrin.

Employers with self-insured plans are likely to be exempt from the ruling under ERISA, observers say.

"I think there are some limits on the breadth of the plans for which an employee can seek coverage, in that under ERISA and DOMA, federal law still doesn't recognize same-sex spouses," said Brian Kopp, an attorney with Nixon Peabody L.L.P. in Rochester, N.Y.

States have long recognized marriage in other jurisdictions. 'Otherwise, every time you moved, you'd have to get remarried.'

Joanne Hustead, The Segal Co.

However, "I think it's going to be tough to argue ERISA pre-emption for a marriage law," said J.D. Piro, an attorney at Hewitt Associates Inc. in Norwalk, Conn. "I think it's more of an issue of whether New York state's own marriage law precludes recognition of a same-sex marriage, which is one interpretation of the *Robles* decision."

Mr. Smith said he believes if the decision is upheld, health insurers "may feel like they have to at least offer" a policy offering same-sex spouse benefits, but until further guidance from the New York Insurance Department or the state's legislature on this issue, "I don't think they would be required" to do so.

It could also affect public employers and non-ERISA-regulated benefits, including bereavement and other leave that does not fall under the federal Family Leave and Medical Act, said Ilse de Veer, a principal with Mercer L.L.C. in Norwalk, Conn.

Laurel Pickering, executive director of the New York Business Group on Health, said also most of its members, which are larger firms, already provide domestic partner benefits, "so a ruling like this doesn't necessarily impact them in a large way." A ruling is more likely to affect smaller businesses that "may not be in the habit of offering these kind of benefits," she said.

Patricia Martinez vs. County of Monroe, Monroe Community College, Trustees of Monroe Community College and Monroe Community College Director of Human Resources Sherry Ralston, in her individual and official capacity, Supreme Court of the State of New York, Appellate Division, Fourth Judicial Department, 1562 CA 06-02591.

Manslaughter: U.K. law on corporate killing prompts look at coverage

CONTINUED FROM PREVIOUS PAGE

"We looked at this last year and felt that our wordings covered corporate manslaughter for employers and public liability. If an insured faces these charges—and provided that we have agreed with their course of action—there is cover for legal expenses for an investigation and a first instance prosecution," he said.

But QBE has introduced a separate limit of £1 million ($1.9 million) for corporate manslaughter to employers and public liability, Mr. Noonan said. Standard limits—of up to £10 million ($19.5 million)—for prosecutions bought under the Health and Safety at Work Act are unchanged, he added.

Zurich Financial Services Group Inc. has taken a similar approach and plans to introduce a standard £1 million sublimit for legal defense costs in corporate manslaughter prosecutions, although it will be possible to buy higher limits of say up to £2.5 million ($4.7 million).

"We have not made any changes to our policies yet, but we intend to extend all policies from April 1 this year and we will issue an endorsement to all employee liability policyholders, existing and new," said Richard Nicholls, head of employers liability in the United Kingdom for Zurich Global Corporate, part of Zurich, Switzerland-based ZFS.

"So far we feel the impact on the pricing model will be minimal, so at the end of the day it would be impossible to charge for additional cover," Mr. Nicholls said.

Like Marsh, Zurich found that the market's response to the new legislation had been slow. "Even as we speak, it is not certain what our competitors are doing in this area and few have gone public. But we think that we will be the benchmark for the market and I would be surprised if carriers would provide coverage up to policy limits," Mr. Nicholls said.

D&O policies could also provide companies with some coverage, although typically directors and officers insurance provides for individuals and not companies, experts say.

"The (Corporate Manslaughter and Homicide Act 2007) is clearly targeted at companies and not at the individuals in a corporation," said Chris Hewitt, London-based executive director at Lockton Cos. International Ltd., part of Kansas City, Mo.-based brokerage Lockton Cos. Inc.

But D&O liability policies, which are intended to provide coverage to individuals, would not typically cover legal expenses for the company itself, if it were to face corporate manslaughter charges, Mr. Hewitt added.

D&O underwriters have considered whether they should offer so-called entity cover for corporate manslaughter charges, which would give an insured company some legal expenses coverage, Mr. Hewitt said.

But D&O underwriters, concerned over how to price such coverage, have so far held back, he added. "No one is offering (entity coverage) for corporate manslaughter," Mr. Hewitt said. "Even in a soft market, it is such an issue, and underwriters are still trying to get their heads around the act," he added.

While the new law is not intended to target individuals, directors and officers face increased exposures, Mr. Hewitt said, noting they could be dragged into a corporate manslaughter prosecution against their company, he added. "The exposure level increases, but from a defense perspective, even though a successful conviction will go against the corporation not the directors," he said. "My general view is that it will create more activity, and more potential notifications for D&O insurers, where directors are drawn into a fatal accident," he added.

Buyers should check D&O policies for bodily injury exclusions and make sure that they have appropriate defense costs for directors and officers should they be drawn into any corporate manslaughter litigation.

Zurich's directors and officers coverage does not exclude or sublimit defense costs for corporate manslaughter prosecutions, according to Douglas Robare, D&O manager for Zurich Global Corporate in the United Kingdom.

"There is no change in pricing. And until case law or claims frequency changes to support it, we will not see rates rise" because of corporate manslaughter prosecutions, he added.

Lloyd's seeks to set up as reinsurer in Brazil

By STUART COLLINS

LONDON—Lloyd's of London has applied for admitted reinsurer status in Brazil and is to establish its first representative office in Rio de Janeiro.

The Brazilian reinsurance market was liberalized under legislation enacted Jan. 15, 2007, ending the monopoly position of state reinsurer, Instituto de Resseguros do Brasil. In December last year, the Brazilian insurance regulator, the Superintendence of Private Insurance, published reinsurance rules that meant foreign reinsurers with a financial strength rating of A- or above did not need to post collateral to meet claims liabilities.

Lloyd's cited recent legislative changes by the Superintendence of Private Insurance, Brazil's strengthening economy and the growing demand for insurance in the region as key reasons for the application. Lloyd's already participates in the Brazilian market as a reinsurer to IRB.

Earlier this month, Munich Reinsurance Co. announced that it was to open a subsidiary in São Paulo, where it has had a representative office for the past 10 years.

Munich Re said that annual premium income from primary insurance in Brazil was about $27 billion, making the country the largest insurance market in Latin America. "Liberalization of the reinsurance market, coupled with the country's overall economic development is expected to make demand for reinsurance solutions in Brazil increase markedly," Munich Re said in a statement.

Runoff: Report examines concerns in wind-ups

CONTINUED FROM PREVIOUS PAGE

Kingdom generally has a longer tail than Continental Europe, in large part due to London market's position as a global insurance market with significant exposure to U.S. long-tail liability risks, according to the report.

Eighty percent of respondents in the United Kingdom said it would take 10 years or more to run off their business, compared with 67% of Continental European respondents.

"Both these figures are high and will naturally be an area of concern for senior management," the report said.

The survey also ranked the most significant challenges facing insurers with runoff business.

The most frequently cited challenge was that runoff business tied up capital, with 63% of respondents citing that concern. "Consequently, managers of runoff portfolios will look for ways to release locked up capital through techniques such as business transfers, sales or structured exit mechanisms," PWC said in the report.

Of the respondents, 59% cited adverse loss development as a top challenge and 56% cited operational costs. While the recent hard market has cushioned insurers and reinsurers from cost concerns "as markets soften, organizations will be increasingly motivated to gain a better understanding of the true costs associated with owning and managing runoff business," the report said.

The report is available at www.pwc.co.uk

Probe: Raises concerns over health care cost hike

CUOMO'S CHARGES

Specific charges made in the New York attorney general's notice of proposed litigation:

- The Ingenix database lacks information about providers' training and qualifications, the type of facilities where comparative services were provided and the condition of patients.
- Ingenix manipulates that database by deleting valid high charges and by deleting proportionately more high charges than low charges.
- Ingenix deletes from the database charges that have modifiers to indicate procedures or services with complications. These charges are typically higher.
- Ingenix fails to collect information affecting the value of a service, such as whether a service was performed by someone other than a physician.
- Ingenix pools data from dissimilar providers (such as nurses, physician assistants and physicians) for use in its database.
- The Ingenix database contains outdated information.
- Ingenix fails to audit the data it receives from data contributors to ensure that they have submitted all the appropriate data and have not included negotiated or discounted rates.
- Some data contributors delete higher charges from the data they submit to the Ingenix database, thereby skewing reimbursement rates downward.
- Ingenix uses the defective data in the database, and a deficient methodology, to "derive" additional charges. The use of defective data to formulate a rate for other charges means that the resulting rate itself is defective.

Source: New York attorney general

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In response to Mr. Cuomo's announcement, UnitedHealth issued a statement defending its UCR database. The insurers that were issued subpoenas issued statements that said they were cooperating with Mr. Cuomo's investigation.

If the litigation determines that the Ingenix system is skewed in favor of payers, it could affect self-insured employers as well as insurers since most of them also rely on the Ingenix UCR database when calculating out-of-network provider reimbursements, benefit experts note.

"It is bad news for several reasons. Self-insured employers use the same reasonable and customary basis for out-of-network claims, so it could lead to higher claims costs," said Joe Martingale, an independent benefit consultant based in New York.

"The net effect is that the insurers didn't pay enough, and self-insured employers that bought into those systems are going to be similarly affected," said Mark A. Rucci, senior vp at APEX Management Group, a benefit consulting unit of Gallagher Bassett Benefit Services based in Princeton, N.J.

The New York attorney general's attack on UCRs "defies everything that we've been doing in health care cost management for years," said Helen Darling, president of the Washington-based National Business Group on Health, a consortium of the nation's largest employers, all of which self-insure their health care plans.

UCRs were created to slow down the rate of increase in doctor fees and to curb billing abuses by physicians, Ms. Darling said. While employers could control their in-network expenses through their preferred provider contracts, there were no such cost controls on out-of-network provider billing, she noted.

"Physicians were constantly increasing fees," she said. "The doctors want costs to climb faster, while employers want to slow down the rate of increase."

Ms. Darling also asserted that despite the NYAG's allegations that UCRs are too low, "doctors are still getting good, reasonable fees from the commercial payers." The UCR rates are considerably higher than the compensation providers get under Medicare and Medicaid, she said.

Karen Ignagni, president of America's Health Insurance Plans, the Washington-based health plan industry trade group, also defended the use of UCRs in keeping health care costs in check.

"At a time when the costs of medical services soar above inflation every year, health insurance plans' tools and techniques are mitigating the damage done to consumers and employers," Ms. Ignagni said in a statement.

"It's unfortunate that today's media event ignored these pacts and failed to address the appropriateness of charging out-of-network patients $200 for a simple doctor visit lasting 15 minutes, which equates to a billing rate of at least $800 an hour. As medical costs continue to soar, this is the discussion that public policy leaders need to have," Ms. Ignagni said.

"It's really a battle for income," said Ed Kaplan, national health practice leader at the Segal Co., a New York-based benefit consultant that uses Ingenix's PCSR database as part of its TPA audit practice.

"The physicians are struggling to grow their incomes. Their costs are going up, and the payers are holding the lid as best they can. In addition, Medicare and Medicaid increases have been pretty modest," he said.

If UCRs are increased as a result of the New York investigation, "in the end, it's all going to be paid by the consumer," because those higher costs will result in higher premiums and greater out-of-pocket expenses, he said. "The underlying fact is the system is broken."

Ingenix database used by insurers, TPAs to calculate out-of-network reimbursements

UnitedHealth Group Inc. formed Ingenix in 1996 as a health information technology company to provide various data collection and analysis services to insurers, providers, pharmaceutical manufacturers, biotechnology companies, federal and state agencies and large employers.

Ingenix's Prevailing Healthcare Charges System, one of more than 100 products, includes the consolidated data from Medicode, a medical coding software firm Ingenix acquired in 1997. The PHCS also includes usual and customary rate information from a database Ingenix bought in 1998 from the former Health Insurance Assn. of America when that group merged with the Group Health Assn. of America to form America's Health Insurance Plans.

The PHCS database contains 1.3 billion records submitted by 100 major contributors, including insurers and third-party claims administrators. The oldest data collected is 15 months old, and updates are issued every three to six months, according to Dave Ostler, executive vp at Eden Prairie, Minn.-based Ingenix.

The UCR pricing data is presented in table form, divided into 50th, 80th and 90th percentiles. A median price is also provided, he said.

Ingenix uses a "rigorous methodology to validate the data," said Mr. Ostler, adding that the company is preparing a tutorial for nonstatisticians in response to the UCR controversy.

Ingenix says it derives UCR charges by culling insurers' billing information for similar types of medical services, taking into account the type of physician providing them and their geographic location.

For example, if a submitted claim exceeds the norm by an excessive amount—say a $30,000 charge for a 15-minute office visit—it is omitted from the database. However, Mr. Ostler said Ingenix deletes more lower-cost outliers than high-cost ones, contradicting an assertion made by the New York attorney general.

—By Joanne Wojcik

Blast: Full extent of sugar refinery's insured losses still unclear

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Imperial Sugar. The brokerage declined to comment on its client's insurance arrangements.

According to the Georgia State Board of Workers' Compensation documents, New Hampshire Insurance Co., a unit of New York-based American International Group Inc., provides workers compensation coverage for Imperial Sugar. AIG declined to comment.

According to Imperial Sugar's 10-K, in 2007 it purchased property coverage, and listed an increase in its insurance coverage costs as among several reasons why its margins decreased during 2007.

Imperial Sugar did not return calls seeking comment on the explosion.

Although the cause of the explosion is still under investigation, government researchers have found that combustible explosions have caused significant damage in recent years.

Experts agree that the infrequency of dust explosions often renders them a low safety priority, but incidents can be severe.

In a November 2006 report, the CSB identified 281 combustible dust incidents occurring over 25 years that killed 119 workers and injured 718 others. At least four of those happened since 1995 and each "caused damages costing many hundreds of millions," the CSB reported.

According to the report, 24% of the dust explosions occurred within the food industry, several of which took place at sugar plants.

DUST DANGERS

10 years of incidents, injuries and fatalities of combustible dust fires and explosions.

Source: U.S. Chemical Safety and Hazard Investigation Board

In conjunction with its report, CSB called on the U.S. Occupational Safety and Health Administration to adopt National Fire Protection Assn. standards so there would be a consistent, nationwide effort to address dust explosion hazards.

Otherwise, enforcement has been left to state and local officials, resulting in a "patchwork of adapted and adopted voluntary standards that are challenging to enforce," CSB said.

OSHA, so far, has not adopted NFPA standards, however, in October 2007, it issued a directive emphasizing inspections of workplaces handling combustible dust.

Chemical dust explosions occur when the right combination of finely ground particles find an ignition source. They can occur at companies that handle rubber, plastic, chemical, metal, lumber, and wood products, according to OSHA.

Many companies still have not addressed the potential for combustible dust hazards because of cost concerns and the infrequency of explosions, said Bill Stevenson, vp of engineering at CV Technology Inc., a Jupiter, Fla.-based engineering company specializing in mitigating plant explosions, who also sits on NFPA committees that establish standards addressing combustible dust risks.

Engineers say that while dust explosions can cause severe losses, the exposure can be mitigated with attention to plant hygiene and safety practices that prevent fugitive dust from accumulating around equipment and machinery.

But even companies that implement sound risk management practices can have trouble keeping dust from accumulating, especially when their facilities are dispersed.

"There is a challenge for companies to do a good and consistent job with risk controls, especially for large organizations that have multiple locations where the exposure may exist," said Jim Johnson, a managing director for safety solutions at Liberty Mutual Group in Boston.

SUMMARY OF PROSECUTION, DEFENSE POSITIONS

RONALD E. FERGUSON

Former Chief Executive Officer
General Re Corp.

