

**Feds to OK captive use
to fund benefit risks / 3**

**Conning study finds
TRIA inadequate / 4**

Business Insurance

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\$4

Wide implications seen for ruling on scope of employer arbitration agreements

High court hears docs' RICO case



By MARK A. HOFMANN

WASHINGTON—The Supreme Court will further define the limits of employment arbitration agreements as it decides a case pitting physicians against managed care organizations.

And although the case involves the medical profession, the high court's ruling could have implications for all employers that use employment arbitration agreements.

The central issue in *PacifiCare Health Systems Inc. et al. vs. Book et al.*—for which in the high court heard oral arguments last week—is whether the Federal Arbitration Act requires courts to enforce arbitration agreements that bar arbitrators from awarding the full range of statutory remedies to plaintiffs. In this case, such a requirement could bar the awarding of treble damages permitted under the Racketeer In-

fluenced and Corrupt Organizations Act, according to the physicians involved.

In this complex case, various physicians and physician groups had signed a wide range of arbitration agreements with a host of managed care organizations. The physicians grew unhappy with the arrangements and filed a nationwide class-action suit against 10 of the managed care groups in 2000. Among other things, the physicians claimed that the managed care organizations had conspired to not properly pay claims, which the physicians claimed constituted a RICO violation.

The managed care organizations responded that arbitration could decide any RICO claims. Many of the physicians had signed arbitration agreements that, among other things, barred arbitrators from

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Late News

House panel to vote on 401(k) reform bill

The House Education and the Workforce Committee is expected this week to approve legislation that would allow 401(k) and other defined contribution plan participants to sell company stock contributed as a match after three years of service or after three years of receiving the shares. The legislation, H.R. 100, is similar to a bill the House passed last year in response to the Enron Corp. debacle. Enron employees were barred from selling Enron stock matches until they were aged 50.

Kemper to sell surety renewal rights to Arch

Kemper Insurance Cos. said has agreed to sell the renewal rights to its surety business to Arch Insurance Group. Arch, a unit of Bermuda-based Arch Capital Group Ltd., will also acquire some Kemper Surety division's staff as part of the deal, Kemper said in a statement. Terms of the sale were not disclosed. In 2001, Kemper Surety wrote about \$79.2 million in net premiums, accounting for more than 4% of the insurer's commercial lines net premiums.

IPO raises \$220 million for Endurance Specialty

Endurance Specialty Holdings Ltd. completed a \$220.8 million initial public offering last week, selling 9.6 million shares at \$23 per share. The property/casualty insurance holding company's stock began trading today on the New York Stock Exchange. Bermuda-based Endurance will use the proceeds to add capital to its operating units, repay portions of its outstanding debt and for general corporate purposes, the company announced.

Teleglobe directors covered in lawsuit

Canadian telecommunications giant BCE Inc. has \$280 million in directors and officers liability insurance to cover five former directors of Teleglobe Inc. who are being sued by Teleglobe's court-appointed interim receiver, Kroll Restructuring Ltd. In a lawsuit filed in the Ontario Superior Court, Kroll alleges that Teleglobe's directors violated the Canada Business Corporations Act by

See **LATE NEWS**/page 3

Few likely to opt for Cal-COBRA

Program may see pre-emption

By JUDY GREENWALD

SACRAMENTO, Calif.—California employers with insured health plans are likely to see a discernible, if small, increase in their health care premiums beginning in 2005, as a result of a state law that extends coverage beyond the maximum mandated under the federal Consolidated Omnibus Budget Reconciliation Act.

The law applies to workers who began their COBRA coverage as of Jan. 1 and provides them with up to 36 months of COBRA coverage, or another year and a half beyond the period normally provided under

federal and state law. As a result, they would not begin to receive the extended coverage any earlier than July 2004.

Observers say the number of workers who are likely to opt for the coverage provided under A.B. 1401 is small. However, those who do obtain the coverage would probably do so because they expect to need it, and so would be likely to generate a relatively large amount in claims. This would probably be reflected in employers' health plan rates in 2005, the year after the extension kicks in.

The law, which was enacted last year but which many observers are only now becoming aware of, does not apply to self-insured health care plans.

Mark Straus, a senior consultant

See **CAL-COBRA**/page 20

Rate hikes boost revenues, profits

When rates slow, will growth stop?

By SALLY ROBERTS

A heavy dose of premium rate hikes, coupled with acquisitions and new business development, produced impressive top- and bottom-line growth at the world's largest publicly held brokers in 2002.

All of the brokers annually surveyed by *Business Insurance* reported

double-digit revenue growth for the year, and all but one reported double- or triple-digit profit increases.

Much of the growth is attributable to the higher insurance rates underwriters are charging, which translate into higher commission and fee income for the brokers placing the business, analysts say. They predict, though, that while the rate increases will continue for the rest of 2003, they will begin to diminish by 2004.

As a result, some analysts are beginning to question brokers' ability to maintain their growth in the future and to wonder what will happen to the brokerage industry if insurance rates begin to slide.

The last time the market turned

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Brokers

2002 RESULTS

International

FILM FINANCE CASE CLEARED FOR TRIAL

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Late News

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redeeming and retracting preferred shares of stock while the company was insolvent. The suit asks that the five directors reimburse Teleglobe \$661.5 million Canadian (\$442.7 million).

Mental health parity bills before House, Senate

Employers would have to offer the same coverage in their health care plans for the treatment of mental disorders as they do for other medical conditions under legislation introduced last week in the Senate and House of Representatives. The legislation, The Senator Paul Wellstone Mental Health Equitable Treatment Act of 2003, is named after the Minnesota Democrat who died last year in a small-plane crash. Sen. Wellstone, along with Sen. Pete Domenici, R-N.M., led the congressional drive for mental health care parity.



PHOTO: REUTERS/CJ GUNTHER

The town of West Warwick, R.I., has coverage for claims stemming from a recent club fire.

Town insured for claims from nightclub fire

The town of West Warwick, R.I., has only \$4 million in liability insurance to cover any claims arising from a fire last week at the Station nightclub, which killed about 100 people and seriously injured dozens more. West Warwick has liability coverage through the Rhode Island Interlocal Risk Management Trust, a mutual insurer for municipalities in the state, said Wolfgang Bauer, town

Labor Dept. expected to OK ADM benefits captive plan

By JERRY GEISEL

WASHINGTON—The U.S. Department of Labor this week is expected to formally propose that agribusiness giant Archer Daniels Midland Co. be allowed to use its captive to reinsure group life insurance benefits.

When the Labor Department's ruling is finalized, as is virtually certain after a public comment period, it will allow Decatur, Ill.-based ADM to use its 15-year-old Vermont captive, Agrinational Insurance Co., to reinsure hourly and salaried employees' life insurance benefits. The ruling would also set a precedent that would speed up the approval process for other employers seeking to make similar use of their domestic captives.

Employers have long discussed expanding their captives to fund benefit risks for a variety of reasons, including cost savings, broadening their captives' premium base and possibly increasing the likelihood they can take a tax deduction for property/casualty premiums paid to their captives.

But a more than 20-year-old

Labor Department rule had stood in the way of that approach. Under that rule, at least 50% of a captive's business must be made up of third-party risks for the parent to fund employee benefit business through the captive. Few captive owners have been willing to take on that much unrelated business.

But in 1999, in a pledge of new flexibility on the issue, a key Labor Department official said that meeting the 50% test would no longer be a prerequisite for winning department approval for funding benefits through captives. The department would alternatively consider the quality of the primary insurers used by a captive and whether plan participants would benefit from the arrangement.

A year after that pledge, the department approved Columbia Energy Group's application to use the Vermont branch of its Bermuda-domiciled captive to reinsure its long-term disability benefits program. To gain approval, Columbia Energy, later acquired by NiSource Inc., agreed to sweeten participants' LTD benefits,

among other changes.

Last year, ADM, following the "Columbia model," boosted basic and supplemental life insurance benefits and told the Labor Department it would contract only with top-rated insurers to issue policies and would use an independent fiduciary to ensure that all conditions of the Labor Department ruling—known as a prohibited-transaction exemption—were met.

Once the ADM prohibited-transaction exemption receives final Labor Department approval, future applicants who also want to fund benefits through their captives will be able to take advantage of a special expedited review process, in which the department make must a decision within 45 days. To qualify for this fast-track procedure, an applicant has to cite two "substantially similar" exemptions approved by the Labor Department within the past five years.

The proposed ADM exemption—and the conditions ADM has agreed to meet—will be published in the Federal Register this week.



areas of immediate focus include: improved financial oversight; medical cost containment; consistency in determining the level of

permanent disability; improved coordination and communication with state agencies regulating the system; continued aggressive fraud interdiction; creation of a 24-hour medical care system merging health insurance with workers comp medical care; and development of training and quality standards for service decision-makers.

Briefly noted

The Bermuda Insurance Institute has named Robert Newhouse as the recipient of its Lifetime Achievement Award for 2002. James P. Bryce has been named the BI's 2002 Market Leader of the Year. Mr. Newhouse, who is chairman of AXIS Specialty Ltd., was a longtime executive at Marsh & McLennan Cos. Inc. Mr. Bryce is president and chief executive officer of property catastrophe reinsurer IPC Holdings Ltd....**Montpelier Re Holdings Ltd.** reported profits of \$152 million for 2002, which was its first full year of operation. The Hamilton, Bermuda-based insurer, which was established shortly after the Sept. 11, 2001, terrorist attacks, reported gross premiums of \$607.7 million in 2002....**Allied World Assurance Co. Ltd.** has increased its excess casualty limits to \$50 million from \$25 million....**Factory Mutual Insurance Co.** posted net income of \$244 million in 2002, compared with a loss of \$132 million in 2001. Premiums at the insurer, which does business as FM Global, rose 61% to \$3.3 billion.

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manager for West Warwick. The town of West Warwick will likely be seen as a source of compensation, he said. That is because neither the club nor Great White, the rock band playing at the time of the fire, is likely to have significant insurance coverage, Mr. Bauer said. Representatives of the club could not be reached for comment.

Munich Re renewals see rate hikes, new business

Munich Reinsurance Co. says it is "well satisfied" with its Jan. 1 renewals of reinsurance business, adding that higher premiums, larger shares of renewal business and new writings more than offset business the company chose to terminate. The reinsurer said that 65% of its

total portfolio was up for renewal Jan. 1. Of that amount, approximately 16% was not renewed because the business did not meet Munich Re's profitability criteria. Renewed business saw rate increases of 11% on average, Munich Re said.



PHOTO: SUN

Bayer settling Baycol claims

Beleaguered German pharmaceutical firm Bayer A.G. says that, to date, it has entered into settlement

agreements with 450 individuals—or their families—who suffered serious side effects or died after taking the cholesterol-lowering drug Baycol. Bayer said in a statement that Baycol was the subject of about 7,800 lawsuits to date. Bayer's chairman, Werner Wenning, said that the group may have to set aside provisions for Baycol liabilities over and above its insurance coverage. Bayer said it has paid about \$125 million in settlements.

California commissioner proposes comp reforms

California Insurance Commissioner John Garamendi is proposing immediate action in seven areas to restructure California's workers compensation system. The seven

Inside Business Insurance

Trying a new approach to cutting drug costs

A consultant is trying to save some employers money by changing the way their PBMs price drugs. **Page 4**

Staten Island fire under investigation

Cleanup and an investigation are under way after a deadly fire at a Staten Island fuel depot. **Page 4**

Putting the threat in perspective

Paul Winston discusses one individual's efforts to allay some of the fears about terrorism. **Page 6**

Club tragedies highlight need for risk control

The recent nightclub accidents underscore the need for good risk management. **Page 8**

Stopping mold problems before they start

Risk managers should take steps to protect against potential mold-related problems. **Page 10**

Regulators derail sale of Gerling Global Re

German regulators have blocked the proposed sale of Gerling Group's reinsurance unit. **Page 17**

Online

- The **Datebook** calendar lists upcoming industry seminars and meetings and allows you to add info on your own event.
- Searchable **directories** of all the listings of industry vendors found in *BI's* Market Sourcebook.
- New **Opinion Poll** for readers: For every \$1 in COBRA health care premiums you collect from beneficiaries, how much do you pay in claims?

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REPORTING ON CORPORATE RISK AND EMPLOYEE BENEFIT MANAGEMENT NEWS.

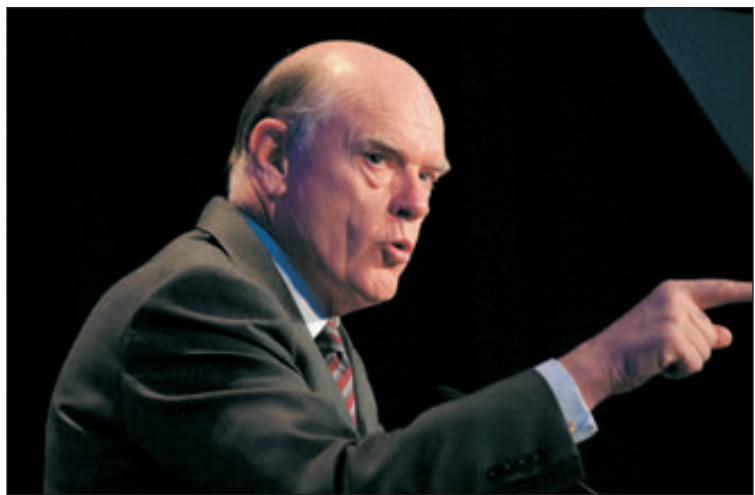


PHOTO: UPI

Under TRIA, Treasury Secretary John Snow has the authority to determine whether a terrorist act meets the requirements needed to trigger the federal backstop.

TRIA leaves problems unsolved, study says Terror act deemed inadequate

By MEG FLETCHER

The Terrorism Risk Insurance Act of 2002 has done little to solve the problems that businesses and insurers face in dealing with terrorism risk, according to a study released last week by Conning Research & Consulting Inc.

"The placebo effect of passing this legislation is beginning to wear off," said Bruce Thomas, a New York-based vp with Conning. "While the act will provide some

capital relief in the event of another large-scale terrorist attack, it will not prevent insurers from becoming insolvent if their exposures are too concentrated," he said.

From a policyholder's perspective, there are three reasons that the coverage mandated by TRIA's federal backstop program is inadequate, according to the 53-page report, "Terrorism Risk Insurance Act of 2002: Problem Not Solved." They are:

- The act does not address all

losses that may arise from terrorism, because it does not address domestic terrorism or losses from nuclear, biological and chemical hazards.

- Many policyholders still believe that the price of the coverage is too high.

That situation, though, is expected to improve due to competition for all but the most high-risk properties, Mr. Thomas said.

- The U.S. Secretary of the Treasury has substantial authority to in-

See TRIA/page 23

Exxon Mobil self-insured for fire at fuel terminal

By MICHAEL BRADFORD and SARAH VEYSEY

NEW YORK—Cleanup is underway at an Exxon Mobil Corp. fuel terminal that was heavily damaged by a deadly fire late last month.

Two employees of Bouchard Transportation Co. and an Exxon Mobil employee at the Port Mobile Terminal on New York's Staten Island were killed when a huge fire erupted as fuel was being unloaded from a barge. The barge, owned by Bouchard, had unloaded about half its cargo of 100,000 gallons of unleaded gasoline when the fire broke out.