PROSECUTION ALLEGES: Mr. Ferguson took the Oct. 31, 2000, call from former AIG CEO Maurice R. Greenberg that set the loss portfolio deal in motion, and knew early on that it was to be a no-risk transaction for AIG. He was briefed on the deal's structure, negotiated Gen Re's $5 million fee with Mr. Greenberg and received e-mail updates as the deal progressed. After Elizabeth R. Monrad told him that there may be "nonmirror image accounting" between Gen Re and AIG, he insisted on making it clear to AIG that Gen Re would account for the deal as a deposit. In one e-mail, he told Gen Re executives to "keep the circle of people involved in this as tight as possible"; in a later e-mail, he inquired about the status of Gen Re's "fee recoveries" from AIG. Asked about the reputational risk of the deal in a recorded phone call, Gen Re President Franklin Montross IV said, "Ron signed off on this, since it's his deal."

DEFENSE: Mr. Ferguson denies there was ever a side agreement not to cede risk to AIG and argues that he believed the deal to be a legitimate finite risk transaction. Countering evidence that he told former Gen Re Senior Vp Richard Napier that AIG would bear "no real risk," he argued that the phrase is synonymous with "finite risk" and does not mean "no risk." Regarding evidence that more than half of the $500 million portfolio ceded to AIG was already reinsured elsewhere, Mr. Ferguson said he was misled about the portfolio by John Houldsworth, former CEO of Cologne Re Dublin. Roughly 42 people at Gen Re knew of the deal at various stages, he argued, including Gen Re CEO Joseph Brandon and Warren E. Buffett, chairman of Gen Re parent company Berkshire Hathaway Inc. Close to retirement at the time the deal began, he maintained he had no motive to participate in a fraud.

CHRISTOPHER P. GARAND

Former Senior Vp, North American finite underwriting
General Re Corp.

PROSECUTION ALLEGES: Mr. Garand first suggested structuring the deal as a no-risk transaction, according to Mr. Napier. He was also a key participant in unrelated transactions that concealed AIG's payment of $15.2 million to Gen Re to cover the premium due to AIG for the loss portfolio deal and Gen Re's fee. In a recorded call, Mr. Garand suggested moving part of the money to Cologne Re Dublin by having Gen Re write a "losing contract" with its Dublin unit. He discussed with Robert D. Graham the idea of ceding the loss portfolio first to a non-U.S. AIG unit so that Cologne Re Dublin would not appear in the statutory statements of AIG's U.S. subsidiaries. When Mr. Houldsworth asked in another conversation "how much cooking goes on" in AIG's financial statements, Mr. Garand answers, "They'll do whatever they need to make their numbers look right."

DEFENSE: Mr. Garand, working part-time and nearing retirement in 2000, was "disengaged" from the deal's development, but believed it to be a legitimate finite contract. He denied coming up with the idea of a no-risk contract and attacked Mr. Napier's testimony as "ludicrous." The commutations that resulted in Gen Re retaining $15.2 million of an AIG unit's funds were a legitimate unwinding of a longstanding relationship, and Mr. Garand in any case was not a key participant, but simply relayed information to Gen Re management. Mr. Houldsworth drafted the loss portfolio deal's terms; Mr. Garand's only suggestion was to add a commutation clause, which in fact was already in the draft.

ROBERT D. GRAHAM

Former Senior Vp, legal counsel
General Re Corp.

PROSECUTION ALLEGES: Mr. Graham knew that AIG would refund Cologne Re Dublin's premium and pay Gen Re a $5 million fee, but kept those terms out of his draft of the loss portfolio contract. He suggested ceding the portfolio first to an offshore AIG unit and then to AIG in the U.S. so anyone reviewing AIG's U.S. statutory statements could not "connect the dots" to the Dublin company. He reviewed but did not object to a fake offer letter making it appear that Cologne Re Dublin asked AIG to participate in the deal. In an e-mail to Gen Re's general counsel, Mr. Graham noted that Gen Re would

Gen Re: Defendants await the jury's verdict in finite risk case

CONTINUED FROM PAGE 1

mate finite risk transaction and that they were misled about the degree of risk in the portfolio by others, including John Houldsworth, a star government witness and the former chief executive officer of Gen Re's Cologne Re Dublin unit.

Awaiting the jury's verdict are former Gen Re CEO Ronald E. Ferguson; Christopher P. Garand, former senior vp in charge of U.S. finite underwriting for Gen Re; Robert Graham, former senior vp and legal counsel for the reinsurer; Elizabeth Monrad, Gen Re's former chief financial officer; and Christian M. Milton, AIG's former vp for reinsurance.

In their summation and a rebuttal to defense arguments, prosecutors urged the jury to "follow the money" in the transaction: More than a year after the deal's inception in October 2000, Gen Re commuted an unrelated set of contracts with Hartford Steam Boiler & Inspection Insurance Co., an AIG subsidiary, and retained $15.2 million of HSB's funds in payment for the loss portfolio deal, prosecutors say.

Gen Re kept $2.6 million—its half of the $5 million fee plus interest—then transferred $12.6 million to Cologne Re Dublin in the guise of a loss payment under another bogus reinsurance contract between the companies, the government alleges. Cologne Re Dublin kept its part of the fee and wired $10 million to AIG's National Union Fire Insurance Co. of Pittsburgh, Pa., as the premium it owed for the loss portfolio contract (see chart).

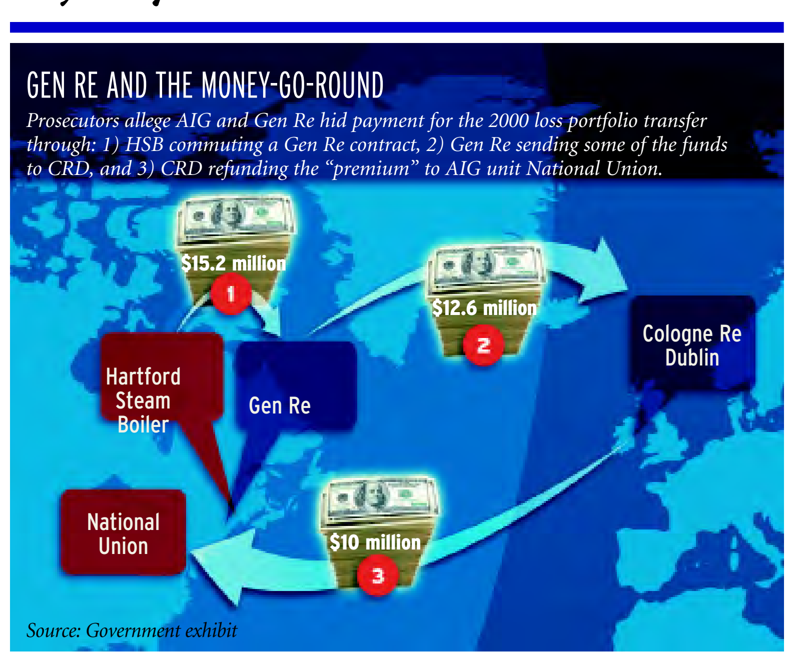
"Insurance companies do not pay to take on risk of loss," Assistant U.S. Attorney Raymond Patricco told jurors. Because the defendants knew that AIG was paying Gen Re to assume the loss portfolio, "each of them knew without a doubt that this was a no-risk deal."

Over five weeks of trial, prosecutors presented other evidence of the alleged fraud, introducing dozens of Gen Re e-mails and conversations between Mr. Houldsworth and some defendants that had been automatically recorded by a Cologne Re Dublin system. Jurors also heard testimony by Mr. Houldsworth and Richard Napier, a former Gen Re senior vp, both of whom have pleaded guilty to conspiracy and are cooperating with the government.

Mr. Houldsworth testified, for example, that Cologne Re Dublin had already reinsured $315 million of the portfolio's $500 million in reserves, making it "virtually impossible" that AIG could suffer a loss. Those reserves included $254 million from Coral Reinsurance Co. Ltd., an AIG affiliate (see related story).

He also testified that he drafted a bogus underwriting slip—showing a $600 million limit for a $500 million premium—aimed at giving the appearance of risk transfer.

The defendants knew that "the only reason AIG would want to make it look like a risk deal is so they



GEN RE AND THE MONEY-GO-ROUND

Prosecutors allege AIG and Gen Re hid payment for the 2000 loss portfolio transfer through: 1) HSB commuting a Gen Re contract, 2) Gen Re sending some of the funds to CRD, and 3) CRD refunding the "premium" to AIG unit National Union.

Source: Government exhibit

could book the loss reserves," Mr. Patricco told jurors.

Gen Re accounted for the deal as a deposit.

Defense lawyers pressed an array of arguments intended to raise doubts about the prosecution's case.

While prosecutors presented evidence that Messrs. Ferguson and Garand were aware that AIG would bear "no real risk," their lawyers argued that the phrase is industry jargon for finite covers.

"It does not mean fraud. It does not mean 'no risk.' 'No real risk' is shorthand at General Re for finite," said Mr. Garand's lawyer, Jonathan Rich, who is with Proskauer Rose L.L.P.

Messrs. Milton, Ferguson and Graham also were never told that the bulk of the $500 million in reserves were already reinsured, and were thus misled about the portfolio's risks, their lawyers argued.

Ms. Monrad may be in a tougher position on this issue: In a recorded Nov. 15 conversation, she asks Mr. Houldsworth about the portfolio contracts and he describes them at length, noting that some are "effectively already retroed" and that "there's really no risk in this" because AIG would get the benefit of the previous retrocessions.

Reid Weingarten, Ms. Monrad's lawyer, told jurors that she "missed the import" of that description and was misled by other statements of Mr. Houldsworth suggesting that the portfolio carried risk. Mr. Weingarten is with Steptoe & Johnson L.L.P.

The defendants also pointed to the participation of other executives, including current Gen Re CEO Joseph Brandon and Warren E. Buffett, chairman of Gen Re parent company Berkshire Hathaway Inc.

Mr. Brandon, an unindicted co-conspirator in the case, was consulted early in the deal's development, received numerous e-mails as it progressed and signed off on the wire transfers arising from the HSB commutation, documents show.

Mr. Ferguson also consulted with Mr. Buffett about the deal and its reputational risk to Gen Re, and "it's crystal clear that Mr. Buffett approved the $5 million fee that Gen Re charged AIG," argued Mr. Ferguson's lawyer Michael Horowitz, who is with Cadwalader, Wickersham & Taft L.L.P.

Mr. Patricco countered that there was no evidence that Mr. Buffett knew of the deal's fraudulent aspects, and that the participation of others is irrelevant.

"If I wanted to rob a bank, and I went to Warren Buffett and he said, 'OK, I approve the reputational risk,' would that help me when I came up for trial?" Mr. Patricco asked jurors.

book the deal as a deposit, but that "how AIG books it is between them, their accountants and God." He also noted that Mr. Ferguson and other senior management had accepted the risk that insurance and securities regulators "may attack the transaction and our part in it."

DEFENSE: Mr. Graham acted in good faith, performed legal work he was asked for, and believed that the deal transferred risk to AIG. No one ever told Mr. Graham that the bulk of the portfolio had already been reinsured. There was nothing improper about Mr. Graham's suggestion about using an offshore AIG entity as an intermediate reinsurer. Mr. Graham added clauses to the loss portfolio contract that increased AIG's exposure, consistent with his belief that AIG was assuming risk. AIG's agreement to return the premium and pay Gen Re a fee was a noncontractual "handshake" of the kind that is common between longtime partners in the industry. Regarding the offer letter, the question of which company initiated the deal is legally irrelevant and would never have been reflected in the contract in any case. While believing the deal was lawful, Mr. Graham "stuck his neck out" and advised Gen Re's general counsel of potential regulatory concerns.

CHRISTIAN M. MILTON

Former Vp-reinsurance
American International Group Inc.

PROSECUTION ALLEGES: Mr. Milton told Mr. Napier that AIG only wanted "reserve impact" in the transaction, and knew that AIG would not assume risk and would secretly return Cologne Re Dublin's $10 million premium and pay Gen Re a fee. He agreed with Gen Re officials that AIG needed a "paper trail" for the deal, received a fake offer letter making it appear that Gen Re had requested the transaction, and passed a misleading underwriting slip on to AIG's own accountants so that the deal would be booked improperly as a risk transaction. Mr. Milton conceded to AIG lawyers investigating the deal in 2005 that he never did any underwriting analysis of the $500 million portfolio and never received or requested reserve development reports that Cologne Re Dublin was supposed to provide. He was unable to explain to the same lawyers why AIG agreed to refund the premium and pay Gen Re a fee.

DEFENSE: Mr. Milton believed that AIG was assuming risk, never agreed to a no-risk transaction and was deceived by Mr. Napier and others at Gen Re about the amount of risk in the portfolio. Gen Re officials never told him most of the portfolio business was already reinsured. The deal to refund Cologne Re Dublin's premium is not proof that the deal transferred no risk. No underwriting analysis of the portfolio was necessary because Mr. Greenberg had already agreed to the deal and to Gen Re's fee. Mr. Houldsworth said in several recorded conversations that Gen Re could "stick" AIG with losses if AIG failed to refund the premium and pay Gen Re's fee; he testified that AIG may have believed that losses were possible under the contract. Mr. Milton is not an accountant and was not involved in AIG's accounting decisions.

ELIZABETH A. MONRAD

Former Chief Financial Officer
General Re Corp.

PROSECUTION ALLEGES: Ms. Monrad helped lead the development of the loss portfolio deal, knew it would transfer no risk and knew that AIG would account for it improperly. In recorded conversations, she told Mr. Houldsworth "not to worry" about using deposit liabilities for the portfolio, and that "we told AIG there would not be symmetrical accounting here." Mr. Houldsworth told her that most of the portfolio business was already reinsured. She discussed provisions in a draft slip that give the misleading impression that risk was being transferred to AIG; expressed concern about Gen Re being "out of pocket" the $10 million premium and discussed mechanisms for returning the premium and fee to Gen Re in unrelated transactions. She made the decision not to put the side agreement in writing, and stressed confidentiality, expressing concern that details of the transaction might appear in public documents in Ireland.

DEFENSE: The loss portfolio deal was an accommodation to AIG for which Gen Re properly collected a fee. Ms. Monrad correctly accounted for the deal as a deposit and is not responsible for AIG's accounting decisions. Mr. Houldsworth drafted all of the deal's terms, and misled her and others at Gen Re about the degree of risk in the portfolio; she did not understand his explanation that most of the business was already reinsured, and believed his assertions that Gen Re could hit AIG with losses if AIG failed to repay the premium with Gen Re's fee. Ms. Monrad relied on the approval of the deal by higher Gen Re executives, including Mr. Ferguson; current CEO Joseph Brandon; and Warren E. Buffett, chairman of Gen Re parent Berkshire Hathaway Inc. She urged a review of the contract by lawyers, and disclosed the transaction to Gen Re's auditor, Deloitte & Touche.

PHOTOS: AP PHOTOS, LANDOV

Ghost of Coral Re returns in Gen Re fraud trial

By DOUGLAS McLEOD

HARTFORD, Conn.—The fraud trial of five former General Re Corp. and American International Group Inc. executives has resurrected a controversial 20-year-old AIG reinsurance venture: Coral Reinsurance Co. Ltd.

Barbados-based Coral Re was organized by AIG in the 1980s to assume uncollectible reinsurance balances of AIG's U.S. subsidiaries, helping those units avoid charges to their statutory surplus for overdue reinsurance.

At the time, AIG claimed Coral Re was not an affiliate, even though AIG managed the reinsurer and organized the sale of its stock to investors that included several prominent U.S. businessmen. In the 1990s, regulators challenged the notion that Coral Re was an unaffiliated reinsurer, and AIG agreed to stop ceding it business.

Coral Re later ceded its contracts to Gen Re's Cologne Re Dublin unit, and in 2000, the Dublin company's chief executive officer, John Houldsworth, included the business in the allegedly fraudulent loss portfolio deal with AIG that is at the heart of the current criminal case.

Cologne Re Dublin, though, had in fact already retroceded the Coral Re business elsewhere, and its inclusion in the loss portfolio deal was one sign that the transaction was a sham, prosecutors charge.

The idea of adding Coral Re to the loss portfolio originated with Hans-Peter Gerhardt, a former Cologne Re executive in Cologne, Germany.