The cause of the blaze had not been determined last week. Damage estimates were unavailable.

A spokesman for Exxon Mobil confirmed that the oil company is self-insured but could not provide further details. London market

sources said Exxon Mobil's property risk is self-insured up to \$450 million.

The oil company is a member of Hamilton, Bermuda-based mutual insurers Oil Insurance Ltd. and Oil Casualty Insurance Ltd. OIL offers property insurance limits of up to \$250 million per occurrence, and OCIL offers excess liability limits of up to \$150 million.

The fire shut down the 203-acre terminal, which housed 39 tanks that held gasoline and other fuels. At the time of the accident, less than 500,000 barrels of fuel were stored at the facility, which can hold up to 2.5 million barrels.

According to an Exxon Mobil statement, the company does not expect the shutdown of the terminal to cause significant delays in providing fuel to its customers. The company began redirecting fuel

from other locations soon after the fire broke out.

London market sources said the Bouchard-owned barge that sank was valued at around \$3 million, with its cargo having a similar value.

West of England Ship Owners Mutual Insurance Assn., a protection and indemnity club based in Luxembourg, provided Bouchard's third-party liability coverage, a spokeswoman for Bouchard confirmed.

According to Christopher B. Kende, a maritime attorney with the New York firm Cozen O'Connor, who is not connected to parties involved in the Staten Island fire, "normally, a vessel owner has no responsibility in unloading." The port workers, generally, handle that task, he said, "so if there was a problem with the unloading, it would probably be Exxon's liability."



PHOTO: KRT

A fire that broke out late last month when a barge was unloading fuel at a terminal on New York's Staten Island caused an undetermined amount of damage.

ABA Insurance Risk Management Annual Conference

Rate hikes slowing for property risks

By RODD ZOLKOS

ST. PETERSBURG, Fla.—Property insurance markets may be stabilizing ahead of casualty markets, but buyers of property coverage still face a market environment that requires hard work to get the best price and capacity.

"We're starting to see a break in the very bad pricing trends of the last couple of years," said Anne K. Anderson, managing director, property and international practice at Marsh USA Inc. in New York.

Speaking as part of a panel on the property market at the American Bankers Assn.'s Insur-

ance Risk Management Annual Conference and Meetings earlier this month in St. Petersburg, Fla., Ms. Anderson said that price increases averaged 80% through 2002. But Jan. 1 renewals saw increases in the range of 10% to 20%, she said, with some critical sublimits being increased. "In some cases, we're actually seeing a flat renewal," Ms. Anderson said.

There's also "the beginning of a feeling of slight competition" on higher layers, she said.

Available capacity is increasing somewhat, in part because of new capacity in the London and Bermuda markets. "The new Bermuda markets have become real players, particularly in first excess layers," Ms. Anderson said.

But Kenneth I. Johnson, assistant vp, corporate accounts un-

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Conference coverage continues on page 15

Firm urges change in method of calculating prices of drugs

Consultant says federal limits should determine costs

By MICHAEL PRINCE

NEW YORK—A benefit consulting firm is working to help a group of employers reap savings in their drug

benefit plans by changing the method used in calculating drug prices.

If the change is implemented, the self-insured employers could save

between 1% and 3% of their total annual prescription drug spending, according to Sean Brandle, vp at The Segal Co. in New York, who is involved in the effort.

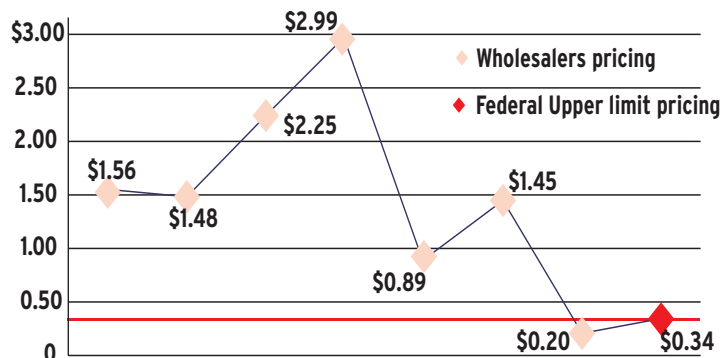
Currently, the prices drug plans use for prescription drugs are almost exclusively based on a figure called the average wholesale price, with the employer receiving a discount—generally between 10% and 20%—off that figure.

The average wholesale prices are

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COMPARING WHOLESALE DRUG PRICES

Prices from drug wholesalers for a single 150 mg tablet of Ranitidine* vary compared with federal upper limit pricing



* Ranitidine, which is marketed under the brand name Zantac, is used to treat and prevent the recurrence of ulcers and other conditions where the stomach produces too much acid. Source: The Segal Co., Red Book 2002

Errors & omissions

- Due to incorrect information supplied to *Business Insurance*, the ZIP code for Bickmore Risk Services in the Feb. 17 ranking of independent U.S. risk management consultants was incorrect. Bickmore Risk Services is at 1020 19th St., Suite 200, Sacramento, Calif. 95814.

RRG seeking government-backed reinsurance Equitime remains on hold

By GAVIN SOUTER

NEW YORK—Equitime, the risk retention group formed to cover airline terror risks, is currently in a holding pattern while its organizers work to find a government-backed reinsurance program to support the facility, one of Equitime's sponsors said.

Among the options that are available, given the Federal Aviation Administration's failure to establish a government-backed reinsurance program for Equitime, is the possibility of using provisions of the 2002 Terrorism Risk Insurance Act to provide reinsurance coverage, said Chris Duncan, vp-finance and chief risk officer for Atlanta-based Delta Air Lines Inc.

The establishment of Equitime, though, is just one of several creative uses of alternative risk financing facilities that have taken off with the arrival of the hard market, said speakers at a meeting of the Assn. of Professional Insurance Women in New York earlier this month.

Equitime, which received its contingent license in Vermont in May 2002, was formed to provide war risk coverage for airlines after the market for the coverage virtually disappeared following the Sept. 11, 2001, terrorist attacks. The facility was designed to offer airline members \$1.5 billion in war risk limits, but only \$300 million of the limit would be retained. The organizers of Equitime proposed that a government-backed reinsurance program

should be set up to reinsure the facility, but, so far, the government has failed to act.

The project was opposed by commercial insurers that offered their own terrorism coverage, and "there has been an increasing desire by the government to let the market work," Mr. Duncan said. "But the market hasn't worked, because it's uninsurable," he said.

After the terrorist attacks, the FAA established a temporary insurance

'There has been an increasing desire by the government to let the market work. But the market hasn't worked, because it's uninsurable.'

*Chris Duncan
Delta Air Lines Inc.*

program for airlines. That program has since been renewed several times and is due to expire Aug. 31.

The extension gives Equitime's sponsors "breathing space" to try to secure government-backed reinsurance, Mr. Duncan said.

Among the options being considered is the possibility of using the provisions of TRIA to secure a government backstop for Equitime, he said.

Under TRIA, the federal government agreed to cover the bulk of insured terrorism losses after insurers meet individual deductibles. The government must certify an event

as an act of terrorism for the program to be triggered.

"We're still evaluating whether or not this option really exists, and how a new TRIA-based version of an airline risk retention group might be able to cover the risks not reinsured under TRIA," he said.

Equitime is just one example of how RRGs and captives can be used to provide coverage options for risk managers, Mr. Duncan said.

"A captive is the Swiss Army knife of risk financing," he said. It can be used for traditional risk financing to curb insurance costs, or it can be used as a creative tool to produce profits, such as by writing coverage for affinity groups, Mr. Duncan said.

The current hard market is leading to a sharp increase in captive formations, said Jill Husbands, managing director at Marsh Management Services (Bermuda) Ltd. in Hamilton.

One of the main reasons captives are formed when insurance rates are increasing is to give policyholders direct access to reinsurance markets, she said.

Captives also free policyholders from coverage restrictions that commercial insurers apply during a hard market, Ms. Husbands noted.

And in the current atmosphere of increased regulatory scrutiny by organizations such as the Securities and Exchange Commission, a captive formalizes risk financing programs more readily than does a traditional self-insurance program, she said.

Paul Winston Facts can free us from our fear

In a time when we are reminded almost daily of the threat of terrorism—not by devastating acts of terrorism themselves, but by our memories of Sept. 11, the anthrax scare and persistent government warnings to be vigilant—it is all too easy for many people to become paralyzed by fear and anxiety.

That is the purpose of terrorism: not so much to inflict mass destruction and bodily harm but to instill fear in a population, thereby destabilizing a society to achieve the terrorist's aims.

An insurance industry executive recently made me aware of a paper written by a former soldier who hopes to diminish the power that terrorists have over the American people by helping them to more realistically appraise

the risks they face from such attacks. In so doing, he seeks to free people from crippling fear that he contends is not wholly justified by the threat.

In sharing this information with me, the executive suggested that many would benefit from reading the soldier's paper, and I agree.

The paper is titled, "Words of Wisdom About Gas, Germs and Nukes" and was written in September 2001 by Red Thomas, who retired several years ago as a sergeant first class in the U.S. Army. In Red's 20 years of service, he received training in nuclear, biological and chemical warfare.

In explaining his purpose, Red writes: "Since the media have decided to scare everyone with predictions of chemical, biological, or nuclear warfare on our turf, I decided to write a paper and keep things in their proper perspective."

For a start, he advises everyone to forget everything they ever saw on television or the movies or read in a novel about the destructive power of such attacks. For most people, fiction about a drop of a toxic substance wiping out thousands of people will be their only frame of reference, but "it was all a lie," he writes.

Red's paper reviews how chemical, biological and nuclear weapons work, explains why they generally are not effective as tools of mass destruction, and specifically, how unlikely it is that terrorists could effectively use them in a way that would put more than a relatively few people at risk.

Take chemical weapons, for example, which he categorizes as nerve, blood, blister and incapacitating agents.

"Contrary to the hype of reporters and politicians, they are not weapons of mass destruction. They are means of 'area denial,'

effective to keep an enemy out of a particular zone for a limited period of time: terror weapons that don't destroy anything. When you leave the area you almost always leave the risk," Red writes.

Chemical weapons are hard to deliver, they require heavy concentrations to be effective and targets must have it remain on their skin—or breathe it deeply—for a prolonged period of time to be effective, he contends. If an attack does occur nearby, staying calm, leaving the area and getting fresh air is going to greatly increase chances of survival. Time and geography—as well as simple things like wind and temperature—diminish the potency of chemical agents.

"Bottom line on chemical weapons....They are intended to make you panic, to terrorize you, to herd you like sheep to the wolves. If there is an attack, leave the area and go upwind, or to the sides of the wind stream. You're more likely to be hurt by a drunk driver on any given day than be hurt by one of these attacks. Your odds get better if you leave the area. Soap, water,

time and fresh air really deal this stuff a knockout punch. Don't let fear of an isolated attack rule your life. The odds are...on your side."

Red's key message is that the more we know about the actual risk and its limitations—and some common sense measures for minimizing it—the less likely fear will rule our lives. It applies just as readily to nuclear and biological weapons. His paper provides similarly detailed reviews of these weapons and their limitations for mass destruction. While each weapon is different, it is still very difficult for terrorists to not only obtain them but also to deliver them effectively, he contends.

His intention is not for people to ignore such threats and discount these weapons completely but to realize that maybe they do not warrant the paralyzing anxiety that now grips some people in our country. If people can regain their freedom from fear, then they rob terrorists of their power.

Red's paper is widely available on the Internet. One site with critical commentary is www.snopes.com/rumors/realdeal.htm.

Next week, I'll write about an interview I did with Red Thomas and share his thoughts on putting government warnings and advice on duct tape and plastic sheeting into perspective, why he wrote his paper and how it has been received.

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Paul Winston



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Editorial

Don't offer what you can't afford

BARRING AN UNFORESEEN, last-minute development, tens of thousands of Bethlehem Steel Corp. retirees will lose their retiree health care benefits at the end of the month, when their bankrupt former employer terminates coverage.

The cancellation of coverage does not come as a surprise. Bethlehem is selling its assets to another company, and the buyer did not want to take on what surely are several billion dollars in retiree health care liabilities.

Robert S. Miller, Bethlehem's chairman and chief executive officer, bluntly but accurately told retirees that the benefits were put in place when health care costs were

lower and the company's financial condition was stronger. Now, though, Bethlehem can no longer afford to provide the benefits, he explained.

To be sure, many Bethlehem retirees will be better insulated from the loss of employer-provided coverage than will other retirees. That is because many of the steel company's retirees will be eligible for a federal tax credit against 65% of the cost of premiums of replacement coverage. That credit is available to Bethlehem retirees age 55 to 65 because the Pension Benefit Guaranty Corp. has taken over the company's pension plan.

Still, the loss of their health care coverage will be costly for Bethle-

hem's retired workers. And, as many benefit experts predict, such financial pain is likely for retirees elsewhere, as other financially strapped employers jettison their health care plans.

What happened to Bethlehem's retiree health care plan should serve as a wake-up call both to the employers that still maintain these plans and, in cases in which employees are represented by organized labor, to unions.

Employers need to examine now—not when they are in a financial death spiral—the benefits they truly can afford to provide. We wonder, for example, why most employers would even want to offer health care to retirees who are not

yet eligible for Medicare coverage. The enormous cost aside, we question the wisdom of encouraging employees—often an employer's most experienced employees—to retire in their 50s or early 60s by providing company-subsidized health care coverage.

Unions, too, must be sensitive to the cost of retiree health coverage. They need to be more flexible and accommodating when employers seek to amend plans to try to hold down costs.

Those unions that resist such changes may find that the employers they are negotiating with today may one day no longer be around, and that surely cannot be a result any responsible union would want.

Nightclub scrutiny a necessary cost

AT A TIME WHEN SO MUCH attention is focused on the risks of war and terrorism, two recent nightclub tragedies remind us not to lose sight of the need to also manage some basic risks that can be just as deadly.

For the majority of nightclubs and concert venues nationwide, there is unlikely to be a dedicated risk manager identifying hazards and protecting the public. These are small businesses without the resources for such professionals, let alone sophisticated fire suppression systems. Even so, there usually is ample attention paid to the risks of security, crowd control and fire safety. This comes not only from the common sense of management but also from local law enforcement

and fire safety professionals who enforce regulations designed to protect the public. Most of the time, this system is effective at ensuring the safety of these clubs, their performers and their patrons.

In the case of the Chicago and Rhode Island tragedies, though, it appears that lapses in judgment allowed deadly hazards to spread unchecked. Combined with the density of the crowds and the inability to identify exits in a crisis, the result was a devastating loss of life.

In the wake of these disasters, nightclubs will undergo much tighter scrutiny from their owners, government agencies and their insurers. And they should. If these disasters do not result in improved

attention to the safety of the public at other venues, then that would be doubly tragic.

New attention will be paid to the use of pepper spray to subdue unruly patrons, and to the training received by security personnel. In addition, a closer look should be paid to the use of pyrotechnic displays at concerts, and to the prevalence of flammable materials on stage and in clubs in general. Scrutiny should also focus on the adequacy of exits and how to make patrons more aware of those locations.

For some clubs, this will be business as usual. For others, the costs of upgrading safety and paying more for insurance will be ruinous. But, as both of these nightclub tragedies show, the risk of not mak-

ing a venue safe for performers and the public is much greater, resulting not only in the loss of a business but in the loss of life.

Letters to the Editor

In praise of AS/NZS 4360 as risk-measure standard

To the editor: According to your sources in Judy Greenwald's Feb. 17 story, "Measuring Risk's Scope a Tough Job," there is no single "established standard for measuring risk." The Australia/New Zealand Risk Management Standard, AS/NZS 4360, has been around since 1995.

The United Kingdom and Canada also each have a general standard, but neither is as complete as AS/NZS 4360.

I have been using AS/NZS 4360 for years and chiding RIMS for

Prevent mold problems before they start

By Sharon M. Stecker and Eric Harrison

Toxic mold claims have become a major workplace issue. Corporate insurance and risk managers are well advised, therefore, to take protective measures against mold infestation.



The following steps can help in reducing the liabilities associated with mold:

First, try to eliminate the water or moisture intrusion that causes virtually every mold problem. Check for condensation and leaks and fix them within 48 hours. Keep indoor humidity low—ideally, below 60%. Check heating, ventilation and air conditioning systems regularly. Designate a “point person” to monitor mold and catch problems while they are still



small. A musty odor may signal hidden mold growth, so check inside air spaces, ducts, and wall cavities; a Certified Industrial Hygienist

can advise you if further inspection and/or testing are needed.

Second, prepare and disseminate a detailed company policy and information sheet with contact numbers addressing water damage, mold, related health issues, and emergency procedures. This may be a major asset in defending a case.

Third, line up your local experts ahead of time: A law firm with expertise in real estate and environmental litigation, and an environmental engineer and/or a CIH qualified and licensed to properly oversee sampling and inspection.

Covered or not?

Property/casualty insurers across the country have been struggling with mold claims for several years. The industry is very much in a state of flux, and few courts have provided guidance regarding the extent to which mold claims are covered.

Insurers generally may rely on one of the following:

- Specified-loss and concurrent-causation exclusions. Some insurers have cited the “wear and tear” exclusion under ISO Form BP 00 02 01 97, which excludes “loss or damage...from...rust, corrosion, fungus, decay, deterioration, hidden or latent defect or any quality in property that causes it to damage or destroy itself.” In ISO Form BU 04 01 01 94, the “wear and tear” exclusion may afford a stronger defense, as it expressly uses the words “fungus” and “mold” in conjunction with “concurrent causation” language.

But this so-called “concurrent causation”

exclusion is still being litigated. Some jurisdictions, including California, find it violates public policy; at least two others, including New Jersey, find the opposite. Texas, California and Washington courts have refused to apply concurrent-causation exclusions to mold, while an Arizona federal court ruled in *Cooper vs. American Family Mutual Insurance Co.* that it precludes coverage for all first-party mold claims, regardless of how the mold occurred.

- The absolute pollution exclusion. It is a very open question whether the absolute pollution exclusion will be applied to mold claims as it has for lead and asbestos. Courts have universally barred coverage for impacts from leaking storage tanks or landfills, but are divided on lead paint in buildings, some declining to classify lead paint as a pollutant. Mold spores dispersed through a contaminated HVAC system would seem to fit the pollutant model, thus precluding coverage, but no published opinion has addressed this issue yet.

- Policy conditions. Specific policy conditions can offer a viable defense against a mold claim—particularly where the policyholder fails to provide prompt notice of the reported losses, secure the damaged property to mitigate the loss, permit timely inspection and/or protect property from further damage. These duties are particularly important in mold cases, because any delay may result in the rapid growth and spread of contamination.

- The 2002 mold exclusion. The comprehensive “fungi or bacteria exclusion” in ISO Form CG 21 67 04 02 may change this picture.

Added last year to ISO commercial general liability policies, it specifically excludes “bodily injury” or “property damage” that would not have occurred except for the “actual, alleged or threatened inhalation of, ingestion of, contact with, exposure to, existence of, or presence of, any ‘fungi’ or bacteria on or within a building or structure, including its contents, regardless of whether any other cause, event, material or product contributed concurrently or in any sequence to such injury or damage.” The mold exclusion further excludes coverage for any loss, cost or expense “arising out of the abating, testing for, monitoring, cleaning up, removing, containing, treating, detoxifying, neutralizing, remediating or disposing of, or in any way responding to, or assessing the effects of, ‘fungi’ or bacteria, by any insured or by any other person or entity.”

Many states have refused to approve policy forms that contain this exclusion, but many excess lines underwriters have successfully incorporated it, due to the comparatively modest regulation of excess lines nationwide. Even in states where the exclusion has been approved, we anticipate legal challenges on the basis of public policy, the reasonable expectations doctrine and other legal and equitable grounds. It remains to be seen whether the new fungi exclusion will be enforced as intended throughout the country.

Sharon M. Stecker is a principal environmental scientist at BEM Systems Inc., a Chatham, N.J.-based national environmental engineering and consulting firm. Eric Harrison is counsel with the law firm Methfessel & Werbel in Edison, N.J.

Court OKs limit on LTD mental health benefits

A county's disability benefits plan that limited benefits for disability due to mental illness but did not similarly limit benefits for physical disability did not violate federal or state equal-protection guarantees, according to the Supreme Court of Minnesota.

In 1987, the Minnesota county of Anoka added long-term disability insurance to its employees benefits package. In 1994, the county accepted a LTD policy from Sun Life Insurance Co. of Canada that contained a distinction between mental and physical disabilities.

The policy limited benefits for mental disability illness to 24 months unless the employee were confined to a hospital or licensed psychiatric institution; it did not contain a similar limitation for physical disabilities. The county provided the policy to its employees, without regard to their physical or mental status, at no cost to them. Gloria Kolton, a county employee, resigned due to mental illness and received disability benefits for 24 months, at which time the insurer terminated her benefits because she was not confined to a hospital or licensed psychiatric institution. Ms. Kolton sued the county, charging violation of the federal and state equal-protection guarantees. The trial court ruled for the county, and Ms. Kolton appealed. The appeals court issued a split decision and both parties appealed to the Minnesota Supreme Court.

The Minnesota Supreme Court said that the mandate of the equal-protection clause is that all similarly situated individuals shall be treated alike. According to the court, the standard for review of challenges based on equal-protection claims is whether there is a

Legal briefs

rational basis for the classification. The court concluded that the county's plan was rationally related to a legitimate governmental interest of providing the same plan to all county employees while maintaining the county's fiscal integrity. Thus, the court held that the plan did not violate equal-protection guarantees.

Kolton vs. County of Anoka, Supreme Court of Minnesota, June 13, 2002 (BI/05/F.-\$10)

Fuel accident coverage barred under exclusion

Siphoning gasoline from the tank of a functioning motor vehicle to determine the source of a leak was “maintenance” within the meaning of an automobile exclusion of a commercial general liability policy, according to the Court of Appeals of Indiana.

Jon B. Purkey of Purkey's Heating & Cooling was covered under a CGL insurance policy issued by Meridian Mutual Insurance Co. The policy excluded coverage arising out of the ownership and maintenance of an “auto.” In 1996, Mr. Purkey purchased a 1988 Ford Bronco for business and personal use. In 1997, having smelled gasoline and seen drips of gas under the vehicle, Mr. Purkey backed the vehicle into a garage he rented in an apartment building. He began siphoning gas from the tank into an open container to allow him to determine the location of the leak. A fire occurred, injuring Mr. Purkey, damaging the Bronco and

destroying the apartment building and other buildings. Mr. Purkey was sued by several of the property owners for negligence. The insurer sought a declaration from the court that the auto exclusion applied to its liability for the damages. The trial court ruled against the insurer.

The appellate court, however, said that by siphoning the gasoline from the tank of the still-functioning Bronco to facilitate the repair of the leak, Mr. Purkey was keeping the Bronco in a state of repair or efficiency and was, therefore, “maintaining” it for purposes of the policy's exclusion. Furthermore, the court said that there was no doubt that the damage arose out of Mr. Purkey's maintenance of the Bronco. The trial court decision was reversed.

Meridian Mutual Insurance Co. vs. Purkey, Court of Appeals of Indiana, June 14, 2002 (BI/03/F.-\$10)

Court clarifies meaning of ‘collapse’ in policy

“Imminent collapse” covered by a property insurance policy means that collapse is likely to happen without delay, according to the Supreme Court of South Carolina.

Ocean Winds Council of Co-Owners Inc. was covered under a property insurance policy issued by Auto-Owner Insurance Co. The policy provided coverage for loss or damage caused by or resulting from risks of direct physical loss involving collapse of a building caused by hidden decay or hidden insect or vermin damage. Ocean Winds alleged its buildings have suffered “substantial structural impairment” from hidden decay as a result of water and termite

damage, although the buildings have not fallen to the ground. Ocean Winds sought payment from the insurer under the collapse coverage, and the insurer denied the claim, contending coverage is not triggered until the buildings fall. Ocean Winds sued the insurer in federal court, and that court requested the Supreme Court of South Carolina determine when coverage is triggered under South Carolina law with regard to the policy clause providing coverage for risks of direct physical loss involving collapse.

The Supreme Court of South Carolina said that the word “collapse” as used in property loss insurance policies has spawned much litigation. “The modern trend is to find the word ‘collapse’ ambiguous,” the court said, “and construe it to mean a ‘substantial impairment’ of the building's structural integrity.” The court concluded that it would define “imminent collapse” to mean collapse likely to happen without delay. “This construction protects the insured without distorting the purpose of the clause to protect against damage from collapse,” the court said. Thus, the court said that the policy here required proof of imminent collapse for coverage to be triggered.

Ocean Winds Council vs. Auto-Owner Insurance Co., Supreme Court of South Carolina, June 17, 2002 (BI/01/F.-\$10)

These abstracts were prepared by Mayo H. Stiegler. Copies of these decisions are available, at \$10 each, by sending a check payable to Mayo H. Stiegler, to Business Insurance 740 N. Rush St., Chicago, Ill 60611-2590. Provide the listed number for each opinion ordered.

Comings & Goings

Insurers

Branchville, N.J.-based Selective Insurance Group Inc. has made several senior executive promotions:

- **Dale A. Thatcher** has been promoted to executive vp and chief financial officer from senior vp and CFO.
- **Ronald J. Zaleski** to executive vp and chief actuary from senior vp and chief actuary.
- **Debra P. Carter** to senior vp and human resources director from vp and human resources director.
- **Sharon R. Cooper** to senior

vp and director of corporate communications from vp and director of corporate communications.

Selective is a holding company for five property/casualty insurers that offer primary and alternative market coverage for commercial and personal risks.

Eileen O'Shea Auen has been named president of Health Net of the Northeast. Ms. Auen previously served as one of three regional presidents for CIGNA HealthCare, overseeing the company's Atlantic region.



Mr. Mazzotta



Mr. Narvell



Mr. Callahan

Philadelphia-based ACE USA has made several appointments as part of its new regional organizational structure:

• **Gary Hightower**, senior vp of Risk Management, an operating unit of ACE USA, was named senior regional executive.

• **Pam Humphrey**, vp of ACE Risk Management, was named Houston branch executive.

• **Scott McKeon**, formerly a vp at Tri-City Brokerage Inc. in Chicago, was named Midwest regional executive.

• **Steve Meyer**, vp of sales for

ESIS Inc., an operating unit of ACE USA, was named Northwest regional executive.

• **Paul O'Neill**, senior vp for energy property for ACE USA's Specialty Property & Casualty division, was named Southeastern regional executive.

• **Greg Otterson**, senior vp and head of ACE USA's surety operations, was named mid-Atlantic regional executive.

• **Dorien Smithson**, senior vp for sales and marketing at ESIS, was named New York regional executive.

• **Karen Sothorn**, senior vp for U.S. International in the Specialty Property & Casualty division, was named New England regional executive.

• **Laura Ulrich**, vp of ACE Risk Management, was named Western regional executive.

Raymond R. Mazzotta has been named chief executive officer of medical malpractice insurer OHIC Insurance Co. of Columbus, Ohio. Mr. Mazzotta joined OHIC more than three years ago and previously held the titles of president and COO. He replaces **Gerald J. Cassidy**, who will continue to serve as chairman.

Brokers:

James B. Meathe was named president and COO of Savannah, Ga.-based broker Palmer & Cay Inc., replacing **F. Michael Crowley**, who was promoted to vice chairman. Mr. Meathe previously led the Midwest operations for Marsh Inc.

Reinsurance:

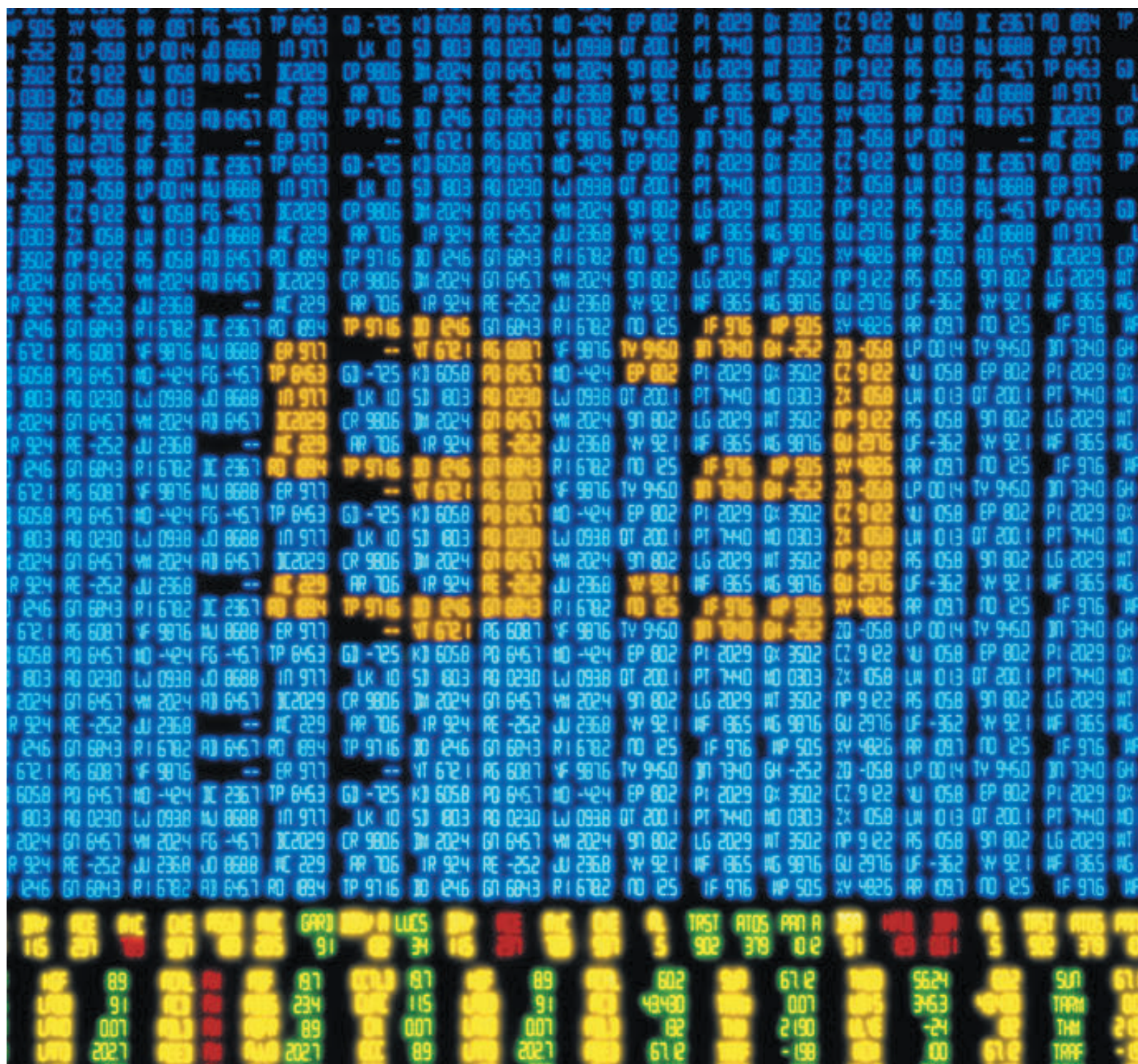
John Narvell was named global chief actuary at Employers Reinsurance Corp. of Overland Park, Kan. Mr. Narvell formerly served as chief actuary at XL Wintherthur International in London and Switzerland.