In a recorded Nov. 14, 2000, phone conversation, Mr. Gerhardt and Mr. Houldsworth discuss contracts that could be transferred to AIG: "What about ceding the Coral reserves back to them?" Mr. Gerhardt asks.

"Oh, you're a bad boy," Mr. Houldsworth answers. "We could. Yeah, we could."

The next day, Mr. Houldsworth sent an e-mail to Gen Re's then-chief financial officer, Elizabeth A. Monrad, attaching a list of portfolio contracts that included Coral Re, which accounted for $254 million of the portfolio's $500 million in reserves.

LANDOV

'We're giving them their own losses back, effectively, there. So we thought that was quite sweet.'

John Houldsworth,
Cologne Re Dublin

"We're giving them their own losses back, effectively, there. So we thought that was quite sweet," Mr. Houldsworth said later that day in a recorded call to Ms. Monrad and Richard Napier, a former Gen Re senior vp.

Evidence related to Coral Re was a subject of heated pretrial wrangling between the prosecution and defense lawyers.

The dispute focused partly on a recorded Dec. 28, 2000, conversation between Mr. Houldsworth and Christopher Garand, a former Gen Re senior vp, about AIG's accounting practices.

"How much of this sort of stuff do they do?" Mr. Houldsworth asks in the call. "I mean, how much cooking goes on in there? I mean, I know they've got a bit of a slight reputation for it."

"Um, they're fairly aggressive," Mr. Garand replies. "They'll do whatever they need to make their numbers look right."

The two men then go on to "speculate as to the extent of AIG's efforts to manipulate its financial statements, and they discuss several possibly fraudulent transactions that AIG used to accomplish this goal over a period of several years," including contracts with Coral Re, U.S. District Judge Christopher F. Droney wrote in a ruling on the evidence.

Judge Droney excluded most of this conversation on the grounds that it would be prejudicial to Christian M. Milton, a former AIG reinsurance vp.

The judge also barred prosecutors from presenting evidence that AIG's dealings with Coral Re were themselves fraudulent, finding that the evidence was "not necessary to demonstrate that the (loss portfolio transaction) was a fraud."

Judge Droney allowed evidence that Cologne Re Dublin had already reinsured the Coral Re business before ceding it back to AIG in the loss portfolio deal.

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News In Brief

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staggered, three-year terms, under a proposed charter amendment. Shareholders will be asked to approve the proposal at New York-based MMC's annual meeting in May. An MMC spokeswoman said the proposed change is a "hallmark of good corporate governance practice."

NCQA to measure obesity treatment

The National Committee for Quality Assurance said plans to apply two new standards to the Healthcare Effectiveness Data and Information Set focusing on obesity in children and adults. The organization said it is adding assessments of body mass index—the ratio between a person's weight and height—and how consistently physicians perform BMI assessments to HEDIS. Also, two additional standards to HEDIS will address care for people over 65, covering pain screenings, a functional status assessment, medications review and advance care planning.

Three convicted of comp fraud

The U.S. Justice Department said that three individuals have been convicted of defrauding professional employment organization clients nationwide into paying at least $75 million for sham workers compensation coverage. Trial evidence established that between 2001 and 2004, the three conspired by using "corporate names of purported insurance companies and offshore foreign corporations in order to provide an air of legitimacy to their fraudulent scheme," the Justice Department said in a statement. The three convicted of conspiracy, wire fraud, mail fraud and money laundering are: Donald Touchet of El Cajon, Calif.; Richard E. Standridge of Tempe, Ariz.; and Robert J. Jennings, a former resident of Danville, Ill.

R.I. official proposes 'play-or-pay' care

In the latest state 'play-or-pay' proposal, employers in Rhode Island that do not offer health insurance coverage would have to pay a $1,000 per employee annual assessment to the state under a reform package unveiled Tuesday by Lt. Gov. Elizabeth Roberts. The money raised by the assessment would be used to help subsidize coverage for the uninsured. Additionally, the reform package would require individuals whose income exceeds 400% of the federal poverty level to obtain health insurance.

Pennsylvania cuts comp rates by 10%

Pennsylvania has approved a 10.22% average rate reduction for workers compensation policies that is expected to result in $250 million savings for Pennsylvania employers. The Pennsylvania Compensation Rating Bureau in December proposed the 10.22% average loss cost decrease with an effective date of April 1. Gov. Edward G. Rendell attributed the rate decrease to a competitive workers comp insurance market, a decline in claim frequency and employer safety programs.

Lerach sentenced to two-year term

A U.S. district court judge in Los Angeles last week sentenced William S. Lerach, once one of the most prominent class action plaintiffs attorneys in the country, to two years in a federal penitentiary last week for making illegal payments to clients in a kickback scheme. Mr. Lerach had pleaded guilty to a conspiracy charge last year, admitting that he paid clients a portion of the lawyers' fees in securities class actions to file complaints, and thus make Mr. Lerach's former firm—Milberg Weiss L.L.P.—the lead counsel in such cases. Mr. Lerach was also ordered to pay $8 million in fines and penalties.

Brokers: Growth harder to come by as market softens

CONTINUED FROM PAGE 3

million.

Results from the fourth quarter of 2007, however, are more indicative of current market conditions, analysts say.

For example, Itasca, Ill.-based Gallagher's brokerage segment, excluding discontinued operations, recorded zero organic growth in the quarter, and Brown & Brown reported a 7.8% drop in organic growth. Marsh & McLennan Cos. Inc. reported a 1% rise in organic growth for its Marsh Inc. brokerage unit in the fourth quarter, but overall its risk and insurance services segment posted a 5% drop in organic growth.

"The fourth quarter of 2007 was a very challenging quarter," said J. Hyatt Brown, chairman and chief executive officer of Daytona Beach, Fla.-based Brown & Brown, in a statement. "Property and casualty lines of insurance continued to renew at 15% to 30% less than expiring premiums. New business production was in line with expectations, but not sufficient to make up the price reductions," he said.

Brown & Brown's 9.3% growth in brokerage revenues for all of 2007 was buoyed by $107 million in acquired annualized revenues.

Among the group, analysts say they were most surprised by London-based Willis Group Holdings Ltd.'s fourth quarter performance.

Willis reported a 7% drop in its North America segment's organic growth and zero organic growth overall in the quarter.

"They did so well in the first nine months. Seeing the pull back in the fourth quarter was a bit of a surprise," said Cliff Gallant, an analyst with Keefe, Bruyette & Woods Inc. in New York.

In a conference call with analysts, Joe Plumeri, Willis' chairman and chief executive officer, said that while its 2007 margin expansion plan for its North American segment was successful, it came at the expense of top line growth. Willis closed a handful of offices in 2007, hired fewer producers and fired underperforming brokers, he said.

Mr. Plumeri said that the North American operations are "back on track" in the first quarter of 2008 and that "you can expect positive revenue growth" in the first quarter.

In addition to shortfalls in its North American operations, reinsurance brokerage revenues were "significantly affected" by declining premium rates and higher retentions taken by insurers throughout 2007, Willis said. Willis Re reported a 4% decline in organic growth for the year.

Chicago-based Aon Corp. bucked the trend of stagnant underlying growth with a 3% rise in organic revenue in its Americas segment for the fourth quarter and 2% organic growth overall.

"I think it's pretty clear that Aon is going to lead the entire industry in organic growth for the quarter, but I also think we'll continue to see that trend in '08," said Keith F. Walsh, an analyst with Citigroup in New York. "They're growing their top line a little bit faster and they're growing their expense line a little bit slower."

"It's not as though the market is deteriorating uncontrollably," said Meyer Shields, an analyst with Stifel, Nicolaus & Co. Inc. in Baltimore. "If you continue to recruit fairly aggressively and sharpen up your marketing, then there is some modest, but positive organic growth to be had."

While brokers continue to compete fiercely for new business in the soft market, they also say they intend to cut expenses.

Gallagher said in its fourth-quarter earnings release that it intends to sell its global reinsurance brokerage operations and its small wholesale brokerage operation in Ireland to improve profitability and pretax margins. The brokerage also plans to eliminate 400 back-office positions and cut travel and entertainment expenses, among other things.

Willis said it expects to take a $60 million to $90 million pretax charge in the first quarter of 2008 to cover costs associated with contract buyouts, property closures, lease terminations and layoffs. These efforts will lead to annualized cost savings in the range of $20 million to $40 million in 2008 and rising in 2009, it said. With the savings, Willis said that it will invest between $30 million and $50 million back into the company.

Managing expenses will be a key focus of the new management team at Marsh.

Recently appointed Marsh CEO Dan Glaser said he is moving "swiftly" to simplify the organizational structure, streamline reporting lines and drive profitability at the struggling brokerage. He said Marsh should achieve $200 million in savings in 2008 from corporate cost cutting as well as savings in pension, benefits and other on-time costs. Those savings, however, will be offset to some extent by increased salary and compensation costs as the broker continues to compete for talent, he said.

Overall, MMC reported 7.6% rise in 2007 revenues, while profits, which include proceeds from the 2007 sale of Putnam Investments, more than doubled to $2.48 million.

"I still believe this company has severe headwinds in '08," Citigroup's Mr. Walsh said. "Even though I do believe that (Mr. Glaser) will be successful in streamlining the company, if they can't grow the top line, they can't expand margins. When you've got reinsurance declines and Risk Capital Holdings substantially cut down, you've got a lot of high margin revenue gone away," he said.

Revenues from Guy Carpenter & Co. L.L.C. fell 2% in the fourth quarter to $167 million. Organic growth was down 4%. Risk Capital Holdings, its insurance investment unit, reported a 90% drop in revenue in the quarter to $8 million.

With Marsh, "it's just a matter of making sure there's enough revenue coming through the door and managing expenses. It's not rocket science," Mr. Shields said. "What we found with Aon is when you've got people with a feel for…expense discipline running the company then you can turn it around."

For its part, Aon said at the end of October that it was embarking on another restructuring effort that is expected to result in cumulative pretax charges of about $360 million from workforce reductions, lease consolidation and other related costs, resulting in $420 million in annualized savings by 2010.

The effort is similar to Aon's three-year restructuring effort it implemented in 2005, which resulted in a net reduction of about 3,600 employees and cost about $365 million. Cumulative cost savings from the first effort resulted in $225 million in savings in 2007 and is on track to achieve $270 million of cumulative cost savings in 2008, Aon said.

While the large global brokers will focus on winning new business and managing expenses, smaller regional brokers are likely to have a tougher time in the soft pricing environment, analysts say.

"I still question how in a really difficult top-line environment they can hold margins. I think you're going to see margin deterioration on all three of the regional brokers," Mr. Walsh said, referring to Gallagher, Brown & Brown and HRH.

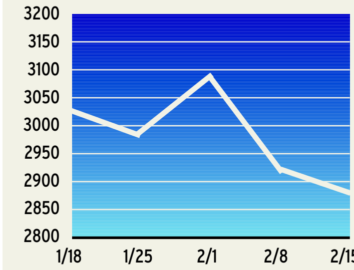
"I think '08 looks like a very challenging year for these regional guys. There's not a whole lot they can do except try to acquire their way out of it," he said.

Stock Index

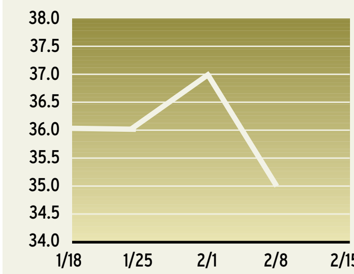
[2/11- 2/15]

Up-to-the-minute data for all 82 companies that comprise the BI Stock Index can be found at www.IndustryFocus.com.

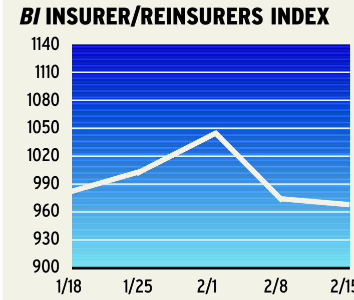
BI STOCK INDEX



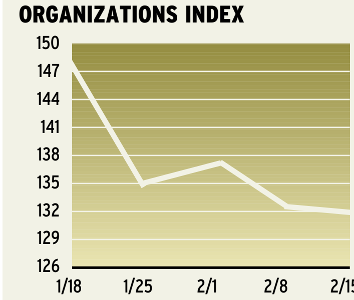
BI BROKERS INDEX



BI INSURER/REINSURERS INDEX



BI MANAGED CARE ORGANIZATIONS INDEX



Percentage change of BI Stock Index vs. key indicators

BI STOCK INDEX	
2888.94	-0.85%
DOW JONES	
12348.21	1.36%
S&P 500	
1349.99	1.40%

LARGEST GAINS

PMA Capital Corp.	6.07%
UNICO American Corp.	5.87%
American Safety Insurance	5.87%
Health Net Inc.	4.89%
Gainsco Inc.	4.76%

LARGEST LOSSES

Brown & Brown Inc.	-17.50%
MBIA Inc.	-16.16%
CNA Financial Corp.	-13.99%
CNA Surety Corp.	-9.60%
XL Capital Corp.	-9.44%

Source: Financial Content Inc. http://financialcontent.com

Business Insurance END PAGE

Insurer hopes LeBron scores with young adults

ZUMA PRESS

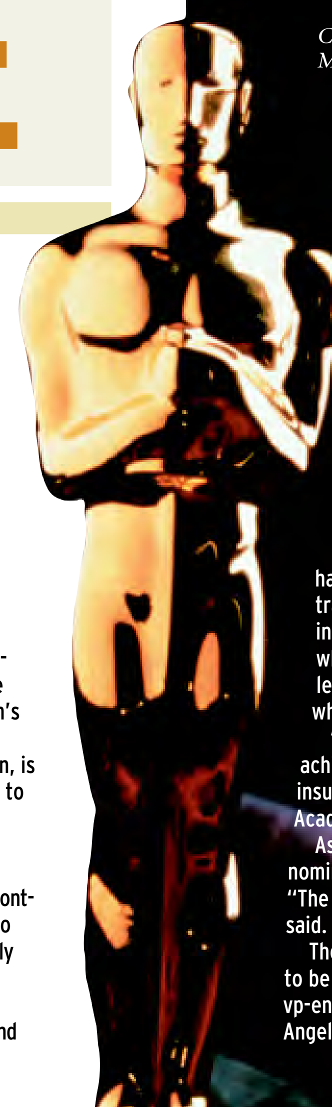
LeBron James, arguably the most popular player in the NBA, inked an agreement with one of the nation's most popular insurers.

Mr. James, NBA All-Star of the Cleveland Cavaliers, entered a marketing agreement with Bloomington, Ill.-based State Farm insurance, with hopes that he can lure young adult policyholders. Terms of the agreement were not disclosed.

"Our relationship will be focused on helping connect our State Farm brand and products—particularly our auto and renters insurance—to a young audience in new and relevant ways," said a spokeswoman for the insurer.

Last week's announcement came just two weeks after Mr. James was ordered to pay $259 in fines and court costs after being caught driving 101 mph on an Ohio interstate on his 23rd birthday in December. It appears that the traffic violation had no affect on State Farm's decision to partner with Mr. James, who incidentally has been a State Farm customer since 2004.

Contributing: Jeff Casale, Mark A. Hofmann, Sally Roberts



'Wild' wins Oscar for hardest to insure

If there was an Oscar awarded to the hardest-to-insure movie of the year it would go to the odyssey "Into the Wild," according to the film's insurer Fireman's Fund Insurance Co.

The film, written and directed by Sean Penn, is based on a true story of a young man's quest to shed the trappings of modern society and explore the Alaskan wilderness by himself.

Many of the perils that lead character Chris McCandless, played by actor Emile Hirsch, confronted were among those that Fireman's Fund had to consider when insuring the film, which reportedly cost between $15 million and $20 million.

The movie, for instance, was shot in several rugged locations including cliffs, rocky ledges and whitewater rapids, which can prove hazardous not only for actors, but for cameramen and crew, according to a Fireman's Fund statement.

It noted that medics needed to be on stand-by with access to helicopters to transport cast members to hospitals in case of accidents or injuries.

The film also used bears in several scenes, which Fireman's Fund said could have injured cast and crew despite being trained. The film also took a six-week hiatus in shooting to capture the different seasons, which could have created problems if the lead actors sustained an illness or injury while away from the set, it said.

"Into the Wild," which is nominated for achievement in film editing, is one of 17 movies insured by Fireman's Fund that are up for an Academy Award this year.

As for the least risky of the other 16 Oscar-nominated films, "Lars and the Real Girl" and "The Savages" win the award, Fireman's Fund said.

These "walk/talk" type of productions "tend to be your lower risk films," said Joe Finnegan, vp-entertainment for Fireman's Fund in Los Angeles.

ZUMA PRESS

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'Double Indemnity,' starring Fred MacMurray and Barbara Stanwyck, left, and 'Memento,' starring Guy Pearce and Carrie Ann Moss, were the top two movies on III's list of the best insurance-related films of all time.

'Indemnity' tops III list of the best insurance films of all time

Insurance is not generally thought of as the stuff of high drama.

But according to the Insurance Information Institute, Hollywood doesn't always think that way. In fact, the New York-based III recently released its pre-Oscars list of the top 10 insurance films of all time, a list that encompasses comedy as well as drama.

Topping the list is the 1944 film version of the James M. Cain classic "Double Indemnity." In the film, which garnered seven Academy Award nominations, an insurance man plots the perfect murder but runs into trouble in the form of a claims examiner. Murder is also central to the list's No. 2 film, 2000's "Memento," which involves a former insurance investigator with short-term memory loss trying to track down his wife's killer.

But not all is grim on the list, which is rounded out with 2004's "Along Came Polly" at No. 10. The romantic comedy concerns an insurance risk analyst who finds a new lease on life with a childhood friend played by Jennifer Aniston, which is about as far from the film noir of "Double Indemnity" as one can get.

The complete list of III's Top 10 insurance films, as well as a list of additional insurance-themed movies, can be found at *www.iii.org/media/research/insurancefilms.*

Tom Jones' chest-hair coverage a matter of urban legend

While "it's not unusual" for stars to insure their body parts at Lloyd's of London, 1960's pop idol Tom Jones claims reports that he insured his chest hair are "completely fabricated."

The United Kingdom's Daily Mirror reported earlier this month that the 67-year-old Welsh singer, known for his overt sexuality, insured his chest hair with Lloyd's for £3.5 million ($6.8 million).

"Even at the grand old age of 67, the ladies love his hip-thrusting moves and catching a sneaky peak of his famously rugged chest hair," the Daily Mirror quoted a "mole."

On his official Web site, however, Mr. Jones said "no such insurance policy exists or has ever been considered. We assume this is just the Mirror having a bit of fun and hope no one takes this kind of 'reporting' seriously."

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THREE QUESTIONS

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Wrestling with the R word

Probably because I spend so much time working with them, wrestling them and generally trying to coax them to do my journalistic bidding, I have a certain interest in words.

I enjoy discussion of word choice or nuance, or analysis of the language of public discourse.

My wife, Kathy, has made her career in various words-related tasks as well, and among our friends are others whose careers or passions are wrapped up in language.

Ah, the lively dinner table banter we share.

As 2007 ended and 2008 gets under way, I've found myself interested in a very high-profile demonstration of linguistic wrangling: the debate over what to call what's happening to our economy.

You know, the debate over "the R word."

Is the U.S. economy in recession? Not, apparently, by the textbook definition, which holds that a recession is a "period of general economic decline; specifically, a decline in GDP for two or more consecutive quarters."

The Commerce Department last month reporter that U.S. economic growth slowed to 0.6% in the fourth quarter of 2007, down from 4.9% in the third quarter. The fourth-quarter growth figure is anemic, sure, but not textbook recession.

In his State of the Union address last month, President Bush called what our economy is experiencing a "period of uncertainty."

Polls have shown increasing percentages of average Americans saying the economy is in recession for months, and academic debates in the future over when or if a recession actually began probably have little bearing on their experience.

Numerous factors are shaping that experience. Higher gas prices, the housing market mess and rising—and, according to many reports, longer term—unemployment are among the metrics on which many Americans base their economic assessment. Some, too, have experienced the subprime mortgage crisis firsthand.

As serious as the implications are, I doubt if bond insurers' woes and their potential to trigger major investment write-downs by Wall Street banks and higher borrowing costs for state and local governments have hit home yet on Main Street.

On the plus side, while a weak dollar does not do much for vacations in Europe, it does hold potential for increased U.S. exports.

In the debate over word choice, accuracy is always a key consideration. But I wonder in this case which is more accurate, the economists' textbook definition of recession, or the reality of people's everyday experience.

In an Associated Press piece late last month, Frank Lichtenberg, the Courtney C. Brown professor of business at Columbia Business School in New York, noted that whether the current economy ever meets economists' definition of recession is "not going to make a great deal of difference to people's economic well-being or their pocketbooks."

"The idea that if you're on one side of the line you're in a recession and if you're on the other side you're fine—that's not really the case," he said. "Clearly, we are in a very difficult period."

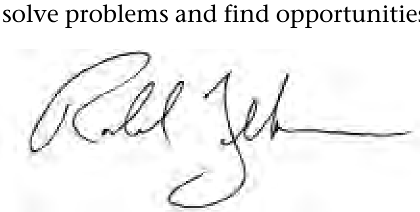
CHALLENGING TIMES present opportunities for creative problem solvers.

Challenging times, though, present opportunities for creative problem solvers.

In this issue of *Industry Focus*, our Cover Focus is Alternative Risk Markets, an area of great interest to me. A few weeks after joining *Business Insurance* a number of years ago, I was lucky enough to be introduced to the world of captive insurance and alternative risk transfer, an area teeming with creativity.

In fact, my experience at *BI* has introduced me to a number of creative individuals crafting risk transfer solutions and new business opportunities across the insurance industry, both in the alternative market and on the traditional side. There are a lot of smart people in this business.

By any name, these are challenging times. But experience suggests that there are creative individuals in this business, ready to solve problems and find opportunities.



AIR finds pattern in hurricanes' genesis, landfall

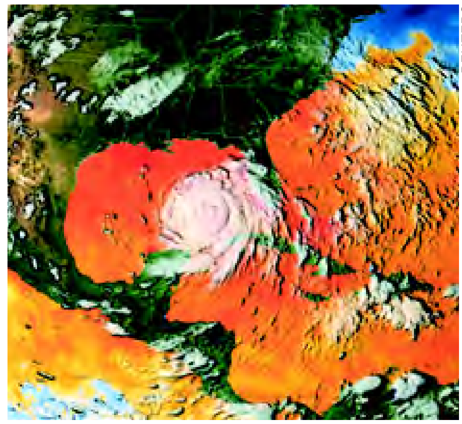
BOSTON—New research by risk modeling firm AIR Worldwide Corp. shows that where a hurricane begins can significantly affect the likelihood of it making landfall in North America.

According to Boston-based AIR, the study shows that using only Atlantic basin hurricane activity as a predictor of landfall activity can produce flawed estimates of both the landfall risk and the potential insured losses.

In a statement announcing the findings, Peter Dailey, director of research in atmospheric science at AIR, said every hurricane season is unique, with actual landfall activity being a function of "complex interactions between a range of environmental factors such as genesis location, sea surface temperatures and the depth of warm ocean waters, wind shear and atmospheric steering."

"A higher number of tropical storms in the Atlantic basin does not translate to an equivalent increase in hurricanes or landfalling hurricanes," Mr. Dailey said.

AIR's study found that the pattern of where hurricanes begin changes from year to year, and that comparing the pattern for

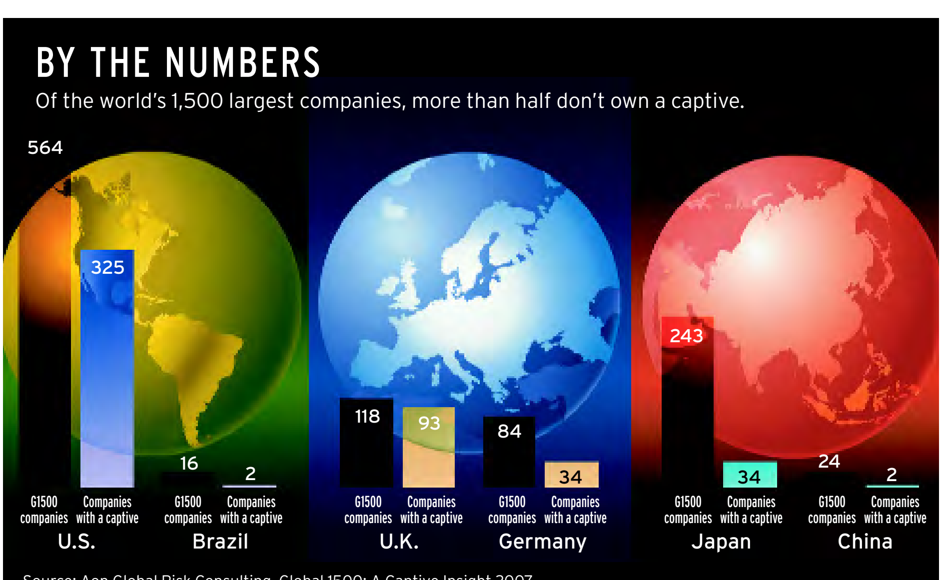

REUTERS

AIR's study found that the pattern of where hurricanes begin changes from year to year.

a particular season to long-term hurricane activity can provide a better understanding of differences in the proportion of storms making landfall from year to year.

Mr. Dailey noted that while forecasters correctly projected a higher-than-average number of tropical storms forming in the Atlantic basin in 2007, "it's much more difficult to predict not only how many of these storms will become hurricanes, but more importantly how many will make landfall as hurricanes."

Similar to many previous hurricane seasons, 2007 demonstrated that "an elevated number of tropical storms does not always translate to more hurricanes or more landfalling hurricanes," Mr. Dailey said. IF



IRISK applies ERM for mid-market, small companies

WEST CHESTER, Pa.—A new independent risk management consulting firm, IRISK Solutions, plans to apply an enterprise risk management approach to serving small to middle-market companies with gross annual premiums of $50,000 to $1 million.

West Chester, Pa.-based IRISK will provide a full suite of standard and custom services, including claims consulting, loss control consulting, trending analysis, managed care review and information systems.

The firm aims to work with insurance companies, program administrators, alternative risk transfer consultants, insurance agents and brokers and insurance buyers.

IRISK Solutions uses a customized version of RiskConsole, a Web-based risk management information system provided in partnership between IRISK Solutions and RiskLabs, which was acquired by Aon Corp. in 2004.

In its ERM approach, IRISK utilizes tools to help clients align risk appetites and strategies, enhance risk response decisions, reduce operational surprises and losses, identify and manage multiple and cross-enterprise risks, take advantage of business opportunities, improve the deployment of capital and manage risk.

IRISK is a subsidiary of insurance services group Inventure Inc., which provides products and services in business segments including specialty program administration, wholesale workers compensation and risk management services. IF

Leonard Crouse, Vermont's top captive insurance regulator for the past 18 years, announced last month that he'll be retiring from his position as Vermont's deputy commissioner of captive insurance June 1. During Mr. Crouse's tenure in Vermont, the state licensed more than 600 captives, and Mr. Crouse has been known not just for promoting Vermont but the captive industry in general. Recently, he talked about changes he's seen in the captive industry, and what he sees ahead for the industry and himself.

Obviously the alternative risk transfer market has grown considerably during your time in Vermont. What do you think are some of the key changes you've seen in the captive business?

The captive industry's changed dramatically in 10 years. Just the types of captives we've had, there's been employee benefits, there's been securitization captives, there's been reciprocal captives.

There are all sorts of different things going on. And the lines of business captives write, that's changed a little as well. Ten, 15 years ago, it was mostly GL, auto, workers comp. Now we see health benefits, TRIA, property, all sorts of lines of business. The alternative market is a perfect place for this business to go and it's going to continue to grow.

It's changed. It's bigger, more people involved. It was a relatively unknown entity when I started 17, 18 years ago. Just the people who were in it knew about it.

The growth that we've had in this business has been phenomenal, too. I think one of my greatest accomplishments is the growth here in the department. When I started here we had four people…and now we have 30 people in the department. The department, building the department, is one of the things I take the most pride in.

How about looking ahead? What are some of the things you see in the captive industry's future?

Continued growth. The securitization activity should continue, at least for a few years, at least until the NAIC and the actuarial committees get some of the reserving issues the life companies are facing straightened out.

The alternative market depends a lot on the fluctuations in the traditional market, the cyclical swings, hard to soft. That affects our market, there's no doubt about it. The reinsurance market affects our market a lot, there's no doubt about that.

You look around. When we started, we were the only (domestic) game in town with Hawaii. Now, there are 30 states with captive legislation. Some of them will be here in 10 years, some won't and that's fine. There should still be plenty of business for everybody. Hopefully, most of it will still come to Vermont.

And for yourself? What's ahead for Len Crouse?

I'll take it a little bit easier. Play a little bit of golf, spend a little more time with the grandkids down in Massachusetts.

I'd like to dabble a little bit in the business. I'd like to do something. We'll see what happens in three or four months. I'm definitely not going to disappear into an easy chair. I want to stay involved, but in a way that gives me a little more time.

I just woke up one morning and decided it was time. That's exactly how it happened. It's been fantastic. Most of it's been the people I've met. You think about it, 600 captives licensed here in Vermont and that means 600 meetings. It's always been a people business and that's the way it should be. IF

BIMA endorses ICCIE educational designation

HAMILTON, Bermuda—The Bermuda Insurance Management Assn. has endorsed the Associate in Captive Insurance designation offered by the International Center for Captive Insurance Education.

The ACI program is the only professional designation for the captive insurance industry. Consisting of seven courses and three teleconferences, the program can be completed online.

At the same time it endorsed the ACI program, the Hamilton-based BIMA, along with the Bermuda Captive Conference, created a scholarship fund for Bermudians. The fund, with an initial amount of $10,000, will cover the complete tuition expenses for two ACI students selected by the Bermuda Insurance Institute Scholarship Committee.

Remaining funds will be used to provide two Bermuda Insurance Diploma scholarships to Bermudian students interested in starting careers in the captive insurance industry. More than 500 people have graduated from the BID program since it was introduced in 1970.

Since its launch in 2004, the Burlington, Vt.-based ICCIE has attracted almost 400 students, with more than half of those pursuing the complete series of courses needed for the ACI designation. IF

Confie Seguros aimed at Hispanic buyers

SAN FRANCISCO—A private equity firm and a California broker have partnered to form a platform to consolidate insurance brokerages focusing primarily on Hispanic buyers.

San Francisco-based investment firm Genstar Capital L.L.C. has partnered with Cypress, Calif.-based Westline Corp. to create Confie Seguros. Over the next three years, Genstar and Confie Seguros, led by John Addeo, chief executive officer, hope to build a national distribution company with more than $300 million in revenue, focusing on markets including California, Arizona, Florida, Texas, Georgia and Nevada.

Based in Cypress, Calif., Westline will serve as the operating platform on which to build Confie Seguros' California business.

Funding for future acquisitions will be provided by a commitment of $75 million from Genstar and a bank facility with an expected capacity of more than $200 million.

> Over the next three years, Genstar and Confie Seguros, hope to build a national distribution company with more than $300 million in revenue.

Mr. Addeo previously served as president and CEO of Alliant Resources Group, and before that as president and chief operating officer of USI Insurance Services. In both positions, he guided efforts to build the firms through acquisitions.

Also involved in Confie Seguros' leadership team are Mordy Rothberg, president, who will lead business development and strategy; Stephan Provenzano, executive vp and chief financial officer; and Andre Urena, senior vp of business development, who also is CEO and founder of the Latin American Agents Assn. IF

THE QUOTE

'I DON'T THINK that the threat of a recession will decrease the need for captives.'

NANCY GRAY
EXECUTIVE DIRECTOR-NORTH AMERICA
AON INSURANCE MANAGERS

Edwards Angell, Kendall Freeman team to work both sides of Atlantic

NEW YORK—U.S. law firm Edwards Angell Palmer & Dodge has merged with the Kendall Freeman firm of London.