Other suppliers:

Joseph Ruggiero has been named executive vp of the retirement plans division of benefit consulting company Chernoff Diamond & Co. L.L.C. of Albertson, N.Y. Mr. Ruggiero previously served as vp of daily operations at CBIZ Retirement Services.

Kent C. Callahan was named president and chief executive officer of Transamerica Retirement Services, a Los Angeles-based retirement plan administrator with \$8.3 billion in plan assets under management. Mr. Callahan previously served as vp of business development and marketing.

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AGENT/BROKER TOPICS

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



M&A continuing, but some say insurance rates and profit margins appear to have peaked

Getting out while the getting is still good

By **ROBERTO CENICEROS**

Flattening insurance pricing, slow internal growth by brokers and the continuing expansion into the insurance industry by banks are expected to fuel producer mergers and acquisitions throughout 2003 and possibly beyond.

Until recently, retail brokers enjoyed the strongest profit margins seen in a decade, noted John Wicher, principal of insurance investment bank John Wicher Associates Inc. in San Francisco. But stock prices for

publicly traded brokers increasingly reflect investors' current view that insurance pricing and account profitability will flatten rather than continue upward, Mr. Wicher said.

Therefore, he said, agency and brokerage owners who are considering selling out may find it optimal to do so before stabilizing insurance prices reduce their valuation.

"So, we are at an interesting point," Mr. Wicher said. "We have strong numbers for 2002, which will be part of negotiations, and you have an environment where investors and others" believe that rates have peaked.

Buyers, he advised, should exercise caution, because sellers' expected future earnings look weaker today than they did during 2002.

Mr. Wicher stressed, though, that buyers have not lost interest in arranging deals. Purchases are still being made when they make good business sense, such as when the buyers stand to acquire good producers or expand into desirable areas.

But while individuals remain motivated to buy, they are not willing to pay the same prices that they did a year ago, Mr. Wicher said.

"Buyers understand they are working in a window where those who want to sell will want to do so before valuations relax and reflect that earnings are not as strong in 2003 and 2004 as they were in 2002," he said.

Mr. Wicher also advises sellers to exercise caution. For them, he said, pricing remains high, but valuations already have matured and started lowering.

"I would tell a broker that they owe it to themselves to look at the market, to do that in an organized way, but to remember when

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The intangibles of goodwill accounting / 12D Acquisition checklist for agency buyers / 12F

Growing a market among teens / 12G

AGENT/BROKER TOPICS

Mergers: Selling businesses while the selling is still good

Continued from previous page they get up every morning to say, 'I don't have to sell,' " Mr. Wicher said.

Currently, though, many companies are exploring deals that should be closing by year's end.

"There is a lot of activity out there right now," Mr. Wicher observed.

Expect to see middle-market publicly traded brokers apply more-aggressive acquisition strategies throughout the remainder of 2003 than were seen during 2002, said Jeff Cappel, chief executive officer

for Hales & Co. Inc., a Chicago-based investment banking and consulting firm.

Brokers showed strong internal growth during 2002 and part of 2001, Mr. Cappel said, but he noted that those growth levels are not sustainable. Consequently, he predicted, brokers will turn to their historical method of growing through acquisitions in order to meet stock analysts' growth expectations.

"I don't think their internal growth rates are going to be at levels that are going to be adequate

for them in 2003," Mr. Cappel said. "So they are going to look to revert back to using M&A as a way to build out the company."

'There is a lot of activity out there right now.'

*John Wicher
John Wicher Associates Inc.*

The rate of transactions taking place during the remainder of 2003 and into 2004 should remain

strong, keeping pace with levels seen during the past three to four years, said Wayne A. Walkotten, a vp with Marsh Berry & Co. Inc. in Concord, Ohio.

Banks large and small, as well as brokers, will remain active dealmakers, Mr. Walkotten predicted.

Many larger banks already have penetrated their target markets, creating their "footprint" by acquiring large agencies, he said. So some of the activity by large banks in buying large agencies may slow, he noted.

But brokers are stepping in and purchasing large agencies similar in size to those the banks acquired to create their foundations, Mr. Walkotten explained. Without the banks competing for those agencies, brokers may find less competitive pressure driving up the price of available agencies.

"Larger agencies that are still available will become realistic opportunities for the middle-market brokers," Mr. Walkotten said.

The bigger banks that already have established their insurance footprints, meanwhile, may execute "roll-up" transactions—purchasing smaller agencies with niche expertise or particularly productive producers that complement their existing foundations, Mr. Walkotten said.

Additionally, smaller community banks—those with less than \$1 billion in assets—are creating plenty of demand for agencies. "They are asking us for a lot of services and are very interested in getting in the business," Mr. Walkotten said.

There also exists a real interest among smaller agencies looking to participate in mergers or acquisitions, some for the first time, said Bob Hilzenrath, vp of mergers and acquisitions for Hartford, Conn.-based agency consultant Business Management Group. BMG's M&A clients produce annual revenues of about \$10 million or less.

Mr. Hilzenrath noted that many smaller agencies are looking to merge so they can remain local entities but can still expand and broaden their product offerings, thus producing enough volume to attract markets.

Like Mr. Wicher, Mr. Hilzenrath said he currently sees the impact of agents' and brokers' recent experience of a very profitable market cycle.

"One of the issues you are starting to rub up against," he said, "is that the sellers' expectations are continuing to rise in terms of the value of their agencies based on their best years ever, whereas buyers are getting a little more leery of paying top multiples for those earnings during the agencies' best years."

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AGENT/BROKER TOPICS

M&A accounting rule leaves questions unanswered

By JUDY GREENWALD

When the Financial Accounting Standards Board first issued new accounting rules in 2001 that regulate how companies should account for mergers and acquisitions, much of the attention focused on Financial Accounting Standard No. 141, which eliminated pooling and required that companies use only the purchase method of accounting.

But attention is now focused on a second standard issued at the

same time. FASB 142 changes how companies carry goodwill on their books with the purchase method, and some observers contend it is being improperly implemented. Goodwill is the premium paid over the market value of a brokerage's tangible and specific intangible assets, such as customer lists.

Both of the new accounting standards changed how companies report their M&A activity. Pooling-of-interest deals, which FASB 141 eliminated, were tax-free, all-stock transactions in which the balance sheets of the two merging

companies were simply added together. Pooling was widely used by banks acquiring insurance agencies, although some brokers used it for their deals as well.

Observers say eliminating pooling under FASB 141 facilitates the analysis and comparison of deals because everyone now uses purchase accounting.

"It now makes it very consistent among all the brokers," said David L. Eslick, chairman, president and chief executive officer of San Francisco-based USI Holdings Corp.

Under purchase accounting, the

acquired company is considered an investment. But the way goodwill is treated has changed under FASB 142. Previously, goodwill was typically amortized, or written off of the company's income statement, over a period of up to 40 years, creating a hit to the buyer's balance sheet.

Under FASB 142, goodwill is instead regarded as an intangible asset that is considered to have an indefinite useful life. It is periodically evaluated and written down only when impaired. Other intangible assets, though, must still

be written off over their finite useful life.

At least in part because the accounting regulation is still relatively new, though, there are still no established standards for determining what should be considered goodwill and which intangible assets must still be written off.

The issue is an important one in the acquisition of insurance agencies and brokers, where about 90% of the purchase price may be accounted for by intangible assets, according to John Wicher, of San Francisco-based John Wicher Associates, an insurance investment bank.

'There's no clear accounting guidance on how to truly allocate and quantify intangibles amongst an acquisition price.'

Kevin Donoghue
Mystic Capital Advisors
Group L.L.C.

Some observers say FASB 142 is being inconsistently implemented.

Corey T. Walker, vp, treasurer and chief financial officer at Brown & Brown in Daytona Beach, Fla., said, "It's unfortunate that the true economics of the deal have never been changed, but there are certain agencies that are buying acquisitions and hiding behind FASB 142 and claiming that the majority of the purchase price they made represents payment of goodwill simply to avoid having a (profit and loss) charge on their (generally accepted accounting principles) financial statements."

"I think it's a terrible misinterpretation of the value of what you're buying," Mr. Walker said, "because when you buy an acquisition, you're buying the underlying cash flows that you expect from those policy renewals, and trying to say that that it is really in payment of goodwill is intellectual dishonesty."

"I don't believe there's any ambiguity. It's a matter of doing the right thing," Mr. Walker said.

Kevin Donoghue, managing director at New York-based Mystic Capital Advisors Group L.L.C., said: "There's no clear accounting guidance on how to truly allocate and quantify intangibles amongst an acquisition price. Therefore, it leaves a great deal of latitude, from the purchaser's perspective, of what goes into intangibles and is amortized and what goes to goodwill and is not amortized."

Mr. Donoghue said he thinks there has been "some aggressive behaviors accountingwise" among some entities that are allocating more to goodwill than they should be.

Patrick Gallagher, president and chief executive officer of Itasca, Ill.-based Arthur J. Gallagher & Co., said, "It's just all over the board in

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AGENT/BROKER TOPICS

FASB: Accounting rule leaves some questions unanswered

Continued from page 12D

how people are doing this. There's no real direction, and deals differ."

A certain amount must be allocated to both goodwill and other intangibles, Mr. Gallagher said, "and there's just different philosophies as to how much has to go into each bucket." On its larger deals, Gallagher obtains the services of independent appraisers "to help us decide which bucket" to use, he said.

Mr. Gallagher added, though, that "it all washes out in the wash. Earnings are earnings.... If someone does their homework and looks at what is actually happening with the company, they should be able to sort it out."

John Pottridge, of Alexandria, Va.-based Pottridge & Associates, a

consulting firm, said, "I would say there are not consistent applications or treatment in terms of determining goodwill. It's all over the board."

"Obviously, banks would like, under most circumstances, to book on their balance sheet as much goodwill as possible," Mr. Pottridge said. "If they can prove that the value of that goodwill holds up, they have a large asset on their book that maintains value and is there for years. But they have to meet reasonable criteria in order for that to happen, and...there's very little industry practice to look to," he said.

"There isn't any real, solid test, in our view, to determine that goodwill. It's mostly trying to be reasonable and verifiable, testable,

and if the assumptions are good and reasonable, it should pass," Mr. Pottridge said.

Bobby Reagan, chairman and CEO of Reagan Consulting Inc. in Atlanta, said: "We are seeing a variety of opinions as to how the allocations between goodwill and other identifiable assets should be handled. The most prevalent approach that we are seeing is that approximately 50% of intangible values are being assigned to goodwill, with the balance being assigned to other intangibles, with those being written off over 10 to as much as 20 years."

"We're also seeing some more aggressive approaches, where a heavier percentage is being assigned to goodwill," Mr. Reagan said. "Most of the financial

institutions or bank buyers who are using the national accounting firms are tending to be very conservative today. Some other acquirers that may not be public corporations may tend to be a little more aggressive."

Mr. Wicher said, though, that there is no CEO of a public or private firm today of significant size "who isn't thinking about the implications of being aggressive and moving outside what might be viewed as the acceptable boundaries between being conservative, and being more generous in their treatment and moving outside the box. The accountants aren't going to go for it, the boards (of directors) aren't going to go for it, and, certainly, the independent accountants are

not going to go for it."

Mr. Wicher said that while latitude exists in the accounting treatment, "we're in a new environment where there's going to be far less tolerance for accounting trickery."

Observers say that standards will be developed, although not immediately. "I think it will probably be some period of time before we know what is right, what is acceptable practice," said Mr. Reagan.

"Organizations like ours are coming up with some pretty fair models that I think will hold up over time," Mr. Pottridge said. "But, clearly, we need to get some experience behind us and industry practice behind us, so we can look to see how it works over time."

Buyers have much to consider in agency acquisitions

By Steven S. Wevodau

If you're the least bit intrigued by the current merger and acquisition market, you may also be curious about what buyers



are looking for in an acquisition target. The first thing to understand is that there are two types of acquisitions in the insurance distribution system—platform and revenue. Platform acquisitions generally create more value considerations for the seller due to the strategic value that the

combination creates for the buyer. In a typical platform acquisition, the seller's business can operate autonomously in the buyer's environment and can be further developed following the sale. Revenue acquisitions, on the other hand, generally represent an opportunity for a larger entity simply to absorb another agency to add revenues.

The real key for the seller is to determine exactly what type of acquisition it is to a given buyer. Historically, revenue acquisitions will result in multiples of four to six times EBITA—or earnings before interest, taxes, and amortization—while platforms range from five to eight times.

In some instances, there may be confusion as to the acquisition category into which some agencies

A/BT perspective

An agency that has shown above-industry-average loss experience and possesses a well-underwritten book presents itself as a much more attractive acquisition prospect.

would fall. It is important to note that there are hybrid acquisitions in which agencies could be considered a platform to one buyer but present themselves as a revenue acquisition to another. Typically, this is true if the buyer is large and has a mature infrastructure. Likewise, some acquirers can blend their approach where they see some platform or strategic value in parts of the agency but view other parts as a pure revenue target. This usually results in a multiple of earnings being a combination of the above ranges, falling around five to seven times EBITA.

For a prospective seller to determine what type of target it is, it must fully evaluate its value proposition to the buyer. Acquirers generally look for different areas that may significantly enhance the value of their existing infrastructure. It is natural to assume that most agency principals and owners desire to have their business fall into a platform category, thus creating more value in a transaction. As a result, it is essential to understand the key areas of an agency that acquirers evaluate to qualify the agency as a potential platform. They are:

- Size and scale.

An agency needs to have size and scalability to qualify for prime consideration from buyers. Agencies that have between one and three principals who are all sales-focused rarely are viewed as

platform candidates. Buyers look for sales infrastructure, sound operations leadership and certain key administrative professionals to balance out an agency's top line.

- Financial size.

Acquirers are looking for distributors that have demonstrated strong financial performance and that can add profitability to the agency's bottom line. It is difficult to benchmark exactly how much production, revenue or profit must be generated to be considered a platform, as buyers' needs vary in this area. An agency that generates \$1 million in earnings may be a suitable platform for one buyer while it would be entirely too small for another.

- Distribution relationships.

This generally refers to exclusive, long-term distribution contracts to capture production from a particular regional or national source. Acquirers that are already in the market consider these arrangements valuable, in that they see an opportunity to cross-sell more products through a captive distribution channel.

- Aggregation of production and agency-compensation agreements.