The firm will operate as Edwards Angell Palmer & Dodge L.L.P. in the U.S. and Edwards Angell Palmer & Dodge U.K. L.L.P. in London.

Edwards Angell said the merger enhances the capabilities of the firm's insurance and reinsurance practices by providing an international platform to serve clients on both sides of the Atlantic. The firm now has more than 600 attorneys and solicitors practicing in 11 offices.

In addition to its offices in New York and London, the firm has offices in Boston; Fort Lauderdale, Fla.; Hartford, Conn.; Madison, N.J.; Providence, R.I.; Stamford, Conn.; Washington; Wilmington, Del.; and West Palm Beach, Fla.

Partners Alan J. Levin and David Kendall chair the firm's 100-lawyer insurance and reinsurance department. Terrence M. Finn and Charles E. DeWitt will continue to serve as co-managing partners of Edwards Angell Palmer & Dodge.

Laurence Harris will serve as partner-in-charge of the London office, and, along with Mr. Kendall, will join the firm's executive committee. IF

USA Risk Group taps into Barbados with majority stake in MIMS International

MONTPELIER, Vt.—Independent alternative risk market service provider USA Risk Group has expanded into Barbados, purchasing a majority ownership in MIMS International (Barbados) Ltd.

Martin Hole, principal officer of MIMS, will remain as head of the Barbados office, which will be renamed USA Risk Group (Barbados) Ltd.

MIMS has been involved in captive management since 1986 and services 22 captives under management with a staff of five. It was the first captive manager licensed in Barbados.

In addition to its new presence in Barbados and its offices in Montpelier, Vt., USA Risk Group provides captive management, program administration, reinsurance and other related services in all major North American domiciles, Bermuda, the Cayman Islands and the British Virgin Islands. IF

AI Risk launches LexExpress cover for small fleets

NEW YORK—AI Risk Specialists Insurance Inc., a brokerage subsidiary of New York-based American International Group Inc., has introduced LexExpress, excess auto liability insurance coverage developed to address the needs of small to midsize trucking fleets.

LexExpress provides limits of $1 million in excess of $1 million in primary coverage. In addition to the standard excess auto liability coverage, the policy provides such additional coverages as pollution and accident and health coverage.

Through the program, AI Risk can address the exposures of long- and short-haul truckers, flat-bed haulers, dry bulk garbage, mix-in-transit, and moving and storage.

LexExpress is underwritten on a nonadmitted basis by Lexington Insurance Co. as part of the AIG Transportation Solutions practice, and is available throughout the United States, except in Alabama, Delaware, Louisiana, New York City and New Jersey.

LexExpress was developed to cover small to midsize trucking fleets.

The LexExpress product can be quoted quickly and bound online through AI Risk ProgramConnect at *www.programconnect.com*.

AI Risk provides specialty property/casualty and personal lines insurance underwritten by Lexington Insurance Co. and other AIG companies. **IF**

Beazley aims to connect specialty lines to brand

LONDON—Beazley Group P.L.C. is embarking on a rebranding effort that the London-based company said it hopes will emphasize the creativity of its various business areas while linking those teams to the broader Beazley brand.

The current Beazley logo is being replaced with a line drawing of the Beazley name. Logos and images representing individual teams, such as scales of justice for Beazley's lawyers professional liability team or an underwriter's pen for the company's specialty lines division, will likewise be depicted in line drawings, with the continuous line connecting to the Beazley logo.

On Beazley's new Web site, the line will be animated to "draw" the team-specific illustrations.

The line drawings symbolize Beazley's creativity and help create a more prominent sub-brand identity for the company's underwriting and claims teams, while making it clear they're all part of Beazley, said William Pitt, the company's chief marketing officer, specialty lines.

"A lot of companies, not just in insurance, have struggled with sub-branding and we think this represents an elegant solution," Mr. Pitt said.

The current Beazley logo (left) is being replaced with a line drawing.

The specialty insurer will retain the "Beazley pink" shade featured in its prior branding to accent text and for other promotional purposes, and will continue to use the advertising tagline "Straight Answers." **IF**

MEMIC exec named chair of ACORD board

PEARL RIVER, N.Y.—John Leonard, president and chief executive officer of the MEMIC Group, has been named the 2008 chairman of the ACORD board.

It is the second time Mr. Leonard has chaired the board of the Pearl River, N.Y.-based Assn. for Cooperative Operations Research and Development, having previously held the position in 2001.

Mr. Leonard joined the Portland-based Maine Employers' Mutual Insurance Co. in 1993 after a 27-year career with Travelers Cos. Inc. where he led the commercial lines agency marketing and underwriting division.

Mr. Leonard

He is a former president of the American Assn. of State Compensation Insurance Funds and chairman of its executive committee, and also serves on the board of the National Council on Compensation Insurance and on the board of the National Workers Compensation Reinsurance Pool.

ACORD also announced three new members elected to its board for 2008: Lawrence E. Blakeman, senior vp and chief information officer, individual business at Metropolitan Life Insurance Co.; Robert Slocum, president of the Slocum Agency Inc. in Warwick, R.I., representing the Independent Insurance Agents & Brokers of America; and Andreas Beerli, chief operating officer and member of the executive committee of Swiss Reinsurance Co.

ACORD is a global nonprofit association working to facilitate the development and use of standards for the insurance, reinsurance and related financial services industries. **IF**

New York-based Marsh Inc. has made several appointments as part of a global reorganization. **Joseph M. McSweeny**, former chairman of Willis Risk Solutions, was named president of Marsh's U.S./Canada division. Mr. McSweeny had been on the faculty of St. Thomas Aquinas College since 2005. **Alexander Moczarski**, who had been chief executive officer of Marsh's Europe, Middle East and Africa region, has been named president of the company's new international division. **David Batchelor**, who had been head of Asia Pacific for Marsh, was named to succeed Mr. Moczarski as CEO of Marsh's EMEA operations. **Alexander W. Vietor**, who joined Marsh in December from Aon Corp., where he was an executive vp, will serve as president of Marsh's global specialties unit.

Aon Ltd., the London-based unit of Chicago-based Aon Corp., has appointed **Robert Brown** to head its U.K. corporate insurance business. As CEO of Aon Corporate, Mr. Brown, who previously headed Aon Global U.K.'s risk transfer unit, will be responsible for the company's large commercial insurance, professional services and trade credit operations.

Chicago-based CNA Financial Corp. has named **John A. Beckman** senior vp and chief risk officer. Mr. Beckman recently served as president of ReAdvisory, a unit of specialty reinsurance broker Carvill that provides consulting services on areas including enterprise risk management.


Ms. Doyle

Wausau Insurance Cos. has appointed **Susan Doyle** president and chief operating officer. Ms. Doyle, who most recently was executive vp of field operations at the Wausau, Wis.-based insurer, replaces Mark Fiebrink who retired.

Farmers Group Inc. has named **Scott Lindquist** executive vp and chief financial officer. Mr. Lindquist had been controller of Genworth Financial Inc. Mr. Lindquist takes a position previously held by Pierre Wauthier, who left Los Angeles-based Farmers last year to become group treasurer and head of finance operations at Zurich Financial Services Group, Farmers parent company.

The New York Insurance Assn. Inc. has named **Ellen D. Melchionni** president. She succeeds Bernard N. Bourdeau who retired. Ms. Melchionni previously was a vp at NYIA.

Frederic Goldstein has been named president, director and COO of U.S. Preventive Medicine Inc., a Dallas-based company focused on building a prevention-based health network. Mr. Goldstein has been president and CEO of U.S. Care Management Inc., USPM's disease management subsidiary.

Overland Park, Kan.-based third-party administrator FMH Benefit Services Inc., has named **Ben Frisch** president. Mr. Frisch had previously been the company's vp of sales and marketing. FMH is a unit of Lake Forest, Ill.-based CoreSource Inc.

Marvin H. Feldman has been named president and CEO of the Arlington, Va.-based Life and Health Insurance Foundation for Education. Mr. Feldman, who succeeds David F. Woods, who is retiring, previously had been chairman of the foundation's board and is principal of the Clearwater, Fla.-based Feldman Agency and Feldman Financial Group.

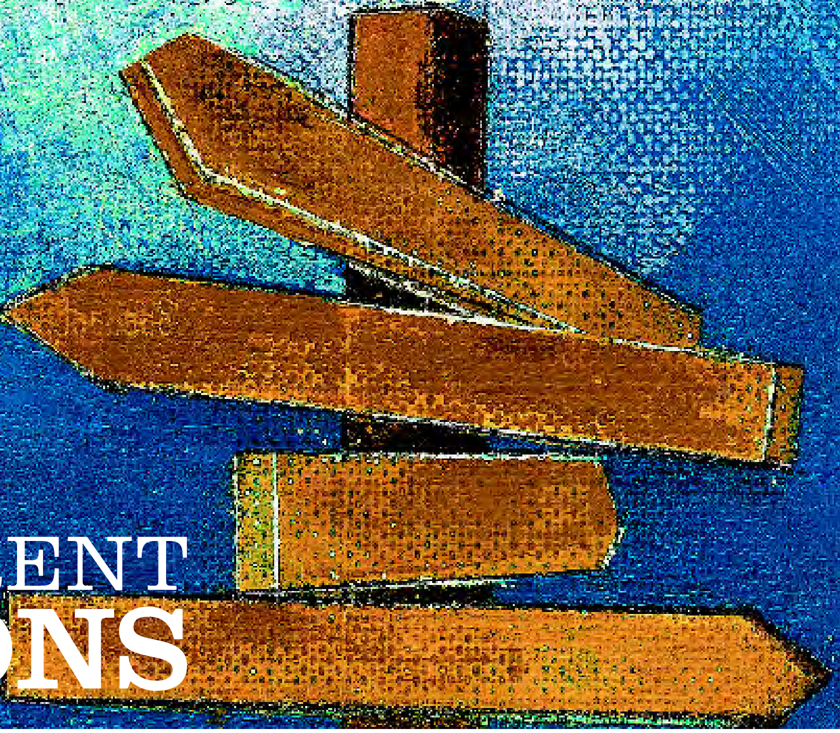

Ms. van Staveren

New York-based AXA Equitable Life Insurance Co. has hired **Suzanne van Staveren** as vp and COO of Corporate Markets, a newly created distribution channel providing retirement plan solutions to Fortune 1000 companies and their employees. Before joining AXA, Ms. van Staveren spent 13 years with Fidelity Investments, most recently as vp, scale and profitability for large corporate market retirement services at Fidelity Employer Services Co.

Denver-based health care service provider Bridge-Health International Inc. has named **Dr. Andrew Dombro** chief medical officer. Dr. Dombro has practiced medicine in various settings for more than 20 years, and is a professor at the University of Colorado Health Sciences Center.

Hamilton, Bermuda-based Platinum Underwriters Holding Ltd. has named **Kevin S. Marine** COO of its U.S. reinsurance subsidiary, Platinum Underwriters Reinsurance Inc. Mr. Marine will continue to serve in his role as chief underwriting officer-property and marine of the U.S. operation. The company also named **Thomas P. Kelly** chief underwriting officer-casualty of Platinum Underwriters Reinsurance. Mr. Kelly has been with Platinum Underwriters since the company's inception in 2002, most recently as senior vp of the commercial liability department.

London-based Willis Group Holdings Ltd. has appointed **Eugenio Paschoal** CEO for Latin America. For the past 10 years, Mr. Paschoal has been CEO of Willis Brazil and will be based in São Paolo. Mr. Paschoal replaces Jose Ribeiro who left Willis to take a position at Lloyd's of London. Separately, Willis named **Flavio Piccolomini** CEO of its Continental Europe operations, including the Nordic region. Mr. Piccolomini most recently was CEO of the broker's Italian operations. Guido De Spirt will succeed Mr. Piccolomini at Willis Italia S.p.A. IF



DIFFERENT DIRECTIONS

Lloyd's-like insurance exchange gets fresh scrutiny in N.Y.

By Meg Fletcher

NEW YORK—New York Insurance Superintendent Eric Dinallo says the time is right to consider reviving the New York Insurance Exchange, a reinsurance marketplace that had early success but later shut down and took 18 years to pay its secured claims.

Conditions have changed since the NYIE, a Lloyd's of London-type exchange in Manhattan that opened in 1980 and shut down in 1987, ceased operations. Now, there is "tremendous potential to reopen it successfully," Mr. Dinallo said recently.

Reinsurance markets today are more global than the soft market that dimmed the NYIE's prospects. Also, today's technology could allow such a facility to operate very efficiently, he said.

Most importantly, "I think there are tremendously higher amounts of capital investment that didn't exist 20 years ago," Mr. Dinallo said. Hedge funds and other financial services companies seek opportunities to invest capital in risks, such as natural catastrophes and terrorism, that are uncorrelated to risks of their other financial investments.

For example, New York-based Goldman Sachs Group Inc. recently invested $200 million to establish a syndicate at Lloyd's of London. Arrow Syndicate 1910 will write reinsurance, the company said.

Shortly after New York Gov. Eliot Spitzer appointed him superintendent in December 2006, Mr. Dinallo said he began reading insurance law, became intrigued with the exchange concept and started discussing the idea with industry representatives. He's ready to appoint an advisory group to review the concept and determine its workability by the middle of this year.

Many industry representatives say the idea is worth exploring.

Some, though, are wary and fear that a regulator-driven proposal might fail to attract enough insurance industry support. They say there already is sufficient capacity for average risks and that offshore and alternative U.S. markets offer attractive options in the form of sidecars and protected cell companies.

Among cynics may be former exchange participants and their customers, who had to wait until 2005—18 years—for the exchange's security fund to pay out about $82 million, or about 74 cents for every $1 due in claims.

LAW STILL ON THE BOOKS

Mr. Dinallo envisions such an exchange offering reinsurance for local and international risks, direct coverage of major properties and other unspecified innovative coverages.

Reviving the concept also would mesh well with the spirit of a statewide regulatory modernization initiative that seeks to help New York enhance its status as the world's financial capital, he said. The proposal also demonstrates another aspect of Mr. Dinallo's continuing interest in reinsurance, as previously seen in his proposal to relax collateral requirements for non-U.S. reinsurers doing business in the state.

A key factor is that legislation authorizing the exchange is still on the books, Mr. Dinallo said.

The two-and-one-half page law, Article 62, broadly outlines the exchange facility consisting of member syndicates and member brokers, and gives the New York insurance superintendent "broad discretion," Mr. Dinallo said.

The law describes the exchange as a facility for underwriting reinsurance for all types of insurance, direct insurance of all types of risks located entirely outside the United States and direct insurance of U.S. risks on an excess and surplus lines basis.

It requires that the exchange have a constitution and bylaws covering the role of governors and members, their voting powers and establishing a security fund. It provides that exchange contracts are not covered by any New York security or guaranty funds.

SHAPING IDEAS

Two decades of advances in communication technology would allow an exchange to operate efficiently and without a lot of administrative overhead, compared with the former exchange's paper-based operations. "It would be a great clearing mechanism," Mr. Dinallo said.

In addition, oversight of the exchange could use a regulatory approach compatible with "deep pocket" backers expected to participate in the revived exchange, he said. Such an exchange, which would not handle policies for individuals, needs to be regulated from a business point of view and not a consumer point of view, Mr. Dinallo said.

The department

Learn from past mistakes to find success in the future

By Meg Fletcher

Mr. Bickford

Exploring why the New York Insurance Exchange failed to meet its potential during the 1980s may provide some insight into how such an exchange should operate in a proposed revival, sources say.

The NYIE opened in March 1980 "to great fanfare and expectations…to help stem the flow of capital and premiums out of the United States," said Peter H. Bickford, a New York-based attorney who is an independent insurance consultant and a certified reinsurance arbitrator. He was the NYIE's vp, general counsel and secretary from 1980 to 1985 and subsequently represented some syndicates. He wrote a book on the exchange and related papers.

Initially, the NYIE was a success and by the end of 1984 ranked as the eighth-largest U.S. reinsurer with $345.6 million in premium volume and as the fifth-largest based on its $182.6 million policyholder surplus, Mr. Bickford said.