An agency's ability to achieve the highest level of production-based compensation, or contingent commission, certainly adds value. From the economic perspective, this could enhance a potential acquirer's portfolio of insurer

relationships, particularly if the agency possesses a unique relationship that provides top-level compensation.

- Operating proficiency and profitability.

Operating proficiency and overall return on revenues are key economic value creators. An evaluation of pending inventory, placed cases or premium by head count are key metrics that can add value if the result reflects consistent proficiency. Also, by demonstrating the ability to work with the ebb and flow of case traffic by appropriately deploying processing personnel, a business can really increase its value. If an agency is able to grow quickly, manage its workflow efficiently and return profitability on a per-unit basis, significant worth is added to the business. Finally, an agency that has demonstrated above-industry-average loss experience and possesses a well-underwritten book of business presents itself as a much more attractive acquisition prospect.

- Technology.

Value is created when an agency is able to deploy an efficient, cost-effective, systematic approach to its operations. The agency's value is further enhanced if it uses proprietary or unique applications such as Web technology, application order taking, status, rating or underwriting.

- Internal growth rate.

Historical growth rates are also important. If the agency management can navigate market cycles and demonstrate that it can continually add new business through new products, carriers and distribution, this adds significant value. Trending is very important, and if an agency can weather the storms of the market, it can reap the additional value.

- Product margins.

Another key issue is the net retention of the agency on a per-unit basis. What is the agency receiving in gross compensation, and what is it paying to its

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Compliance & filing
2 column x 5"

AGENT/BROKER TOPICS

Perspective: Agency buyers have decisions to consider

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distribution to acquire the revenue? This is an assessment that can make a big difference, particularly when an acquirer is assessing the company. If the agency is rapidly adding new distribution and demonstrating top-line growth through aggressive compensation, this does not necessarily lend itself to being regarded as a platform. Acquirers are typically leery of agencies that pay the lion's share of compensation out to producers and survive on razor-thin margins and inferior service. The best model is

one that demonstrates good, fluid growth through unmatched service.

- Management infrastructure.

This is extremely important to buyers that are new to the market. A target agency that demonstrates depth and breadth of management across all core channels definitely presents itself as a solid platform for growth.

- Product diversity or niche.

If there are proprietary product offerings or an agency has a form of exclusive rights to certain distribution channels or carriers, that is an advantage. Also, an agency that has a broad product offering may demonstrate the

ability to be countercyclical or, at least, to ride out market downturns due to its diversity. This enables the agency to spread market risk throughout numerous products and carrier relationships. Agencies that are entirely commodity-based and operate in easily accessed markets generally hold the least value and will generally be viewed as revenue acquisition targets.

- Operating model.

An agency that demonstrates a boutique environment, or one that provides "high-touch" service, always gets greater valuation consideration. Such factors clearly denote more repeat business,

greater penetration among producers, better product submissions and accolades from carriers and other industry professionals.

- Brand-name recognition.

An agency that has an industry name presents a great deal of goodwill value. Management depth within an agency is another key value factor. All key areas of agency operations that are represented with industry professionals present significant value.

- Recurring revenue.

An assessment of the in-force business by policy year and future commission streams is important.

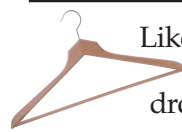
Renewal income minimizes risk factors for an acquirer and adds economic value to any transaction. While a robust renewal stream may not qualify an agency as a platform, it certainly helps to support rationalization for a greater purchase consideration through risk reduction.

Steven S. Wevodau is a principal with WFG Capital Advisors L.P. in Harrisburg, Pa. Mr. Wevodau is also managing principal of WFG's national insurance and financial services division, Capital Financial Services Inc.



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Progressive wants 15- to 17-year-olds to remember auto insurer when they're in their 20s Campaign targets teens as future market

By SHANNON MORTLAND

Insurance to guard against pimples?

Progressive Corp. isn't actually selling pimple insurance, but it's using the concept to plant the Progressive name in teen-age minds so the young consumers will remember the company when it's their turn to buy auto insurance.

The Mayfield Village, Ohio-based auto insurer recently launched its first advertising campaign aimed at teen-agers—specifically, those ages 15 to 17—in hopes of increasing its sales once that age group reaches its early 20s, said Alex Ho, Progressive's brand development director.

The TV and print campaign will run nationally for at least three years, which is the earliest point at which it's expected to show results,

Mr. Ho said.

"This campaign is not designed to get immediate sales from teens," he said. "Typically, the people who buy their first insurance policy are in their early 20s."

But Mr. Ho said that Progressive, which a decade ago catered only to high-risk drivers such as teen-agers, wanted to target the group now by "showing them we care" about the current dilemmas and earth-shattering events in their lives, such as pimples or being embarrassed in front of a someone on whom a teen has a crush.

Progressive hired G Whiz, a New York agency that specializes in youth-focused advertising, to create the ads.

Mr. Ho would not disclose how much Progressive is spending on the effort to market to teens, but he said it is "significant" because the

company is conducting a "multimillion-dollar, multiyear" campaign.

The result of G Whiz's work was two 30-second spots that will run on seven youth- or family-oriented cable networks, including MTV, Cartoon Network and ABC Family.

'Anything that drives home the concept of insurance is definitely something the insurance industry could get behind.'

Mary Bonelli
Ohio Insurance Institute

In the first spot, a teen-age girl is walking through a school hallway when she sees the boy she has a crush on eyeing her. She then trips and falls, prompting the ad to suggest that "social disaster insurance" could guard against such tragedies.

The second ad suggests "boredom insurance" is needed when a group of teen-agers sitting around in a backyard decides to alleviate their boredom by launching items such as tricycles, lawn ornaments and even a fellow friend into the yard with a makeshift catapult.

The print ad, which shows a boy on yearbook photo day with bad

hair and a huge pimple on his nose, will run in 10 national magazines such as YM, Seventeen and Transworld Skateboarding, Mr. Ho said.

The ad's tagline reads, "We wish we could guard you against everything from volcanic zits to crappy haircuts. But for now, we can just offer real simple car insurance. When you need some, think Progressive."

The concept of targeting teen-agers as a potential sales booster is a new one in the auto, home and business insurance sectors, said Mary Bonelli, a spokeswoman for the Ohio Insurance Institute, a Columbus-based organization that represents personal lines and commercial lines insurance companies.

"It does make some sense to me, though, because 7% of the drivers in Ohio in 2000 were teen-agers," she said.

Progressive's approach is bringing insurance "to a level that teen-agers understand," Ms. Bonelli said.

"Anything that drives home the concept of insurance is definitely something the insurance industry could get behind," she said.

Mr. Ho said the ads aren't an attempt to put Progressive's focus once again on high-risk drivers, even though teen-agers tend to fall into that category.

Instead, he said, the ads are one marketing tactic Progressive plans to use to boost insurance sales. Mr. Ho would not discuss other tactics Progressive will employ.

Progressive will need to change the ads frequently to keep teen interest, Mr. Ho said.

While Progressive knows teens "find about a zillion other things in their lives right now more important than insurance," he said, the company also believes teens will pay attention to the ads because they view advertising as a form of entertainment.

Shannon Mortland is a reporter for Crain's Cleveland Business, a sister publication of Business Insurance.

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Property: Market still requires hard work

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derwriting at Zurich North America Financial Enterprises in Baltimore, said buyers are still facing tighter terms and conditions in insurance programs.

"Manuscript wording, for instance, is going to be very much restricted," Mr. Johnson said. Insurers are concerned about broad and nebulous policy wordings "and really not knowing what their exposures are," he said.

"Previous assumptions of availability and affordability are seriously being challenged," Mr. Johnson said. "The bottom line is, we have to achieve some sort of collective correction of the market."

'Previous assumptions of availability and affordability are seriously being challenged. The bottom line is, we have to achieve some sort of collective correction of the market.'

*Kenneth I. Johnson
Zurich North America
Financial Enterprises*

"Quite frankly, it's been very difficult to put together programs," Mr. Johnson said, though "I think the biggest hit was last year."

For buyers, a key to dealing successfully with the current property market is presenting the best "story," Ms. Anderson said.

"Information remains critical, and developing the best story for the market is required" to get the best price and capacity, she said. "A well-thought-out story will maximize capacity, sublimits, and minimize price."

Mr. Johnson said that submissions should focus on construction, occupancy protection and exposure. And appraising property and

including information from inspections and surveys also can be helpful, he said. "Anything you can do to tell the story is going to improve the bargaining power you have relative to your insurance program."

Underwriters also are interested in seeing buyers' business continuity plans, Mr. Johnson said. "Basically, what we're trying to do is, No. 1, determine that you have one; No. 2, that it's been well thought out, and; No. 3, that it's been implemented," he said.

"I think the best approach you can take is establishing and strengthening relationships with

your underwriters and brokers," Mr. Johnson said. Such relationships will facilitate the flow of information that will produce the most favorable outcome in buying property coverage, he said.

Another panelist, Gerard M. Kelly, assistant professor of risk management in the Tobin College of Business at St. John's University in New York, also advocated such relationships. "There's no one who knows your risk better than you," he said.

"Underwriters want to know what is going to happen if you have a severe fire loss. What is your extra

expense going to be? How much is that going to cost us?" he said.

Ms. Anderson said that when buyers still find themselves facing a sizable rate increase, "the first line of defense...is to take a larger retention." She conceded, though, that such an option wasn't always viable.

Understanding maximum foreseeable loss is an important part of determining how much risk a company can take and how to deal with it, she said.

Companies with multinational exposures might also be able to gain some price advantage by carving

out some local coverage if they can find lower-priced capacity available locally for low layers that can be overwritten by the company's global program, Ms. Anderson said.

Another challenge facing property insurance buyers is whether or not to purchase terrorism coverage. "Cost on terrorism has shown wide swings. Markets are clearly struggling with pricing on this peril," Ms. Anderson said. An additional challenge for banks is that "financial institutions are skewing on the high end of cost" for terror coverage, she said.

Captives should be another part of buyers' strategy, Ms. Anderson suggested. "If you don't have one, this is the time to evaluate whether one is right for you," she said.



Life is ambiguous

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Over 200 attend ABA's conference

ST. PETERSBURG, Fla.—The American Bankers Assn.'s 2003 Insurance Risk Management Conference & Meetings drew more than 200 attendees to St. Petersburg, Fla., Feb. 2-5.

The theme of this year's gathering was "Succeeding in Uncertain Times," and panel topics included lessons learned from Sept. 11, securities litigation, surviving in a hard market and technology risks.

Next year's ABA insurance risk management conference is set for Jan. 25-28 at the Wigwam Resort in Scottsdale, Ariz. For more information, contact that ABA at 1-800-BANKERS, or visit the organization's Web site at www.aba.com.

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Investment analysts predict more P/C price hikes

By RODD ZOLKOS

ST. PETERSBURG, Fla.—While buyers may be hoping the hard market comes to an end soon, property/casualty insurance pricing needs to remain firm for several more years, according to investment analysts.

"I think you're looking at several years of an upswing here on the pricing side," Hugh Warns, a vp at JPMorgan Securities Inc. in Baltimore, said last month at the American Bankers Assn.'s Insurance Risk Management Annual Conference &

Meetings in St. Petersburg, Fla.

The gap between the return on equity for property/casualty companies and that for companies in the Standard & Poor's 500 continues to widen, Mr. Warns said.

"So, if you look over a period of time," Mr. Warns said, "this is a very difficult market to attract capital to." And, because of their companies' poor stock performance, property/casualty insurer executives are under significant pressure to increase rates, he said.

While the pace of property insurance rate increases should slow,

"my gut feeling is the casualty side is far from being repaired," Mr. Warns said. "One of the things that we're looking for is continued rate increases, but in some moderating fashion."

A number of factors continue to put pressure on property/casualty stock prices, Mr. Warns suggested, including investor concerns about asbestos liabilities, low investment yields and increased terror exposures. Other factors include the industry's asset quality and asset allocation, which Mr. Warns called "very questionable," and directors

and officers liability exposures, which he called "the world's slowest train wreck."

The property/casualty industry hasn't made an underwriting profit in almost 30 years, Mr. Warns said, and over the past 30 years, net written premium growth has outstripped inflation only 10 times.

"Underwriting skills have deteriorated over the long term," Mr. Warns said. "The industry is struggling. I think there has been a degradation of skills of underwriters that has to be fixed."

While it's easy simply to raise

prices, insurers would also have to improve their underwriting over time to distinguish themselves from others in the market, he said.

Mr. Warns also cited the number of companies replacing their chief executive officers as yet another factor that will keep upward pressure on property/casualty insurance prices.

"This has been pretty amazing. I think we're sitting in the middle of an event that's occurring that we don't even realize is occurring," he said of all the recent CEO changes. "I think this is causing a lot of turmoil on the rate side. A lot of people are coming in and saying, 'Not on my watch.'"

Looking at the property/casualty industry from a bond analyst's perspective, Thomas C. Walsh, a senior vp at Lehman Brothers Inc. in New York, noted that over the past five years some of the most significant growth in the property/casualty insurance industry has come through acquisitions or new equity.

'The industry is struggling. I think there has been a degradation of skills of underwriters that has to be fixed.'

*Hugh Warns
JPMorgan Securities Inc.*

One encouraging point from a bond investor's perspective, according to Mr. Walsh, is that there has been a significant amount of equity issuance by the property/casualty industry since Sept. 11, 2001. By choosing to issue new stock rather than sell debt to raise capital, those companies have avoided "leveraging their balance sheet," he said.

But credit stress has hit the insurance sector, with a high number of corporate bond defaults hurting companies' investment portfolios and adversely affecting capital, Mr. Walsh said. And asbestos is as much a concern for holders of insurance company bonds as those with insurance company stock, he said. "For fixed-income investors, every time asbestos hits the tape...my phone's ringing off the hook," he said.

Mr. Walsh noted that, because of investor concerns, property/casualty company debt tends to trade lower than the similarly rated debt of companies in other industry sectors. "I guess what the market's really telling you is, 'We don't believe there is a triple-A property/casualty company,'" he said.

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Between the Lines

Compiled by Joanne Wojcik



It's only funny until somebody loses a job

Members of the Colorado Legislature, playing a prank on new Insurance Commissioner Doug Dean, who is the former House speaker, nearly eliminated the state Division of Insurance. Lawmakers unanimously voted down a bill that would have renewed the department's charter, which was scheduled to sunset June 31. But Mr. Dean called their bluff by turning the tables on the measure's sponsor, suggesting the assemblyman send flowers to a staffer who Mr. Dean said was so devastated by the prospect of losing her job that she broke down crying. In fact, Mr. Dean had warned his staff after realizing the vote was a joke. The next day, the House voted unanimously to restore the division and reinstate the commissioner.



Mr. Dean

Attitude lax toward insurance fraud

Nearly one-fourth of Americans think it's OK to defraud their insurance companies, according to a new study by New York-based management and technology consultant Accenture. The study, based on a random sample of more than 1,000 U.S. adults, found that a significant number of adults believe overstating the value of claims is acceptable, and more than 1 in 10 say they approve of submitting insurance claims for items that were not lost or damaged or for treatments that were not provided. Nearly half of respondents said people commit insurance fraud because they can get away with it, and 24% believe the people who commit insurance fraud do so because they believe they pay too much for insurance. Twenty percent believe that offenders commit fraud to compensate for claims deductibles.