However, it then had rapid growth in premium volume as well as loss ratios, Mr. Bickford wrote. While NYIE officials asked certain syndicates to stop underwriting renewals and new business, "these actions proved to be too little and too late."

In 1985, the exchange recorded its first drop in volume and additional syndicates stopped writing business or sought to withdraw. *Business Insurance* reported that year that about 25 of the exchange's 44 syndicates wrote $309.5 million in gross premiums backed by $194.1 million in capital and surplus. Net premiums were $201.1 million and the exchange's net loss was $42.1 million. At the time, the NYIE had 108 broker members.

According to other *BI* reporting, problems also included back-office accounting difficulties, significant fixed costs including the 1984 purchase of a headquarters building and the failure of many insurer-owned syndicates to maintain staff on the exchange floor.

New York's exchange law also offered "a tremendous opportunity" for self-regulation, but exchange officials did not utilize it, Mr. Bickford said.

The NYIE ceased operations in 1987.

Somewhat similar exchanges in Florida and Illinois also began operating during the 1980s. Florida's ended in several lawsuits. The renamed INEX, the Insurance Exchange in Chicago, experienced the insolvency of several syndicates but continues operating with one syndicate.

Given the problematic history of U.S. exchanges generally, and the NYIE specifically, New York Insurance Superintendent Eric Dinallo said he might consider a new name for the facility. IF proposes to borrow from the United Kingdom's "principles-based" regulatory structure by considering an outcomes-focused "principles-guided approach."

In addition, a revived exchange could be part of a "passporting" mechanism that would help mostly non-U.S. companies write coverage in the United States, Mr. Dinallo said. While getting other states to treat exchange coverage as an admitted asset for ceding companies that buy it could be "a high hurdle," he said all states did accept exchange coverage in the 1980s.

Whether there is sufficient industry support to revive the exchange remains in question.

One reason the NYIE failed was a lack of real support by the insurance industry, Mr. Dinallo said. Currently, other financial services companies are the most enthusiastic supporters. Bankers, however, need to understand that they'd be investing in a liability rather than an asset, but the investment's duration could be as short as one year, he said.

The exchange should be industry-driven, not regulator-driven, said Peter H. Bickford, a New York-based attorney who is an independent insurance consultant and a certified reinsurance arbitrator. He was the NYIE's vp, general counsel and secretary from 1980 to 1985 and subsequently represented some syndicates. He wrote a book about the exchange and has made presentations on the topic.

"The regulators can provide the forum and support for the development of a plan, but the primary force needs to come from inside the insurance and financial services industries if there is to be any lasting success," Mr. Bickford said.

QUESTIONS REMAIN

Several insurance industry representatives thought such an idea merits further exploration.

"I think it's a very interesting idea," said Sean McGovern, general counsel of Lloyd's in London. He said any idea from Mr. Dinallo, whose approach to regulation he considers "very refreshing," is welcome.

Tracey Laws, senior vp and general counsel of the Washington-based Reinsurance Assn. of America, praised Mr. Dinallo for being "a thought leader" and said the RAA would like to participate in future discussions.

Debra J. Hall, senior vp-group legal for Swiss Re America Holding Corp. in Armonk, N.Y., said the New York superintendent's broad discretionary authority puts him in a unique position to consider such a proposal.

Other observers suggested key elements to include in any exchange proposal. Using technology efficiently is critical for any exchange to function successfully, nearly all observers said.

"A new exchange will need to take full advantage of the technical developments over the decades since the original exchange, including instant communications, virtual trading capabilities, and real-time access to and use of transactional and other data," Mr. Bickford said.

State-of-the-art technology should provide "a lower cost" operating environment, said Daniel F. Maher Jr., executive director of the Excess Line Assn. of New York.

Mr. Dinallo also should carefully consider what lines of business the exchange would allow as well as tax and regulatory considerations that force most new insurance capital offshore. Among policies that would help attract needed Wall Street capital would be favorable tax treatment by municipal or state authorities, Mr. Maher said.

Regulators also should allow the exchange to sell unusual products that will attract buyers, said Mr. Maher.

However, regulators need to be cautious about special treatment that would give such an exchange a competitive advantage that current market players might resent, sources said.

Another key component is "a strong commitment on the part of both the regulators and the industry to self-regulation and control of the market," Mr. Bickford said. The industry needs to have "the will to enforce its rules and its financial security requirements." Failure to do so "was a major failing" of the previous exchange, Mr. Bickford said.

And syndicates' capital requirements must be significantly higher than those of the failed exchange, he added.

A viable security fund is also essential, many agreed. The authorizing law requires a security fund, but gives the superintendent great discretion over how it's established or funded.

Many non-U.S. reinsurers have balked at the concept of paying into a U.S. security fund that would duplicate funds in their countries of domicile.

"The issue of security is an important one and must be addressed," Mr. Bickford said. "I don't see the security fund as a hurdle."

Patricia A. Borowski, senior vp government and regulatory affairs for the Alexandria, Va.-based National Assn. of Professional Insurance Agents, said "the security fund is a key issue," as is the proposed regulatory approach.

She said she appreciates New York's aspirations to be a leader in financial services regulation, but questioned what regulators could do to prevent problems that three separate insurance exchanges have experienced (see story, page 11). Principles-based regulation won't necessarily solve everything, she said. In fact, she said such an approach may ignore or try to trump several legal precedents regarding company rights.

"It's ironic that New York is talking about revitalizing the insurance exchange" at this time, said Terry L. Ryan, vp of administration and secretary of INEX, the Illinois Insurance Exchange in Chicago that is the lone surviving U.S. insurance exchange.

INEX has one syndicate operating and is trying to rekindle business after its security fund paid $32 million last July to 2,400 policyholders stemming from six syndicates' insolvencies.

People have stayed away from INEX because they feared having to share in prior losses, Ms. Ryan said. "Now we are hoping since that is behind us, we'll be able to attract new syndicates." IF

Don't wait for a rainy day to

Prepare for a Hurricane

GET A KIT essential supplies include food, water, radio, flashlight, first aid kit and medications

MAKE A PLAN include an evacuation plan, out-of-area people to contact and a meeting place

BE INFORMED if a hurricane is forecasted, listen to local radio and TV and follow the guidance of local officials

To find out more about how you can be Red Cross ready during hurricane season, contact your local American Red Cross chapter or visit **www.redcross.org/beredcrossready**

Be Red Cross Ready American Red Cross

Gaining traction

Sour economy is not hindering the slow, steady growth of benefits captives

By Meg Fletcher

The recent downturn in the U.S. economy is not expected to have a significant effect on the willingness of large employers to consider reinsuring employee benefits through their captives, industry experts say.

Interest in adding reinsurance of benefit risks to the property/casualty risks that are already covered in a captive program is expected to continue at the same measured pace that has characterized the market during the past seven years.

"I don't think that the threat of a recession will decrease the need for captives," said Nancy Gray, executive director-North America of Aon Insurance Managers in Burlington, Vt., which manages more than 1,300 captives worldwide. Employers set up captives because they are in the employer's long-run best interest, she said.

An economic downturn may shift a company's priorities, but employer interest in benefit captives is expected to grow over time, said Sofia Tesfazion, a New York-based consultant with Towers Perrin.

Among employers, the idea of putting benefits in captives "is still a new concept, but it is getting traction," Ms. Tesfazion said. "More insurance companies are getting eager to play in this field," primarily as fronting insurers for an employer's captive arrangement, she said.

Len Crouse, deputy commissioner of captive insurance in the Vermont Department of Banking, Insurance, Securities and Health Care Administration, said the market will grow because "all companies are trying to cut the costs of health benefits," and a good captive program can help do that.

However, market demand for benefit captives has been very slow in developing during the past several years. "It hasn't turned out to be the boom I thought it would be," said Mr. Crouse.

In 2000, benefit captive supporters cleared an important hurdle when the U.S. Department of Labor approved Columbia Energy Group Ltd.'s request to fund long-term disability benefits for its U.S. employees through the Vermont branch of Columbia's Bermuda-based insurance affiliate. Columbia, then of Herndon, Va., subsequently was acquired by NiSource Inc. of Merrillville, Ind.

Since then, nearly a dozen benefits captives have begun operating from U.S.-based domiciles after receiving Labor Department approval, Ms. Gray said.

Several more companies are in the process of studying or applying for permission to begin such arrangements, sources said.

Large U.S. companies regulated under the federal Employee Retirement Income Security Act must obtain Labor Department approval in the form of a prohibited transaction exemption before they can place benefits for U.S. workers into captives. Global programs that insure benefits for non-U.S. employees do not face such a review.

Currently, there are five U.S. jurisdictions that have the authority to license captives to include benefit risks. Vermont is the largest U.S. captive domicile, but benefit captives also are authorized in Hawaii, South Carolina, the U.S. Virgin Islands and Arizona.

Globally, there is greater use of captives by U.S. and non-U.S. employers to provide benefits to non-U.S. employees, experts agree. That's primarily because employers do not have to get Labor Department approval for non-U.S. employees.

European companies' use of captives for employee benefits "is increasing" due to "above-inflation increases for benefits costs, particularly medical, and resulting pressures to avoid medium-term reductions in corporate operating margins," said Markus Mende, managing director, Aon Global Risk Consulting-Continental Europe in Basel, Switzerland.

"By my estimate, there are approximately 40 to 50 captives writing this coverage," he said in an e-mail.

The types of benefit risks that captives reinsure often depend on where employees live, experts say.

In the United States, benefit captives may offer long-term disability, some group life and retiree health insurance. Another option is stop-loss coverage for active employees' medical coverage, Ms. Tesfazion said.

For example, financial services giant Wells Fargo & Co. in San Francisco recently received final Labor Department approval to use its Vermont captive, Superior Guaranty Insurance Co., to reinsure group life and long-term disability policies. The group life policies are being written by Minnesota Life Insurance Co. while the LTD policies are being written by Metropolitan Life Insurance Co. Each insurer is retaining 10% of the risk in the plan.

Outside the United States, benefits may include supplemental medical coverage, which is benefits beyond those offered by a national health insurance program, Ms. Tesfazion said.

European companies are using captives for several employee benefits that include life, disability, medical and accident coverage, Mr. Mende said.

In addition, pensions are "a very new area" of coverage for non-U.S. benefit captives, Ms. Tesfazion said.

DEAL OR NO DEAL

In a typical transaction involving group life benefits, Aon said in a statement, an employer asks its life insurer to be a fronting insurer and to reinsure the coverage with the employer's captive. The employer then pays a premium to the fronting insurer, which in turn pays a reinsurance premium to the captive.

The reinsurance contract is an indemnity reinsurance arrangement, "which means that the fronting insurer will be liable for any claims that, for whatever reason, are not reimbursed by the employer's captive despite the reinsurance contract," according to its explanation. The fronting insurer charges various service fees and requires posting of collateral or a letter of credit to ensure that the captive will meet its obligations under the reinsurance contract.


Ms. Gray

An employer considering putting benefit risks in a captive usually begins by determining whether it will reduce costs by doing so, Vermont's Mr. Crouse said.

Cost savings is only one of several goals that employers hope to obtain from such a program, Ms. Gray said.

Employers often seek improved underwriting and investment income. They also want to diversify property/casualty risk exposures already in the captive with uncorrelated employee benefit risks, she said. A company may also improve its tax position because the Internal Revenue Service considers employee benefits business as being unrelated to that of the captive, Ms. Gray added.

Ms. Tesfazion said savings can result from many areas, including positive loss experience as well as improved cash flow and investment income. Savings also can result from lower costs for administration, underwriting, reinsurance and taxes.

Also, funding a company's benefit risks through a captive often reduces or eliminates a broker's commission, she said.

To calculate the potential savings of such a plan, Ms. Tesfazion recommends that employers consider the comparative costs of captive financing vs. other options to finance the risk exposure, such as a fully insured commercial plan or self-insurance. Comparisons should be based on the aftertax net present value of future cash flows and should consider the earnings impact on income statements of both the captive and parent company, she said.

For many employers that consider putting benefits in captives, "the key driver on all of this is control," Mr. Crouse said.

"It provides an opportunity for companies to unbundle the services they receive from insurers," Ms. Gray said. Better management of benefit claims by an active captive manager can help save costs, too, she said.

Before managers decide to explore insuring benefit risks through a company captive, it is essential that managers seek approval from the company's top financial official, Ms. Gray said. It is important that those executives understand the financial advantages of using a captive and support the idea, Ms. Gray said.

Additionally, a company's risk management and human resources departments need to collaborate on the project, she said. "I think that is key."

"One of the biggest hurdles is the silos" in which the departments often operate, Ms. Gray said.

In many companies, those two departments have historically operated independently, Mr. Crouse said. Their lack of cooperation has been a factor in limiting interest in benefit captives in the past, although it appears that is changing, he said.

One of six essential components for prompt Labor Department approval of captive benefits funding plans is "benefit enhancement," which requires that the employer improve the benefits in some way. That requirement prevents employers from reaping all the benefits of the change to a captive-funded plan through so-called "self-dealing," Ms. Tesfazion said. Examples of enhanced benefits may include higher coverage limits, accelerated death benefits and tuition reimbursement.

Benefit enhancement can be "one of the biggest issues" for companies, Ms. Gray said. "It is sometimes difficult to get agreement on what it should be."

Ms. Tesfazion said to get prompt Labor Department review of a captive benefit application, employers need to:

- Contract with an A-rated fronting insurance company to issue direct insurance for the benefits.
- Obtain a captive licensed by a U.S. jurisdiction that requires audited financial statements for the last fiscal year.
- Certify that market rates will be charged.
- Obtain an independent trustee's approval.
- Inform plan participants of the proposed change.

The Labor Department developed the components for fast-track treatment of benefit captive applications after taking years to review Columbia Energy's application for a benefits captive and that of a later applicant, Decatur, Ill.-based Archer Daniels Midland Co., which won Labor Department approval in 2002.

As a result, an application that contains those components is eligible for expedited review, which can take federal officials as little as 45 days, sources said. There also is a 30-day period during which plan participants are notified of the change, bringing the minimum total time to about 75 days, Ms. Gray said.

"Their turnaround has been timely," Ms. Tesfazion said.

"I think the Department of Labor has been very responsive," Ms. Gray said. Although the proposal to add retiree medical benefits to a captive program does not qualify for the expedited review, department officials said they will try to adhere to a similar timeline, she said.

Once they become operational, benefit captive programs have been very successful from a regulatory standpoint, Mr. Crouse said. "We've had no problem at all with them." IF

Soft power

Reinsurance market conditions give captives strategic options

By Rodd Zolkos

While soft market conditions might prompt owners of some alternative risk transfer entities to turn back to the traditional market for coverage, for many, a long-term risk financing strategy remains the chief consideration.

And those same soft market conditions can hold benefits for captive programs in readily available reinsurance, according to several alternative risk market experts.

"Reinsurance pricing is down, too, and certainly captives and self-insurance pools can benefit from softening in the reinsurance market, as can commercial insurers," said Steve Langford, director at BMS Intermediaries Ltd. in London where he is leader of the specialty risk unit, which works with approximately 50 captives, self-insurance pools and mutual insurers.

"The good news is, right now it's a pretty competitive market across the spectrum in the reinsurance market and the general insurance market," said John Bowman, senior vp and principal in the consultative placement group at Towers Perrin in Boston.

"I think the market interest in supporting captives is broader and deeper than it has been, which I think is a reflection of the fact that there's a lot of capital out there looking for premium," said Brady Young, managing director and president of Strategic Risk Solutions Inc. in Waltham, Mass.

While conventional wisdom would seem to dictate that in a soft market a captive should decrease retentions and take advantage of the opportunity to purchase cheap reinsurance, Mr. Langford said there are some, though, who are choosing to increase retentions.

"Those organizations that can retain more are doing so," he said. But "a lot of these alternative risk mechanisms don't have the wherewithal to take significantly increased risk positions."

But many of those that can retain more risk recognize that in buying reinsurance, even in a soft market, "You're still paying somebody's margin," Mr. Langford said, an argument for retaining risk rather than transferring it.