Hey, batter batter

GAB Robins said it will serve as American Specialty Cos. Inc.'s provider of claims services and claims technology services for all 30 Major League Baseball teams and nearly 200 minor league affiliates. Roanoke, Ind.-based American Specialty, a provider of risk services for the sports and entertainment industry, is partnering with GAB Robins to "hasten a player's return to the field and minimize costs associated with a player's injuries and absence from the game."



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German furor over cost-shifting

The United States is not the only nation suffering from health care system maladies. Germans, covered by a government-run health program, are revolting against proposals to shift more costs to patients. Meanwhile, doctors are staging walkouts protesting a reform plan by Health Minister Ulla Schmidt that would make them more responsible for the treatment they provide by setting up an independent agency to assess the quality of their work. Government reform proposals also include freezing employers' contributions to insurers. Germany pays more for health care than any nation except the United States and Switzerland. It estimates the cost at 14.3% of gross wages.

TV shows facing harsh reality of litigation

A woman who believed she was being hunted by a space alien is suing the Sci-Fi Channel's new reality series, "Scare Tactics," after discovering that she was filmed as an unwitting victim of a prank. Her suit, filed last week in Los Angeles, seeks damages for physical injuries and severe emotional stress. With such legal pitfalls, it's no wonder insurance premiums for reality TV shows are becoming surreal. Though the programs are cheaper to produce than traditional TV shows, the cost of insuring such productions can be 50% higher, says Wendy Diaz, executive underwriter in the entertainment division of the Fireman's Fund Insurance Co. in Los Angeles. And that assumes the producer can find an insurer willing to underwrite the production. When the reality TV craze began, underwriters initially were concerned about whether contestants on such shows as "Survivor" and "Temptation Island" could get hurt performing stunts. But now, as the programs employ the use of hidden cameras, humiliation is more of an issue, says Ms. Diaz, who estimates Fireman's Fund is willing to insure only about 20% of the reality shows that come knocking on its door.

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

ABA Insurance Risk Management Annual Conference & Meetings

D&O rates likely to stay high

By RODD ZOLKOS

ST. PETERSBURG, Fla.—With securities litigation being a major driver of directors and officers insurance rates, the near-term outlook isn't good for D&O buyers, according to one panel of experts.

"Statistically, there's nothing in the numbers that shows any abatement of the frequency and the severity (of securities litigation) that we've seen of late," said Greg J. Flood, executive vp and chief operating officer of National Union Fire Insurance Co. of Pittsburgh, Pa. That bodes ill for D&O rates, the National Union executive suggested.

"Unless there's some trend in the severity that I really don't see, I think that we're all going to be looking at rates that are much higher than what we've been used to over the past few years," Mr. Flood said. And, in addition to rate increases, there have been "huge changes" in retentions over the past 10 months, he said.

Mr. Flood discussed securities litigation and its impact as part of a panel at the American Bankers Assn.'s Insurance Risk Management Annual Conference & Meetings, held last month in St. Petersburg, Fla.

He said that from 1997 to 2001, 726 publicly traded companies—or about 8% of the publicly traded market—filed for bankruptcy, "Which, of course, is one of the primary sources of securities litigation," Mr. Flood said.

"I think more troubling is restatements," Mr. Flood continued, noting that about 1,200 companies restated financial results over the same period. And the rate of restatements is growing, he said, from 10 per 1,000 companies in 1997 to 36 per 1,000 in 2002.

Another panelist, Martin Healey, senior trial counsel in the Securities

and Exchange Commission's Boston district, said that just a few years ago, the SEC's cases fell into relatively easy categories: financial fraud, insider trading and enforcement actions against broker/dealers and investment advisers. "But there were signs that that was going to change," he said.

'It's rare for us to get a case where we don't get an inquiry from the U.S. attorney's office.'

Martin Healey
Securities and Exchange
Commission

For example, he said, from the early to mid-1990s, accounting firms went from earning 55% to 60% of their revenue from accounting to getting most of their revenue from consulting. "That should've sent up all sorts of red flags. It didn't," Mr. Healey said.

"The other thing that was going on, there was a dramatic change in the way executives were being compensated," the SEC attorney said. In addition, there was the increase in restatements, he said.

A major development came last year, when a spate of well-publicized corporate failures resulting from alleged financial wrongdoing "resulted in Congress coming up in world-record speed with a legislative response," Mr. Healey said.

"Oftentimes before in securities actions...you would have companies charged," Mr. Healey said. "The big change is individual liability now."

"The second thing is in the area of enhanced penalties," he said. For example, under the new Sarbanes-Oxley Act, it's possible to bar individuals convicted of financial

wrongdoing from holding positions as company directors and officers. And, Mr. Healey noted, "Cases are more likely to be litigated when you're talking about taking an individual's livelihood away."

Another change recently is that "very much across the country, securities fraud is a big priority now for U.S. attorney's offices," Mr. Healey said. "We can see it in our day-to-day operations. It's rare for us to get a case where we don't get an inquiry from the U.S. attorney's office."

Michael J. Chepiga, a partner with the Simpson Thacher & Bartlett law firm in New York, said efforts to expand the reach of securities litigation are another concern.

"What's going on right now is the effort to expand the scope and range of the securities laws to bring in as many courts and jurisdictions and as many people and institutions as possible," he said. "And they are being brought in."

Among those now being added to the list of defendants in securities litigation are banks as lenders or research analysts, insurers and financial advisers, Mr. Chepiga said. Meanwhile, "many state attorneys general are getting very actively involved in investigations and litigations," he said.

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Business Insurance

U.K. pension conversions expected

Closing defined benefit plans called unlikely to bring needed cost cuts

By SARAH VEYSEY

While many U.K. employers have sought to stem their pension liabilities by closing their defined benefit pension plans to new entrants, this alone may not be enough to sufficiently lower their pension costs.

Indeed, to achieve expected savings, some employers may decide to change pension plan structures for their existing members, pension experts say.

"Employers everywhere still need to bite the bullet and take some hard decisions on cutting their pension costs," said Peter Bowers, European partner at Mercer Human Resource Consulting in London.

Mr. Bowers said that although the costs of running a typical defined benefit pension plan were likely to rise, on average, by about

30% over the next five years, closing such plans to new entrants would likely reduce that projected increase in costs by only about five

percentage points.

Because of declining capital markets, many employers are struggling with their existing defined benefits plans and are being forced to pump in huge sums of money to keep plans afloat, according to Simon Martin, principal and actuary at Aon Consulting in London and an adviser to the U.K. government's Department of Work and Pensions.

He predicted that, in addition to closing the plans to new entrants, many employers would convert their defined benefit plans—known as final-salary schemes—to defined-contribution style plans.

"Closing a scheme to new entrants is a relatively easy decision to take. But employers are fooling themselves if they think this alone will solve the problem of rising pen-

See PENSIONS/next page



PHOTO: GRAEME ROBERTSON/GETTY IMAGES

Pension participants in the United Kingdom may increasingly face changes in their pension plans as employers seek to trim costs.

Suit charges that broker misrepresented risks Insurers can seek rescission of film finance cover: Court

By DOUGLAS McLEOD

LONDON—The United Kingdom's highest court has cleared the way for a trial to determine whether several insurers must cover millions of dollars in loan losses suffered by JPMorgan Chase Bank in a series of disastrous film finance deals.

Ruling on pretrial motions, a panel of the House of Lords concluded that the now-defunct HIH Casualty & General Insurance Co. and several other insurers may seek to rescind contracts that guaranteed repayment of Chase loans to Los Angeles-based Phoenix Pictures Inc. on five films.

Revenues from the films—which included the 1996 Barbra Streisand flop "The Mirror Has Two Faces" and "The People vs. Larry Flynt"—failed to cover their loan obligations, and New York-based Chase is trying to recoup its losses from insurers.

Among the insurers' allegations is that Chase's broker, Heath Group P.L.C., concealed key terms of the finance deals, including large deductions that filmmakers would take from the revenues available to repay Chase. The scale of these deductions made loan losses a virtual certainty even for films that earned more than expected, the insurers say.

The insurers also charge that Heath concealed a loss on a previous film finance line slip and withheld grave concerns about the structure of the Phoenix deals

that were expressed by two underwriters that withdrew from the program.

Chase, meanwhile, contended that insurers are not entitled to rescind coverage and that a "truth-of-statement" clause in its contracts absolved the bank of any liability for misrepresentation or nondisclosure by third parties, including Heath. The clause was intended to "distance" Chase

from responsibility for statements or omissions by other players in the finance deals, given that the bank "was in no better position to estimate the risk than the insurers themselves," one member of the House of Lords panel noted.

Affirming much of a lower appellate court ruling, the high court panel found late last month that any fraudulent misrepresentations or nondisclosure of material facts by Heath, as Chase's agent, would give insurers the right to rescind their contracts despite the truth-of-statement clause. The panel also found that insurers could seek damages from Chase if Heath were found to have committed fraud.

While insurers argued that mere negligence by Heath—as opposed to fraud—should likewise allow them to rescind coverage, the House of Lords panel ruled that the truth-of-statement clause bars rescission and damages against Chase for unintentional misrepresentations or innocent failures to disclose facts.

A final ruling on the effect of the truth-of-statements clause was the last issue to be resolved before a trial in the Phoenix case, now scheduled to begin Oct. 1.

"This clears the decks to trial," observed John D. Gordon III, a partner with Morgan, Lewis & Bockius in New York who is representing Chase in several film finance cases.

The dispute over the Phoenix slate is, in fact, only one part of a larger mass of litigation that has emerged from a number of money-losing insurance-backed film funding deals. Chase is currently in litigation with insurers in the United States over tens of millions of dollars of loan losses on films produced by Los Angeles-based Paramount Pictures Corp. and London-based J&M Entertainment Ltd.



Regulators block sale of Gerling reinsurance operation

BONN, Germany—The proposed sale of Cologne, Germany-based Gerling Global Re to a runoff company has been blocked by the German financial supervisory regulator.

The troubled Gerling Group had planned to sell its loss-plagued reinsurance arm to Global Management, formerly known as Lago Achte GmbH, which is headed by former G.E. Frankona Chief Executive Achim Kann (*BI*, Dec. 2, 2002).

The German regulator, the Bundesanstalt für Finanzdienstleistungsaufsicht, investigates all proposed deals in which a party seeks to buy more than 10% of the share capital of an insurer, a spokeswoman explained.

BaFin has the power to block any transaction if it has concerns about the deal.

The spokeswoman said that confidentiality rules prevented her from explaining why the deal had been blocked. She noted that Gerling is appealing the decision in court.

The entire Gerling Group is up for sale, and a failure to shed the group's reinsurance liabilities could hamper any deal involving the rest of the operations, a Gerling spokesman noted earlier this month (*BI*, Feb. 17).

Ratings agencies have also expressed concern about Gerling having the reinsurance liabilities on its balance sheet.

Gerling representatives could not be reached for comment.

—By Sarah Veysey

World Updates

Swiss Re expects loss for 2002

Swiss Reinsurance Co. says it expects to report a loss of 100 million Swiss francs (\$64.2 million) for 2002 when it announces its annual results next month. Swiss Re blamed poor investment returns for the dip in results. Swiss Re said that rate increases at the Jan. 1 renewal averaged 10% on property/casualty treaty business.

ZFS results dip further into the red

Zurich Financial Services Group posted a \$3.4 billion loss for 2002, compared with a \$387 million loss in 2001. ZFS said that strong premium growth in 2002 had been offset by investment losses and by \$3.5 billion in special charges related to its restructuring efforts. Gross written premiums increased by 11% in 2002, to \$62.2 billion.

Pewter tapped to head Catlin subsidiary

Graham Pewter has been appointed president and chief executive of Catlin Insurance Co. Ltd. in Bermuda, a subsidiary of Catlin Westgen Group, which also owns Lloyd's of London underwriting agency Catlin Underwriting Agencies Ltd. Mr. Pewter was formerly president and CEO of Commercial Risk Partners, the Bermuda-based subsidiary of French reinsurer SCOR S.A.

Glenrand undergoes management buyout

London-based wholesale broker Glenrand Ltd. has completed a management buyout and has rebranded as Glencairn Ltd. Andrew Wallas, chairman of Glencairn, said the broker will seek to increase its U.S. business.

Investment losses hit Aviva again

Aviva P.L.C. reported a pretax loss of £2.46 billion (\$3.96 billion) in 2002, compared with a pretax loss of £546 million (\$794.0 million) in 2001. The results stemmed chiefly from investment losses. Gross premiums at the multiline insurer, which is the rebranded CGNU P.L.C., slipped 2.7%, to £28.63 billion (\$46.08 billion).

Briefly noted

The outlook for the **Norwegian nonlife insurance market** is stable, due to large rate increases and despite declining investment returns, according to Standard & Poor's....U.K. reinsurance broker **PWS Holdings P.L.C.** reported brokerage revenues of £22.5 million (\$36.2 million) in 2002, a 43% increase over 2001. Pretax profit, meanwhile, rose 64.5%, to £5.1 million (\$8.2 million).

Pensions: U.K employers look for ways to cut costs

Continued from previous page

tion costs and increasing risks," Mr. Bowers said. He noted that unless a company had extremely high staff turnover, closing its defined benefit plan to new entrants would not greatly dent those costs.

"There will be a new wave of pension reviews where final salary schemes are either adapted to reduce employer risks or closed to existing members," Mr. Bowers predicted.

According to Graham Snell, a partner at Watson Wyatt in London, employers that have already closed their plans to new entrants would likely wait a while before deciding whether to change their plan structures for existing members.

In a few years time, without the

impact of new entrants, the number of plan members affected by changes will have diminished, making such changes easier, he noted.

But Mr. Snell acknowledged that existing members of plans would likely oppose any changes, and they might even take legal action.

"For existing members, a straight move to defined contribution benefits may be the simplest solution for employers, but there are many issues to address," Mr. Bowers said. He noted that the greatest risk is that disgruntled employees would take action against the company. A compromise solution, such as a hybrid pension plan that involves sharing investment risk between employers and employees, is likely to be more palatable to the work-

force, he suggested.

Changing the structure of a pension plan can create significant human resources problems for em-

Unless a company had extremely high staff turnover, closing its defined benefit plan to new entrants would not greatly dent those costs.

Peter Bowers

Mercer Human Resource Consulting

ployers, said Lesley Browning, of the law firm Norton Rose in London. Before making plan changes, employers should check carefully

that the changes would not violate rules set out in plan-specific trust deeds or in the U.K. Pensions Act, she said.

Mercer's Mr. Bowers suggested that employers might look to hybrid pension plans that combine elements of both defined benefit and defined contribution arrangements.

Mr. Bowers said that new pension models were being developed that would enable employers to share pension financing with their employees. He noted that career-average hybrid plans were among those most popular with employers.

Under the career-average pension design, benefits accruing in a particular year are calculated as a proportion of salary for that year. Each year's benefits are then revalued un-

til retirement in line with an index such as inflation, Mr. Bowers explained. The total pension payout is then calculated as the sum of each year's revalued benefit.

Mr. Bowers said that government proposals to simplify tax on pension funds outlined in a green paper late last year (*BI*, Dec. 23, 2002) would encourage employers to consider new pension plan design.

The Trades Union Congress, a London-based labor group that has long lobbied against the closure of defined benefit pension plans, said that it was encouraging that some employers were beginning to look at ways to combine defined benefit and defined contribution plan elements rather than simply moving away from defined benefit plans.