Mr. Bowman noted that for many captive parents, a growing topic of strategic interest is to "optimize risk within a captive." More and more captives are willing to take larger amounts of risk as long as they're sure that their risk retention decisions are based on sound data, he said, while those concerned about the quality of their data will want to look to transfer risk at lower attachment points.

"Those with better data are acting more like a traditional insurance company," Mr. Bowman said, transferring risk at higher attachment points into traditional reinsurance programs.

In general, though, many captive parents recognize that their captive programs—to the extent possible—exist to smooth out the effects of capacity shortages and soft markets, Mr. Bowman said, and they're using their captives to smooth out those swings and achieve an appropriate balance between risk transfer and risk retention.

Having a captive in place, allows the parent to "transfer risk with greater facility" if they choose, he said, "so you can leverage the market, hedge the market but doing it with the backbone of your overall philosophy."

"I think the buyers' interest in using the captive to access reinsurance is also a function of the market," said Mr. Young of SRS. "I think there are some clients who have longer memories and know the market is cyclical."

Those captive owners realize that while they might be able to save a little money now by abandoning or reducing their captive program, there's value in a long-term risk financing strategy and the partnership they've established with a reinsurer.

In many cases in the current market, it's an issue of "Do you need to? Do you have to? Probably not," Mr. Young said. But, in many cases "People recognize that going to the source of the capital and having a relationship certainly helps you when the market turns and I think some people get that and some people don't."

Medical malpractice captives, for example, typically rely on reinsurance capacity in the London or Bermuda markets. While the traditional med mal market may be softening, offering options other than the captive, parents of some med mal captives may see value in continuing to use their captive to finance risk as a way to maintain their relationships with their reinsurers.

"For some accounts, certain types of risks, it's a good long-term strategy," Mr. Young said.

"Where you can obviously take advantage of the market is when the market's soft you can look at your attachment points," Mr. Young said. "They haven't abandoned the strategy, but they've adjusted the tactics to match the market conditions."

And, he noted, pricing is just one variable in the reinsurance equation, and in a soft market, captives may find themselves able to negotiate other favorable features in their reinsurance programs. "It's not just about price, it's about terms," Mr. Young said.

Mr. Langford of BMS said that the issue for alternative markets when faced with such soft commercial market competition "is that the cheapness of the product in the commercial market is very difficult to ignore."

While in many cases, the argument is still made that you create a captive program to provide stability to your insurance program and smooth out the impact of cycles, Mr. Langford said that BMS has seen cases in which captives and self-insurance pools have been shut down in the face of the cheap coverage available in the traditional market.

Still, "I think a lot of these alternative risk mechanisms are utilizing reinsurance as a means to protect themselves across the cycle," he said.

And for many captive parents, gaining direct access to the reinsurance markets is a key element of a captive's appeal.

The opportunity to get direct access to the reinsurance market "definitely continues to be one of the key drivers" of many captive formation decisions, said Towers Perrin's Mr. Bowman.

And, as they look to transfer risk to reinsurers, many alternative risk financing entities are employing some of the same sophisticated analytical tools and approaches that traditional market insurers are beginning to use in making their reinsurance buying decisions.

"A lot of the work that goes on for our larger insurance company clients is being provided to the captive company clients," such as catastrophe modeling, risk retention analysis and capital analysis, Mr. Bowman said.

"Larger clients, more sophisticated clients, are being a little more thoughtful about what they're doing," Mr. Young said. And, at intermediaries focused on placing reinsurance for captives, today "the people are smarter, they're more serious, they have better analytical tools, they're more technically oriented," he said. "It's not all about golfing and drinking."

"Take cat modeling, for example. Some clients are asking their brokers to engage the modeling firms to model their portfolios," Mr. Young said. "For some clients, it makes sense to be able to go to the reinsurance market "and talk their language."

> **'A LOT OF THE WORK** that goes on for our larger insurance company clients is being provided to the captive company clients.'
>
> **JOHN BOWMAN**
> TOWERS PERRIN

And in trying to get the best deals from reinsurers, data quality is key, according to Mr. Bowman.

"The captive loss data and the quality of the data is really the key driver and helps the captive differentiate itself and gives comfort to the reinsurance community," Mr. Bowman said. Reinsurers like to see five to 10 years' worth of solid data.

"So for newer captives, it's a little tougher, but a new captive can have very good data," Mr. Bowman said. "A more mature captive still has to focus on making sure their data is credible."

For many captive programs approaching the reinsurance market, there's actually "A little bit of a blurry line," Mr. Bowman said. "When people talk about reinsurance for a captive, it often doesn't end up in a quota share," he said. "It's excess and surplus."

Many of the underwriters for captives offer both traditional reinsurance and excess and surplus programs.

"It's blurry in that people, particularly when they're putting together their first reinsurance program, they might start off planning to go into the facultative reinsurance market or even the treaty reinsurance market for a larger captive," Mr. Bowman said. "The gray area is, will it wind up in the traditional reinsurance side of the house or the excess and surplus side."

Recently, he's seen more of the captives he's doing business with get their risk transfer programs accomplished in the excess market.

While reinsurance is "pretty readily available across the board" for captives, "probably an emerging issue is the D&O market," Mr. Bowman said. The subprime mortgage crisis is a concern, with it being heightened by the question of how the fallout from the subprime crisis might affect the ratings of insurers and reinsurers with whom captive owners might be considering partnering.

"There've been a couple of recent downgrades that have underwriters and captive owners alike in a watchful waiting phase," he said.

Though reinsurance is readily available for ART entities, reinsurers are maintaining market discipline, Mr. Langford said. They are looking not to repeat the mistakes of the 1990s, he said, when some offered coverage at less than the loss cost. In today's investment climate, "We don't have the ability for huge investment gains to be made."

Despite the current soft market, "Alternatives are still a viable option," said Mr. Langford. "It's not something that goes away."

And, he said, he would argue that the best time to create an ART vehicle is at the bottom of a soft market so it can be in place when the market turns.

"We will continue to see the creation of new entities. We will continue to see the growth over time of these existing markets," Mr. Langford said. IF

History repeating itself with soft market cycle

By Rodd Zolkos

NEW YORK—The current softening phase of the insurance pricing cycle will pressure insurers' financial performance this year, according to some industry executives, and, despite some suggestions to the contrary, is not markedly different from pricing cycles of the past.

Speaking as part of a chief executive officer panel last month at the annual Property/Casualty Joint Industry Forum in New York, Evan G. Greenberg, president, chairman and CEO of Hamilton, Bermuda-based ACE Ltd., said that if there are differences between the current cycle and those that preceded it, the differences are "on the margin."

PROPERTY/CASUALTY INSURANCE
JOINT INDUSTRY FORUM

Some differences that might help maintain pricing discipline in a softening market could include the current low interest rate environment, greater insurance company use of outside actuaries and governance pressures imposed by regulatory measures such as the federal Sarbanes-Oxley Act.

But, Mr. Greenberg said, insurance is a "lagging industry," with companies not knowing the actual cost of their products at the time they're sold.

"There is plenty of room to kid yourself," Mr. Greenberg said. "I don't think it's different from prior cycles."

Ramani Ayer, chairman and CEO of Hartford, Conn.-based Hartford Financial Services Group Inc., said he thinks reinsurers are being more disciplined than insurers in the current market.

Still, he said, there are "several circuit breakers in the system" that should prevent many insurers from cutting prices too deeply. Among them is a greater emphasis on financial transparency and greater shareholder awareness of insurers' core business performance than in the past.

And Gerald P. Schmidt, president and CEO of Mutual of Enumclaw Insurance Co. in Enumclaw, Wash., said he believes company boards are imposing a certain discipline today that didn't exist in previous cycles.

"I would not want to underestimate the revolution that has taken place in the boardroom since 1990," Mr. Schmidt said. "People's feet will be held to the fire in ways that they were not in the past."

But Anthony J. Kuczinski, CEO of Munich Reinsurance America Inc. in Princeton, N.J., wasn't sure much had changed, and questioned how great an impact the circuit breakers Mr. Ayer cited were likely to have.

"Memories are short in this business and we tend to rationalize. Even with these circuit breakers, there's a lot of cash in this market," Mr. Kuczinski said.

And the need to do something with that cash is likely to drive company behavior, according to some of the executives.

"I think balance sheets in the main are in good shape," Mr. Greenberg said. "I think the industry is pretty well-reserved." The question, though, is what does the industry do with extra capital?

"You can return it to shareholders or you can act like a giant mutual and return it to policyholders through lousy underwriting and that's generally what we tend to do," Mr. Greenberg said.

Mr. Ayer allowed that the industry's economics are such that companies with excess capital for an extended period can put it to work on Wall Street, on Main Street or "you can burn a hole in the balance sheet."

The softening market will make it difficult for the industry to match the financial performance it has enjoyed since 2006, according to some of the executives.

In 2008, "I think combined ratios are going to be markedly under pressure" vs. 2007, Mr. Greenberg said. "It's natural," he said, adding that competition is "fanning the flames."

Barring any serious catastrophe losses, Mr. Ayer said he expects 2008 to be a profitable year for the industry. He added, however, that he thinks the industry needs a greater period of sustained profitability. Mr. Greenberg said he expects 2008 to be "a marginal year," while Mr. Kuczinski said he thinks some lines of business are likely to perform better than others.

On the personal lines side, Thomas J. Wilson, president and CEO of Northbrook, Ill.-based Allstate Corp. and Allstate Insurance Co., said he thinks that while companies' margins will shrink a bit in 2008, "I don't think you'll see the kind of cycles where competition is based only on price."

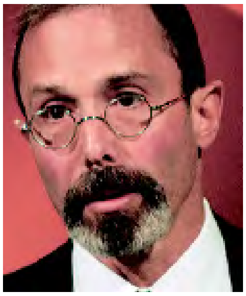
Competition in the personal lines business will be reflected in part by companies spending more on such areas as marketing, technology and claims handling, he said, with that spending having an inevitable impact on margins.

In the current environment, it will be difficult for commercial lines companies to generate top-line growth, Mr. Ayer said, given downward pressure on pricing. "My sense is that in personal lines, you'll see a more mixed story," he said.

"I think you see a little more discipline in personal lines than you have in

'YOU CAN RETURN (extra capital) to shareholders or you can act like a giant mutual and return it to policyholders through lousy underwriting and that's generally what we tend to do.'

EVAN G. GREENBERG
ACE LTD.



'MEMORIES ARE SHORT in this business and we tend to rationalize. Even with these circuit breakers, there's a lot of cash in this market.'

ANTHONY J. KUCZINSKI
MUNICH REINSURANCE AMERICA INC.

the past," Allstate's Mr. Wilson said. "If you think about meeting customers' needs and doing things differently… you can do that on the personal lines side" and generate growth.

Mr. Schmidt cited what he called "a collision of interests" in the homeowners business, though, between consumers' pricing expectations for homeowners insurance and insurers' desire to generate an adequate rate of return. "And currently we are losing that battle in the court of public opinion," he said.

Reinsurers don't appear to be immune from pressures of the cycle. Mr. Kuczinski said "reinsurers were trying to hold discipline, but the prices were somehow deteriorating more than they should have" during Jan. 1 renewals.

"The reinsurers are being disciplined by and large," he said. "I would also say they need to be very selective in who they do business with."

Mr. Greenberg noted that ACE is both a buyer and a seller of reinsurance. As a seller, "we had already contemplated a competitive environment for (Jan. 1) and across all lines it was more competitive than we planned for," he said. Not surprisingly, then, "as a buyer, it was a buyer's market," he said.

Despite the challenges of the current environment, Munich Re America's Mr. Kuczinski said he sees this sort of market as one in which companies can prepare themselves for the future. "I view a market where it's a challenge to make an underwriting profit as a time you position yourself for the next phase in the market," he said.

"One of the things you can do when the market's not working in your favor is start thinking about what does the market need, what is it demanding," Mr. Kuczinski said.

A U.S. recession could be another factor affecting industry performance.

"Unless it's a prolonged recession, I believe we'll recover quickly as an industry," Hartford's Mr. Ayer said. A prolonged recession, however, could confront the industry with both asset and credit issues, he said. The industry also could be hit in such areas as workers compensation with increased claims fraud.

On the subject of the U.S. regulatory system, Mr. Greenberg said, "It's a broken system and it's antiquated."

Mr. Schmidt said he'd like to see things such as portability of licensing from state to state, and cited what he described as onerous pricing restrictions in the current state-based regulatory environment.

The discussion prompted involvement by some regulators on the day's previous regulatory panel, including Sandy Praeger, Kansas commissioner of insurance and president of the National Assn. of Insurance Commissioners.

While defending the state-based regulatory system, Ms. Praeger agreed with the need for increased uniformity. "I think there are some areas where we're going to have to get assistance from Congress to get some uniformity," she said, such as in achieving principles-based reserving.

Franklin W. Nutter, president of the Reinsurance Assn. of America, moderated the CEO panel. IF

Risk laboratory

Florida's experiment with collateral waivers could pay rewards; or backfire

By Meg Fletcher

Florida may become the first U.S. state to effectively waive collateral requirements for the most financially secure non-U.S. reinsurers.

Backers of the idea say it would increase reinsurance capacity in the catastrophe-prone state and should help lower homeowners' rates, but opponents say the state already has plenty of reinsurance capacity and the plan could jeopardize the financial stability of ceding insurers.

Florida Insurance Commissioner Kevin McCarty is developing a rule that would allow him to decide which financially sound, mostly non-U.S. reinsurers can assume Florida risks from ceding insurers. Then, market forces would help determine the amount of collateral a reinsurer must post, with the most secure reinsurers posting none.

Florida insurance regulators are considering adopting such a measure in April as a way to bring new, private reinsurance capital to an area with $1.9 trillion in coastal risks that are threatened by inevitable hurricanes.

Development of the collateral reduction rule is the third major insurance initiative the Florida Legislature authorized last year in an effort to reduce consumers' insurance costs. Two others are already operational.

FLORIDA'S PLAN

First, Florida added an extra $12 billion layer of inexpensively priced coverage through the Florida Hurricane Catastrophe Fund, which had "a significant impact on the market," said Sean Mooney, the New York-based chief economist with Guy Carpenter & Co. L.L.C., a unit of Marsh and McLennan Cos. Inc.

However, rating agency A.M. Best Co. Inc. expressed concern about the creditworthiness of FHCF should a loss occur and Florida had to post-fund it by issuing public debt, he said.

Second, the legislature significantly expanded Citizens Property Insurance Corp., which is pressuring insurers to lower rates due to its increased competitiveness.

Under the third initiative, Mr. McCarty would determine whether a reinsurer is financially stable enough to be considered an "eligible reinsurer" to assume Florida risks. The plan then focuses on ceding insurers by directly regulating the amount of credit they can take on their financial statements for reinsurance coverage they purchase from an eligible reinsurer.

A ceding insurer can claim credit in one of five levels—100%, 90%, 80%, 50% or zero—corresponding to the lowest financial stability rating the reinsurer has received from acceptable rating agencies. The market impact of the plan will be to effectively tie the amount of collateral that the cedent's reinsurer must post to those levels—or 0%, 10%, 20%, 50% or 100%—respectively.

LANDOV

Hurricane Wilma caused extensive damage to buildings in downtown Fort Lauderdale and elsewhere in Florida in 2005.

ONGOING DISCUSSION

Florida's plan makes it a laboratory for modernizing reinsurance regulation, said Walter Bell of Alabama, the immediate past president of the Kansas City, Mo.-based National Assn. of Insurance Commissioners. The NAIC has discussed the topic for more than a decade without resolution.

The focus of the NAIC's ongoing discussion is a requirement that non-U.S. reinsurers post collateral matching their exposures to U.S. risks. Many U.S. ceding insurers and reinsurers have opposed any relaxation, citing financial concerns. At the same time, overseas organizations, notably those in London, have pushed for such relaxation, arguing that many overseas reinsurers offer comparable, or better, security than many of their U.S. counterparts.