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REQUEST FOR PROPOSALS

REQUEST FOR PROPOSAL (RFP) GROUP LEGAL PLAN

The University of California is accepting bids for the Group Legal program to cover employees and retirees of the University of California in California effective January 1, 2004.

Organizations wishing to bid must meet certain minimum pre-qualifying criteria in order to submit a proposal, for example:

Must be able to provide pre-paid/insured group legal services on a nationwide basis.

Have a minimum of five years experience in the legal expense insurance field.

Have at least 25 group legal service contracts in force.

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Maintain general liability coverage of a minimum of \$1,000,000 per occurrence and \$25,000,000 aggregate.

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Include your company name, address, your full name, title, business email address and telephone number in the email. An IE-Engine Customer Support staff member will contact you.

The deadline for contacting IE-Engine to participate in the Pre-Qualification process is 12:00 PM (PST), Friday March 7, 2003. The Pre-Qualification Event will take place in the IE-Engine application from 9:00 AM (PST) Monday, March 17, 2003 to 5:00 PM (PST) Friday, March 21, 2003. Commission or service fees of any kind will not be payable by the University.

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REQUEST FOR PROPOSALS

NOTICE

The Kansas State Employees Health Care Commission will issue two separate Requests for Proposals (RFP). The **dental component (#05797)** and the **prescription drug component (#05798)** are both expected to be released on March 5, 2003. Responses may be for insured, self-funded or capitated arrangements.

Currently, approximately 35,000 active state employees, 3,200 non-state employees, and 10,000 retirees/COBRA participate in the health plan. Total covered lives are approximately 88,000. If interested in receiving a copy of the RFP, please contact:

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LEGAL NOTICE

NOTICE OF SCHEME CREDITORS' MEETING

IN THE HIGH COURT OF JUSTICE (IN ENGLAND AND WALES) No. 1052 of 2003
CHANCERY DIVISION
COMPANIES COURT
IN THE MATTER OF

CHANCELLOR INSURANCE COMPANY LIMITED and IN THE MATTER OF THE COMPANIES ACT 1985

NOTICE IS HEREBY GIVEN that, by an order dated 21 February 2003 made in the High Court of Justice in the matter of Chancellor Insurance Company Limited ("the Company"), a meeting was ordered to be summoned of Scheme Creditors (as defined in the scheme of arrangement hereinafter mentioned) of the Company for the purpose of considering and, if thought fit, approving (with or without modification) a scheme of arrangement proposed to be made between the Company and its Scheme Creditors pursuant to section 425 of the Companies Act 1985 ("the Scheme").

The meeting will be held on 1 April 2003 at the offices of Deloitte & Touche, 180 Strand, London WC2R 1WL, commencing at 10.30am (London Time).

The chairman of the meeting will address Scheme Creditors generally on the Scheme and on issues relevant to voting at the commencement of the meeting.

Scheme Creditors may vote in person at the meeting or may appoint another person as their proxy to attend and vote in their place. Scheme Creditors are, in any event, requested to complete the form of proxy and voting form available from the Scheme Administrators and return it to LCL Consulting Limited, 9 St Clare Street, London EC3N 1LQ, marked for the attention of Keith Towers, by 12:00 pm on 31 March 2003 although if not so returned, it may be handed in between 9:00 am and 10:30 am on the day of the meeting.

Each Scheme Creditor or his proxy will be required to register his attendance at such meeting prior to its commencement. Registration will commence at 9:00 am.

A copy of the Scheme and a copy of the long form explanatory statement required pursuant to section 426 of the Companies Act 1985 can be obtained on request from the Scheme Administrators or on the internet at www.deloitte.com/uk/chancellorinsurance. Voting Forms and forms of proxy for use at the meeting are also available on request.

By the order, the High Court of Justice has appointed James Robert Drummond Smith or failing him, Nicholas James Dargan to act as chairman of the meeting and has directed the chairman to report the results of the meeting to the court.

If approved by the requisite majority of Scheme Creditors, the scheme of arrangement will be subject to the subsequent sanction of the High Court of Justice.

Dated 21 February 2003

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Cal-COBRA: Few are likely to opt for the program

Continued from page 1
with Watson Wyatt Worldwide in Los Angeles, said he suspects insurers would "attribute some small portion of their needed rates for 2005 to the shortfall from this additional California COBRA coverage."
"It will certainly drive up costs. Premiums will go higher as a result of this," said John C. Garner, chief executive officer of Pasadena, Calif.-based Garner Consulting.

Meanwhile, observers disagree as to whether the law is likely to be successfully challenged as pre-empted under the Employee Retirement Income Security Act of 1974.

Federal COBRA coverage is mandated for the former workers of employers with 20 or more eligible employees. In California, Cal-COBRA coverage is also offered to employees with two to 19 eligible employees, in addition to a senior COBRA program for former employees who are age 60 and older.

Covered individuals would have to pay more under the extended program. Under the federal COBRA program, individuals normally pay up to 102% of the group rate. Under the Cal-COBRA program, which they would switch over to after 18 months, though, premium rates may increase to up to 110% of the cost of coverage, based on the group rate of the former employer.

The law applies only to workers whose COBRA coverage has been exhausted after reaching the 18-month maximum that applies when an employee loses group coverage due to the termination of employment or a reduction in the number of hours worked, and not to those who have lost coverage for other reasons, such as failing to pay

premiums or obtaining coverage under other group health plans. Cal-COBRA also would not apply in situations, such as death or divorce, in which a beneficiary would be entitled to 36 months of federal COBRA coverage.

Mr. Garner said he believes it is technically the insurer's responsibility to notify workers about the extended coverage, but he still recommends that employers handle this task themselves. "Employers have a moral obligation, if you will," he said.

'There's a social good to it, obviously....But who's paying for it is another question, and I think all of the insured plans will end up paying a little bit to cover this increased exposure.'

Mark Straus
Watson Wyatt Worldwide

Mr. Garner said he expects that premiums will, in most cases, be paid directly to the insurer by the former employee, "but some employers may wish to make other arrangements."

Richard G. Schwartz, an attorney with Epstein Becker Green in New York, said the law, at the very least, "puts the onus on the employer to call the insurance company to discontinue how it's going to be handled, establish a procedure."

Several health insurers supported the law. "It's a private-enterprise way to

extend the scope of coverage to those who need it," said a spokesman for Woodland Hills, Calif.-based Health Net Inc.

The number of people who opt for coverage is likely to be small, judging by a survey by Chicago-based Charles D. Spencer & Associates Inc. The survey found that only 16.2% of eligible beneficiaries obtained federal COBRA coverage in 2001.

Furthermore, even among those who do get the coverage initially, "very few people make it to the end of the 18 months of COBRA coverage in the first place," said Andy Anderson, a consultant with Hewitt Associates Inc. in Lincolnshire, Ill.

Allan Zaremberg, president of the California Chamber of Commerce in Sacramento, said his organization did not oppose the legislation. "When the bill was going through the (legislative) process, it didn't appear that it was going to be a significant cost for employers," Mr. Zaremberg said.

Roger Arlen, CEO of the San Francisco-based consulting firm ArlenGroup, said, "Ultimately, the employer will pay more, although I don't expect it will be a significant hit to employers, because you're talking about some pretty lengthy durations here, and, in many cases, people are finding new employment" by the time they reach the point at which they are eligible for the extension.

The new law may cause complications, though, for employers that offer both insured and self-insured plans, say observers.

Buck Consultants' Ms. Harden noted that many large California employers offer both types. "The major problem that I'm seeing," she said, "is that when employees have the ability to select among insured

and self-insured plans and only the insured plans are subject to the more generous-type COBRA rules, it raises a lot of issues about switching back and forth among the coverages."
Observers disagree as to whether the law is likely to be pre-empted under ERISA.
"I don't think so," said Ms. Harden. "If it attempted to apply to self-funded plans, then, clearly, it would be pre-empted, but because it only applies to insured plans and insured type-HMOs, then I think not."
"I don't see any basis for a challenge," agreed Mr. Garner.

Others, though, say they are not so sure.
"My gut instinct tells me that this could be subject to pre-emption," said Mr. Schwartz. He said, though, that he is advising clients to assume they have to comply. "The reality is, no one may challenge because it's going to be very expensive" to pursue litigation, he said.

If the issue of ERISA pre-emption does arise, it would not be the first time that it has come up with respect to Cal-COBRA.

When the senior Cal-COBRA program first went into effect in 1995, it applied to self-insured as well as insured plans. The law was revised when lawmakers realized ERISA pre-emption applied to self-insured plans.

Section 514 of ERISA pre-empts state laws or rules that relate to employee benefit plans. Saved from ERISA pre-emption, though, are state laws or rules that involve the regulation of insurance companies, including health maintenance organizations.

Arbitration: Supreme Court to rule on agreements

Continued from page 1
awarding punitive damages or even any extracontractual awards. Other physicians had signed agreements that allowed extracontractual awards but banned punitive damages. The physicians held that the punitive damage ban deprived them of their right to obtain the treble damages under RICO. The managed care organizations, however, argued that the punitive damage ban did not have any impact on RICO claims.

A three-judge panel of the 11th U.S. Circuit Court of Appeals ruled in March 2002 that the physicians were "sophisticated" commercial "actors," and that, in the main, the arbitration agreements were enforceable as written. But the appellate judges, upholding the decision of a lower court, said the physicians could not be forced to arbitrate their RICO claims, because the arbitration agreement barred the awarding of punitive damages.

The managed care organizations appealed to the Supreme Court, which heard the case Feb. 24.

"We should not suppose that the arbitrator will not follow the law," said the managed care organizations' attorney, William Grauer, a partner in the San Diego office of Palo Alto, Calif.-based law firm Cooley Godward L.L.P. "The arbitrator has to interpret the contract," he said.

The attorney representing the doctors—Joe R. Whatley of the Birmingham, Ala., law firm of Whatley Drake L.L.C.—said that federal courts were the proper venue for deciding whether an issue is subject to arbitration. He noted that not all arbitrators are lawyers, and some, he said, "don't follow the law."

That brought a retort from Chief

Justice William Rehnquist. The chief justice drew laughter—an unusual occurrence during Supreme Court arguments—by replying that many judges who are lawyers don't necessarily follow the law themselves.

Despite the specifics of the case, the high court's decision will have implications for employers of all sorts that rely on employment arbitration agreements, said Quentin Riegel, vp-litigation for the National Assn. of Manufacturers in Washington.

"It goes to the fundamental question of the scope of arbitration. We

believe that parties should be able to set the terms of arbitration in advance and enter into a contract with agreement from both sides," Mr. Riegel said.

NAM joined the American Assn. of Health Plans in filing a brief with the high court supporting the position of the managed care organizations.

Both parties to an arbitration agreement should have the right to establish what the terms of the agreement should be, said Robin Conrad, senior vp of the National Chamber Litigation Center Inc. in Washington, which handles litigation for the U.S. Chamber of Commerce. "And it's reasonable for the parties to agree to waive claims for punitive damages," Ms. Conrad said.

"The case applies to anyone who would like to arbitrate their disputes rather than have them be part of lengthy litigation," said Richard Samp, chief counsel of the Washington Legal Foundation. The free market nonprofit group filed a brief with the high court supporting managed care organizations' position.

"The lower court limited the right to arbitrate claims, and we have asked the Supreme Court to allow parties who choose to arbitrate to enforce their arbitration agreement. It happens to involve HMOs, but this case really does have very broad implications for anyone who's concerned about arbitration," he said.

'The case applies to anyone who would like to arbitrate their disputes.'

Richard Samp
Washington Legal Foundation



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AWP: Firm urges new way to calculate drug prices

Continued from page 4
published by two organizations and are derived from the prices that drug wholesalers charge for a specific drug. However, each wholesaler may charge a different price for the same drug, and there are some wide pricing variations, Mr. Brandle explained.

Indeed, "average wholesale price" is a misnomer, because it's not really an average, yet it is still the chief benchmark used in pricing prescription drugs.

"It's akin to a sticker price on a car," Mr. Brandle said.

Because of the variation in average wholesale price figures, the same drug can cost employers different amounts depending on the wholesaler involved. And employers generally are not aware of how much the average wholesale price can fluctuate, he said.

In contracting with prescription benefit managers and health plans, employers negotiate a discount from the average wholesale price, "but they wouldn't know which average wholesale price is being chosen to take the discount off of," he said.

To eliminate this problem and ensure that employers' payments

are based on the lowest average wholesale price, Segal is negotiating with prescription benefit managers on behalf of a handful of self-insured employers to use a different benchmark—the federal upper limit price, Mr. Brandle said.

The federal upper limit price is set by the federal government for generic drugs and others where multiple sources exist. The federal upper limit price, which represents the top price the government will pay, is based on 150% of the lowest average wholesale price.

Using the federal upper limit price eliminates fluctuations in average wholesale price and locks the buyer into the lowest one, Mr. Brandle explained.

Using the new pricing basis, "you're getting the lowest AWP plus 50%," he said.

This switch, Segal calculates, can save the four employers up to 3% of their overall prescription drug spending, he said.

For example, the price for one 150 mg tablet of Ranitidine, often sold under the brand name Zantac, purchased in blocks of 100 tablets varies from 20 cents from one wholesaler to \$2.99 from another, according to figures compiled by Se-

gal. The federal upper limit price is 34 cents per tablet. Therefore, an employer paying 20% off the higher average wholesale price is spending many times the federal upper limit price for the drug, he explained.

Each wholesaler may charge a different price for the same drug, and there are some wide pricing variations.

Sean Brandle
The Segal Co.

While Mr. Brandle acknowledged that such huge cost differences are unusual, he said that it's common for many drugs to have significant price variations.

Whether the PBMs will agree to the change remains to be seen. An earlier attempt to get the PBMs to use the lowest average wholesale price in pricing drugs was rejected, Mr. Brandle noted, so he then proposed the use of the federal upper limit price.

Bill Millar II, co-founder of Pequet Pharmaceutical Network, a

PBM for federal Indian tribes and private employers in Mashantucket, Conn., does not doubt that using the federal upper limit price could save employers money.

But he cautioned that the federal upper limit price is not always lower than the average wholesale price, and using it as a benchmark may not result in lower prices to employers for every drug.

A spokeswoman for CIGNA HealthCare in Bloomfield, Conn., echoed that notion, saying that such a change "has the potential to increase costs to employers." This, the spokeswoman said, is because the federal upper limit price is higher than the AWP on numerous drugs.

Several PBMs did not respond to requests for comment.

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Brokers: Premium hikes, acquisitions fuel growth

Continued from page 1

soft, in the late 1980s, mass consolidation within the brokerage industry ensued, leaving commercial buyers unhappy with the number of brokerage options available to them.

"The brokers are riding the crest of the up cycle," said Michael A. Smith, a managing director of Bear Sterns & Co. Inc. in New York. "That's improving the revenue lines. Expenses are not going up as fast, so margins are improving, and that's having an accelerated effect on the bottom line."

Mr. Smith predicted, though, that "by the second half of 2004, we are going to see pretty clear signs of a downturn" in the market. Consequently, he said, brokers are going to have to find other means to grow their revenue base.

"Brokers will probably go into a comparative tailspin in the next down cycle, just as they did in the last one," Mr. Smith said. He noted, though, that the number of large acquisition targets is much smaller today than it was during the late 1980s.

"I think what's more likely to

happen is that when we do get into a down cycle, management and shareholders are going to become discouraged and you'll see the publicly traded brokers put up for sale. And it's possible that a large bank or investment bank would be an interested buyer," he said.

Hugh Warns, a vp with J.P. Morgan Equity Research in Baltimore, is not as pessimistic.

"The way people were running their businesses in the '90s, during the soft market, really forced discipline to build out best practices," he said of the brokerage industry. "I think you'll see a lot of the brokers emerge from this, even when we go into a soft market, with a slightly higher level of profitability on a go-forward basis. I just think these operations have been cleaned up substantially."

At the same time, Mr. Warns said, a new group of companies such as Hilb, Rogal & Hamilton Co. and Brown & Brown Inc. are now growing national platforms with a wide variety of products and specialties. This second generation of companies "is much stronger today than it was five years ago, and it

was almost not existent 10 years ago," he said. "You were either an alphabet house or you were a local shop."

While their future remains to be seen, brokers are enjoying their financial successes in the meantime.

The world's largest broker, Marsh & McLennan Cos. Inc., reported a 10.9% rise in 2002 brokerage revenues, to \$8.3 billion. Net income rose 40.1%, to \$1.4 billion.



'While our 2002 performance improved, we did not reach our original targets for the year, due in part to some nonrecurring items.'

Patrick G. Ryan
Aon Corp.

Analysts who track Marsh say that most of the broker's growth in 2002 came from premium increases, but because roughly 45% of Marsh's brokerage business is derived from fees rather than commissions, Marsh's revenue growth rate

lags behind that of brokers that derive a majority of their business from commissions. They also note that Marsh is benefiting from its vast expertise as clients face a difficult market and seek alternatives.

Chicago-based Aon Corp. also benefited from premium rate hikes in 2002, analysts say. Brokerage revenues rose 12.9%, to \$6.3 billion, while profits rose more than 200%,

to \$466 million.

Cathy Seifert, an analyst with Standard & Poor's Corp.'s equity group in New York, points out, though, that Aon's operating margins are still under pressure.

"This is a company that has had to focus on integrating a number of acquisitions, and what happened to them on Sept. 11 was a real issue," Ms. Seifert said, referring to the loss of 175 employees and its largest service center, which was located in the World Trade Center. "I don't think they are in much of a position to leverage the opportunities that exist in the marketplace because of issues outside of industry-specific pressures," she said.

In a statement, Patrick G. Ryan, Aon's chairman and chief executive officer, addressed that concern. "While our 2002 performance improved, we did not reach our original targets for the year, due in part to some nonrecurring items," he said. "Our fundamental businesses remain strong, however, and as we address underperformance in certain units and improve expense management, we expect earnings to increase in 2003."

At least one broker is quick to point out that its growth is not just about premium rate hikes.

"JLT's achievements over the last year cannot simply be attributed to increased insurance premiums in the current hard market, but also reflect organic growth achieved through new business wins and the benefits of a well-managed business," Jardine Lloyd Thompson

Group P.L.C. said in its year-end results statement, released last week.

The world's fifth largest brokerage reported £388.1 million (\$583.2 million) in brokerage revenues in 2002, an 11% increase compared to 2001. Profits rose 33%, to £69.3 million (\$104.1 million).

The largest revenue gains among the world's largest publicly held brokers came from the two biggest acquirers.

Glen Allen, Va.-based HRH reported the largest 2002 brokerage revenue increase, with an acquisition-fueled 38.3% rise to \$446.7 million. About \$95 million of revenue in 2002 came from acquisitions made in 2001 and 2002, according to Carolyn Jones, senior vp and chief financial officer. In 2002, HRH made seven acquisitions, with annual revenue of \$104 million. The vast majority of that revenue increase comes from its July 2002 acquisition of Atlanta-based Hobbs Group L.L.C., Ms. Jones said (BI, May 20, 2002).

Acquisitions also were the name of the game for Daytona Beach, Fla.-based Brown & Brown, whose 2002 brokerage revenues rose 25.7%, to \$452.3 million.

Brown & Brown made 32 acquisitions in 2002, which resulted in \$62 million in revenues for the year, a company spokesman said.

But it's not just brick and mortar acquisitions that were made in the brokerage industry in 2002. Brokers also acquired new producers and teams of producers from competitors.

"One of the more-interesting factors is you're seeing more of a war for talent going on in the industry," said Adam Klauber, managing director of Cochran, Caronia Securities L.L.C. in Chicago. Acquisitions are not playing a big role in the growth at such brokers as Arthur J. Gallagher & Co. and Willis Group Holdings Ltd., which have instead opted to take on new producers and teams of producers, Mr. Klauber said.

Itasca, Ill.-based Gallagher, for example, hired 130 new producers between July 2001 and September 2002, according to the company. As a result, Gallagher said in its year-end results statement that it expects salaries and employee benefits costs to be higher than normal throughout most of 2003.

For 2002, Gallagher's brokerage revenues topped the \$1 billion mark for the first time, increasing 21.8% to \$1.1 billion. Profits rose only 3.6%, to \$129.7 million, as a result of a variety of investment losses and a reduction in tax credits, the broker said.

London-based Willis has hired 150 new producers over the last 12 months, according to the company. Potential hires "recognize that this is a new Willis, defined by passion and energy, and want to be a part of building a great company," said Mario Vitale, chief executive officer of Willis North America.

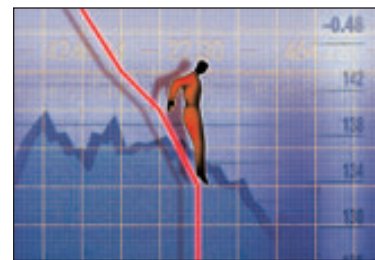
Willis' 2002 brokerage revenues increased 22.4%, to \$1.7 billion, while its profits soared to \$210 million, from just \$2 million in 2001.

For the Record

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

Annuity & Life Re to cease writing new business

Annuity & Life Re (Holdings) Ltd. expects to report a "significant" loss for 2002 and will stop writing new business. The unspecified loss stems largely from increased claims due to a higher-than-expected incidence of mortality and to losses from the reinsurer's largest minimum death benefit contract. As a result of its financial difficulties, the reinsurer will not write any new business and has notified its existing cedents that it will not renew current reinsurance contracts under existing terms.



Capital market declines erode pension funding

Poor investment returns over the past three years have led to double-digit drops, on average, in the funding level of pension plans in

several countries, according to a study by Towers Perrin. In the United States, for example, the funding level of pension plans is down 39% overall for the period beginning Jan. 1, 2000, while the level has dropped 40% in the United Kingdom and 42% in the countries in the Euro-zone. In 2002, funding levels declined by 20% in the United States, 21% in the United Kingdom and 20% in the Euro-zone.



Court allows Chubb recision suit to proceed

A Los Angeles federal judge is allowing a Chubb Corp. unit to proceed with a suit to rescind directors and officers liability coverage it wrote for online real estate company Homestore Inc. Homestore, which is being sued by several of its D&O insurers, had asked the judge to stay the litigation. The Securities and Exchange

TRIA: Study critical of coverage

Continued from page 4

terpret the law, including helping to determine whether or not losses from a terrorist attack were certified. TRIA's granting of this authority is both a benefit and a source of uncertainty, the report says.

In addition, the Conning study said that while there are "a number of methods to estimate insurers' exposure to terrorism losses...in our view, none of the methods is able to estimate the probability of an attack reliably."

That statement conflicts with the position of statistical rating agencies such as the Insurance Services Offices Inc., which uses terrorism catastrophe modeling and defends the credibility of the process (BI, Jan. 20).

Disagreeing, in part, with Conning's assessment is the New York-based Risk & Insurance Management Society Inc. RIMS continues to be a major proponent of the law, said President Chris Mandel.

From RIMS' perspective, it is still too early to assess TRIA's effectiveness, Mr. Mandel said. He noted that the insurance industry is still in the initial phase of implementing the act, under which insurers were required to provide quotes for terrorism coverage and give policyholders time to respond.

While Mr. Mandel acknowledges that the law does not address all ter-

rorism-related losses, it does help risk managers respond to lenders who have balked at making loans for new construction projects. Because of the law, a risk manager now can at least quote the cost of terrorism coverage for a proposed building project and discuss alternatives for financing it, he said.

While there are 'a number of methods to estimate insurers' exposure to terrorism losses...in our view, none of the methods is able to estimate the probability of an attack reliably.'
Conning Research & Consulting Inc.

In addition, the option of obtaining terrorism coverage helps alleviate some concerns of companies' boards of directors that want to be able to evaluate options as part of their due diligence in reviewing operations, he said.

But the law's failure to provide coverage for some exposures, especially biological and chemical attacks, is "a big hole," Mr. Mandel said. To help fill the void, risk managers must emphasize traditional loss control practices such as en-

Commission has accused the company of inflating its 2001 revenues, and four former Homestore officials have pleaded guilty to criminal charges arising from the alleged scheme.

ABI pushes reform of employers liability

The Assn. of British Insurers has called upon the U.K. government to reform the country's system of workplace compensation by separating the funding for occupational disease claims from that for occupational accident claims. In its submission to the Department of Work and Pensions' review of employers liability insurance, the ABI suggested new ways to fund claims for occupational diseases, such as an employer-backed mutual fund or a fund financed by a levy on EL premiums.

Arch records profit in first full year

Arch Capital Group Ltd. earned \$59 million in its first full year of operation. The Bermuda-based insurer and reinsurer earned \$43.1 million in the final three months of 2002, including an extraordinary gain of \$3.9 million resulting from Arch's acquisition of Personal Service Insurance Co., a Columbus, Ohio-based automobile insurer. Arch wrote gross premiums of \$1.5 billion in 2002, of which 61.1% was reinsurance business.

Allied World posts profit in 2002

Allied World Assurance Holdings

Ltd. generated net income of \$127.6 million in 2002, its first full year of operation. The Bermuda-based insurer, formed in November 2001, wrote gross premiums of \$922.5 million last year. Net premiums totaled \$434 million. The company writes mostly property, excess general liability and excess professional liability coverage.

AIG consolidates risk, captive operations

American International Group Inc. has consolidated its global risk



management and captive insurance operations into one unit, AIG Global Risk Management. The unit will combine the staff and operations of AIG Risk Management with the home office risk management staff of AIG's international risk management company, American International Underwriters Risk Management, and the company's AIG Insurance

Management Services Inc. captive insurance operation.

Briefly noted

The federal Judicial Panel on Multidistrict Litigation has transferred a class-action suit brought by physicians against CIGNA Corp. from federal court in Illinois to the Southern District of Florida, where it will join a consolidated class action against managed care organizations. The Illinois case was settled last year, but the federal judge overseeing the consolidated action enjoined the settlement, holding that CIGNA was attempting to circumvent the consolidated case by settling the suit in Illinois...The New York Stock Exchange has notified **Trenwick Group Ltd.** that it may delist Trenwick's stock for failing to meet the exchange's \$1 per share minimum average price over the last month. The NYSE could drop Trenwick shares if they do not exceed the minimum within the next six months, the insurer announced. Trenwick shares dropped below \$1 in December after a series of negative financial disclosures.

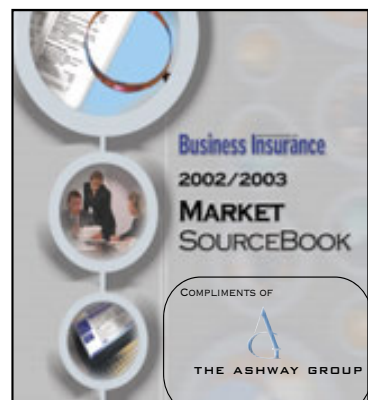
2002 YEAR-END BROKER RESULTS

Year-end financial results for the world's largest publicly held brokers. Dollar amounts in millions.

Brokers	Brokerage revenues	% change from 2001	Corporate revenues	% change from 2001	Net income	% change from 2001
Marsh & McLennan*	\$8,274.0	10.9%	\$10,459.0	5.7%	\$1,365.0	40.1%
Aon	6,317.0	12.9	8,822.0	15.0	466.0	217.0
Willis	1,661.0	22.4	1,735.0	21.8	210.0	NM
Arthur J. Gallagher*	1,052.3	21.8	1,120.8	24.0	129.7	3.6
Jardine Lloyd Thompson**	583.2	15.9	612.8	14.6	104.1	39.0
Brown & Brown	452.3	25.7	455.7	24.9	83.1	54.2
Hilb, Rogal & Hamilton	446.7*	38.3	452.7	37.1	65.1	101.3

* 2001 figures have been restated
** British pound = \$1.5025 (12/31/2002); British pound = \$1.4396 (12/31/2001)
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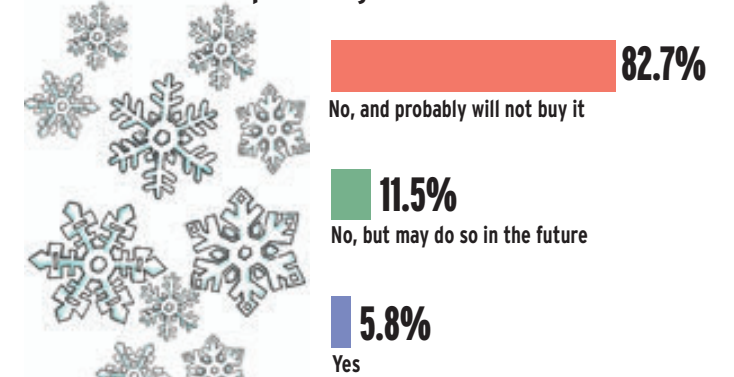
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Online Poll [2/24 - 2/28]

Has the recent East Coast snow storm led your organization to consider purchasing weather insurance?

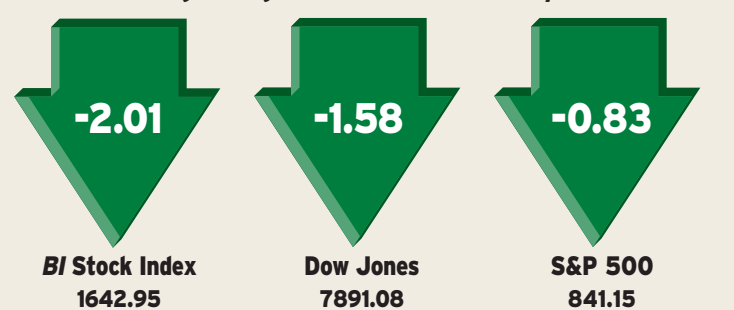


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BI Stock Index [2/24 - 2/28]

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Percentage change of BI Stock Index vs. key indicators



Largest gains

Gainsco Inc.	11.11%
Navigators Group	8.28%
American Financial Group	5.99%
Clark Bardes Holdings	5.21%
Wellchoice Inc.	4.96%

Largest losses

AEGON N.V.	-15.19%
PMA Capital Corp.	-14.64%
Trenwick Group Ltd.	-12.82%
ING Groep N.V.	-11.24%
Sierra Health Services	-10.44%

Weekly change by market segment

Brokers	-0.70%
Insurers/Reinsurers	-1.41%
Managed Care Organizations	-1.01%

Source: CNET Investor (investor.cnet.com)