The Florida proposal brings new urgency to the discussions, according to comment letters written by both supporters and opponents.

According to Mr. McCarty, relaxing the requirements "will lead to increased capital and competition in our state" and help "stabilize and potentially reduce property insurance rates."

Florida regulators are currently reviewing comments and letters received at a November 2007 workshop designed to seek public input on the rule regulators say is designed to seek "the best interests of market stability and the solvency of ceding insurers."

A reinsurer that seeks the "eligible" designation also must have at least $100 million in surplus and be from a jurisdiction that Mr. McCarty approves as "eligible." Among the jurisdictional requirements he will look for are "a satisfactory structure and authority with regard to solvency regulation," as well as "prompt enforcement of valid U.S. judgments or arbitration awards."

In addition, a reinsurer must submit a certificate of good standing from its domiciliary regulator, audited financial statements, proof that it submits to U.S. legal jurisdiction and a list of all disputed or overdue recoverables.

Reinsurers deemed eligible must meet annual requirements to maintain that status, including filing financial statements, and agreeing to immediately advise Florida regulators of any ratings changes.

The commissioner would have the authority to withdraw a reinsurer's status as an eligible company or require it to post additional collateral.

Other provisions include:

- Deferring for one year collateral required for eight short-tail lines that are affected by a named hurricane loss.
- Reducing an eligible reinsurer's minimum collateral by 5% for depositing its required collateral in a depository financial institution in Florida.
- Spelling out specific contract requirements between the reinsurer and ceding insurer.

OTHER VIEWPOINTS

Industry response to the Florida's draft rule split along traditional lines.

Though they'd prefer widespread uniform change, non-U.S. reinsurers view the initiative as a sign of progress.

Swiss Re America Holding Corp. in Armonk, N.Y., "generally supports efforts to reduce collateral as part of comprehensive reinsurance regulatory reform," said Debra J. Hall, senior vp-group legal. Components should include collateral reduction, a single regulator and enhanced risk management, "but we understand that you can't do everything at once," she said.

Lloyd's of London welcomes Florida's plan as a step toward leveling the U.S. playing field that Lloyd's seeks, especially given the NAIC's lack of progress, said Sean McGovern, Lloyd's general counsel in London. If regulators "remove barriers and make the market more efficient, that should improve it," making it more attractive to the worldwide reinsurance market, he said.

In his comment letter, Joseph P. Gunset, general counsel of Lloyd's America Inc. in New York, recommended that Mr. McCarty be given discretion to determine a jurisdiction's eligibility and to waive some or all of the extensive supporting documentation that the draft law requires.

If Florida enacts the proposed rule, "this change will undoubtedly create further needed capacity for the state," David J. Matcham, chief executive of the London-based International Underwriting Assn., said in an e-mail.

Many IUA reinsurers already write substantial amounts of Florida business in spite of current "onerous" collateral requirements, Mr. Matcham wrote. Regulations effectively reducing collateral, "would find favor with these reinsurers and at least encourage them to consider further opportunities to write business in Florida," he wrote.

Bradley L. Kading, president and executive director of the Assn. of Bermuda Insurers and Reinsurers, said in a letter that the association supports Florida's proposed changes.

He made several recommendations, including extending the deferral period for short-tail business to two years instead of one. That would better match the typical catastrophe loss payment period, which is nine quarters, and prevent companies from having to post collateral even though a claim had been paid, he wrote.

The RAA also is concerned about the Office of Insurance Regulation's authority to identify non-U.S. eligible jurisdictions, suggesting that "OIR take the necessary steps to confirm its lawful authority in this area."

UNIFORMITY CONCERNS

Another major problem with Florida's approach is that "it creates a patchwork system," Ms. Laws said.

A potential lack of uniformity was one of several concerns of trade associations representing ceding companies.

Florida's draft rule approach is "inherently flawed," said Michael Koziol, assistant vp and counsel of the Des Plaines, Ill.-based Property Casualty Insurers Assn. of America. He cited numerous ways reducing collateral could impair ceding companies' credit for reinsurance, including "slow-pay" or "no-pay" reinsurers or one that's financially impaired and can't or won't post additional required collateral.

> If regulators **'REMOVE BARRIERS** and make the market more efficient, that should improve it,' making it more attractive to the worldwide reinsurance market.
>
> **SEAN MCGOVERN**
> LLOYD'S OF LONDON

Patricia A. Borowski, senior vp of government and regulatory affairs for the National Assn. of Professional Insurance Agents in Alexandria, Va., also generally supports the state's draft rule. The organization's Florida affiliate is still reviewing the topic before taking a formal position, she said.

A key factor in PIA National's support is the legislature's grant of legal immunity to producers who help provide coverage in transactions covered by the proposed rule, Ms. Borowski said.

Taking a dim view of the proposal's impact, however, are members of the Washington-based Reinsurance Assn. of America and representatives of ceding insurers.

The RAA supports comprehensive reinsurance regulatory reform but opposes the Florida plan. "There isn't any reinsurance capacity shortage in Florida at this time," said Tracey Laws, the RAA's senior vp and general counsel.

Steven A. Bennett, assistant general counsel of the Washington-based American Insurance Assn., questioned the "drastic and unnecessarily dangerous" size of the collateral reductions and their potential impact on the solvency of Florida insurers.

And he challenged the reliance on commercial rating organizations. "They notoriously are too late with their rating downgrades," he wrote. Mr. Bennett urged that a security fund be established to protect ceding insurers.

William Boyd, financial regulation manager for the Indianapolis-based National Assn. of Mutual Insurance Cos., said the proposed rule doesn't deal with potential changes in reinsurers' financial status. "The state is walking out on a plank" when it comes to regulating the solvency risk of ceding insurers, he said.

Florida regulators say April is the earliest the rule could be adopted. IF

Change, while painful, brightens road to future

By Alex Letts

New Year, New Hope. In October 2006, it was suggested that 15% of that season's London treaty reinsurance would be traded electronically at renewals. My prediction was proved hopelessly optimistic as fewer than 1,000 placements were traded in 2006 renewals via RI3K or peer-to-peer. Right vision, wrong time.

By the end of 2007, so much had changed. Lloyd's Chief Executive Richard Ward had emerged as a true champion of electronic trading. Aon Ltd. had committed itself fully to an e-placement rollout. Data messaging gateways were springing up in London insurance companies to enable e-traded risks to come into carrier systems without rekeying. And now Aon has just published an estimate that about 80% of its 2007 renewals were distributed and signed electronically. Aon is also ramping up its specialty and nonreinsurance business, which will multiply trading volumes tenfold.

The price, as in any great battle, has not been inconsiderable. Missteps over the past 15 years have cost the markets hundreds of millions of dollars directly in failed initiatives. And billions of dollars have been squandered in opportunity cost.

LIKE PULLING A TOOTH

Morale in the change arena has been tested to extremes; skepticism and resistance have had to be forcibly extracted, no less painfully than infected teeth. Technologies have, as ever, not lived up to their billing, and processes and implementation have been excruciatingly experimental. The market has been the guinea pig and has justifiably raised its eyes to the heavens and cried in anguish, "Why me, oh Lord, why me?"

But at the end of it all, 2007 was the watershed. Thousands upon thousands of complex, multilayered, multisectioned subscription risks were placed electronically. It wasn't pretty, it wasn't fun, but it got done.

RI3K's trading service alone probably handled placements in excess of $5 billion of premium. Now if you can handle this stuff in high volumes, then direct classes of business are less of a challenge.

Already, the acceleration in nonreinsurance trades is threatening to overshadow the reinsurance trading. At one point in December, RI3K was seeing three trades a minute—trivial by other financial services sectors' trading norms, but unimaginable in the insurance arena until just recently. Over 10,000 individual trading sessions in four weeks tells its own story.

But, more importantly, the market knows there is no going back from here. In years to come, those veterans of the 2007 bedlam will proudly boast to their apprentices that "they were there" in the first electronic trading season in London. Medals all round, and wear them proudly, for legends are made of this stuff.

In time of course, $5 billion of premium will be the monthly run rate for a market that has been expanded by the release from paper processing, but in the meantime, there are still battles to be fought, mistakes to be made, wounds to be healed. But above all else, there's a realization that the tiresome debate of "how" or "if" has been replaced with "how soon" and "how better." The ramp up by the brokers will dictate the answers.

INTO THE LIGHT

2008 is a new year, but it marks the end of an old epoch. Three hundred years of paper-based trading does not disappear overnight, but it will erode over the next 24 months. Increasingly, paper will become the exception, not the norm.

The journey through the darkness is now ending. The market has just stepped out blinking into the light that was glimpsed at the end of the tunnel all those years ago. It will take a moment or two to adjust its eyes, but as soon as it does, it will be released from the shackles that have restrained it. Goodness knows how far and how fast it can now move.

Intriguingly too, London will become an electronic trading zone during the soft part of the insurance cycle, which adds spice in terms of the promise for the future growth and prosperity as the cycle ends. As Western economies stumble grimly through the next five years of uncertainty, the prospects for insurance traders in London have never looked brighter. New Year? New Hope! IF

Alex Letts is chief executive of London-based insurance and reinsurance electronic trading exchange RI3K.

For many captive insurance and other alternative risk transfer arrangements, fronting insurance is an essential ingredient to make the program work. Sometimes, however, ART program parent companies find it difficult to find the necessary fronting coverage. Here's a look at some of the key players in the fronting insurance market, and a brief overview of the type of business they do and some of their requirements.

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WEB SITE: *www.discover-re.com*

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JURISDICTIONS SERVED: ENTIRE U.S. EXCEPT FLORIDA AND OTHER COASTAL AREAS

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FRONTING COMPENSATION: N/A

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JURISDICTIONS SERVED: ENTIRE UNITED STATES

COLLATERALIZATION REQUIREMENTS: CASE-SPECIFIC

FRONTING COMPENSATION: PREMIUM BASED ON LIMITS

PRINCIPAL CONTACT: DAVID BROOKER

PETER BREITSTONE is managing principal and chief executive officer of Aon Environmental Services Group. in Cedarhurst, N.Y.

Sustaining success and job security

"I say the Earth belongs to each generation. No generation can contract debts greater than may be paid during the course of its own existence"

THOMAS JEFFERSON–SEPT. 6, 1789

Sustainability is a global concept requiring that economic development and growth meet the needs of the present without compromising the future. An obscure ecological concept until a decade ago, sustainability is now embraced by many in the business world to connote enhancing shareholder value through social, environmental and ethical responsibility.

Risk managers must recognize that to survive, they must answer the call to address emerging risks that threaten the ability of an enterprise to perpetuate its operations.

Until recently, survival meant a focus on tangible factors deemed essential to corporate value. Likewise, risk management focused on purchasing traditional insurance products to protect those tangible factors.

But today's news is all about emerging risks like global warming, resource depletion, developing economies, water shortages, credit crises and pollution. How should risk managers respond to these emerging concerns, and how should sustainability be viewed against traditional responsibilities?

In the book "The Sustainable Advantage," Bob Willard describes the Company Value Iceberg, which incorporates both tangible and intangible factors affecting an organization's value. He emphasizes that the tangible factors, those typically addressed by traditional insurance programs, are no longer the primary determinants of corporate value. He estimates that intangible factors now comprise up to 80% of an organization's value.

For businesses, this shift can translate into success or failure depending upon the ability to anticipate future events and trends and recognize the associated risks and opportunities. For risk managers, understanding the concepts of sustainability will be essential to their success and critical to their job security.

Some areas to consider when looking at corporate value contributing factors include: brand value and reputation, employee productivity, efficiencies in manufacturing processes, efficient use of energy (beyond reductions in demand), conservation of consumable resources, and innovation and investment in research and development.

Other areas are reduced physical facility costs, customer satisfaction, supply-side security and diversity, risk mastery—buying less insurance and providing better protection for catastrophic risks—and thought leadership and enlightened management.

For risk managers, the news will be mixed. Those driving the identification of emerging risks and promoting the accompanying opportunities will be valued as part of the solution. Those who don't will see the role move to someone else—perhaps the newly hired vp of corporate sustainability.

More than 400 companies now report having an officer of sustainability, and the number is growing rapidly. Viewed as helping the company make money by identifying "green opportunities," sustainability officers have been welcomed into the top executive ranks.

FOR RISK MANAGERS, understanding the concepts of sustainability will be essential to the success of their function and critical to their job security in the future.

Risk management, on the other hand, continues to be perceived as a cost center. It's no wonder that risk managers who aren't conversant with the emerging sustainability issues find their functions being subsumed by the larger category of sustainability.

In this new milieu, risk managers' first task is to understand the issues critical to corporate sustainability. Then they should look for opportunities in the emerging risk areas that can be new business niches or bolster sales of existing products and services.

Risk managers must recognize that if they don't take action, others will, becoming their organizations' thought leaders. Sustainability is a 21st century risk management challenge, but also an opportunity to enhance responsibilities, create reputation and upgrade compensation. For risk managers becoming part of the solution, job sustainability will only be the beginning of future opportunities.

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TECH FOCUS

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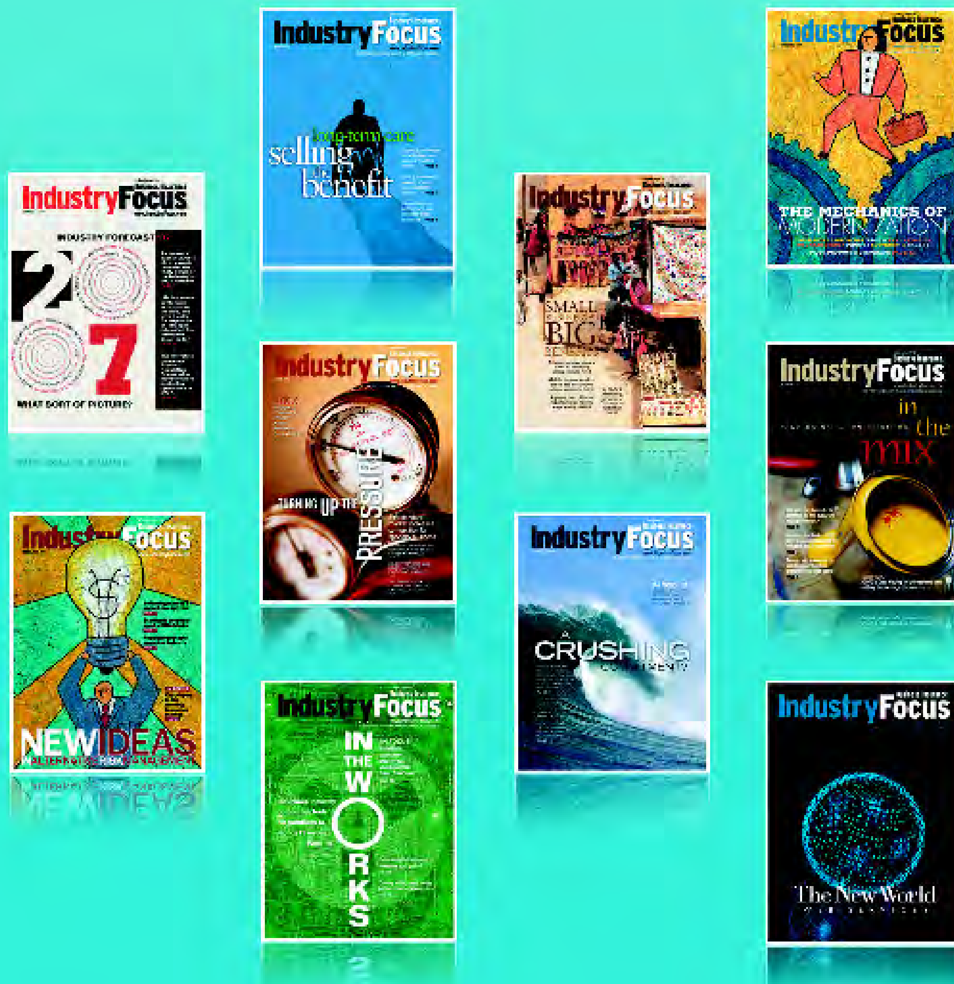
Clear Editorial Focus



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