$5

Business Insurance

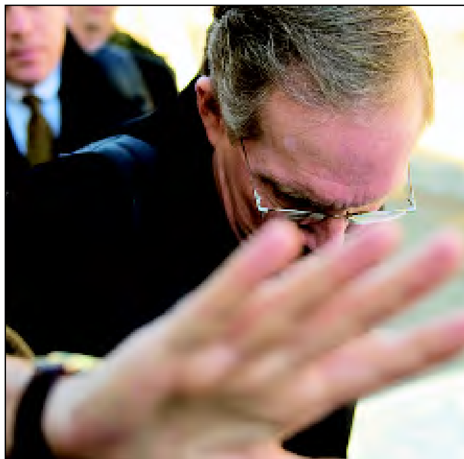
March 3, 2008 www.businessinsurance.com

SUPREME COURT RULING LOWERS BAR FOR SUITS UNDER ADEA / PAGE 3

EMPLOYERS FACE DILEMMA IN WEIGHING CRIMINAL RECORDS WHEN HIRING / PAGE 3

CONTINGENT COMMISSION LAWSUIT AGAINST MESIROW ALLOWED TO PROCEED / PAGE 3

FINITE EXECS GUILTY



BLOOMBERG NEWS/LANDOV

Former General Re Corp. Chief Executive Officer Ronald E. Ferguson leaves court after being found guilty of fraud and other charges.

Fraud convictions raise questions about potential for new cases

By DOUGLAS McLEOD

HARTFORD, Conn.—Five former executives of General Re Corp. and American International Group Inc. sat grimly in a Hartford, Conn., courtroom last week after a federal jury found them guilty of fraud in helping AIG inflate its loss reserves with a reinsurance deal.

After hearing more than five weeks of testimony and deliberating for six days, the jury convicted the defendants on all charges against them, including conspiracy, securities and mail fraud, and making false statements to securities regulators.

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

Following the verdicts, U.S. District Judge Christopher F. Droney set May 15 for sentencing and continued their release on a $1 million bond each.

Defense lawyers said their clients will appeal.

Convicted in the case were former Gen Re Chief Executive Officer Ronald E. Ferguson; Christopher P. Garand, former senior vp in charge of U.S. finite underwriting for Gen Re; Robert Graham, former senior vp and legal counsel for the reinsurer; Elizabeth Monrad, Gen Re's former chief financial officer; and Christian M. Milton, AIG's former vp for reinsurance.

The guilty verdicts quickly revived a question

See **GEN RE** page 25

In Brief

Michigan passes law to allow captives

The Michigan Legislature has given final approval to legislation allowing the formation of captive insurance companies in the state. The state's Senate last week unanimously accepted a measure the House of Representatives approved previously. Unlike many other states with captive laws, the Michigan measure does not impose premium taxes but instead would charge captive parents fees linked to premium volume. The legislation also would allow employers to form branch captives.

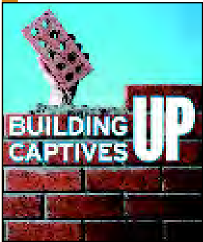
Writedowns hit AIG results

American International Group Inc. reported a 55.9% drop in net income for 2007 to $6.2 billion, as a result of an $11.47 billion pretax charge related to

See **IN BRIEF** page 26

SPOTLIGHT

CAPTIVE SOLUTIONS



Owners of long-established captives expand the range of coverages offered; health care captives used to fund programs aimed at improving risk management; E.U. rule changes may require more capital at some facilities; plus rankings of domiciles and largest managers.

Page 10

UnitedHealth wins OK to buy smaller rival

Sierra deal revamped to allay monopoly fears

By GLORIA GONZALEZ

WASHINGTON—UnitedHealth Group Inc. has won approval of its $2.6 billion acquisition of Sierra Health Services Inc. by agreeing to divest a relatively small portion of its business, but future transactions of this size may be problematic due to antitrust issues, health care experts say.

Federal regulators have shown a willingness to force the sale of assets to ensure continued competition in key markets that the Minnetonka, Minn.-based company enters via acquisitions. But the most recent divestiture was insufficient to quell opposition to the Sierra purchase by provider groups concerned about UnitedHealth's market share in the Las Vegas area.

Humana Inc. will pay $185 million to acquire the part of UnitedHealth's Medicare Advantage health maintenance organization business that the insurer is being forced to divest to complete its acquisition of Las Vegas-based Sierra, increasing Louisville, Ky.-based Humana's Medicare Advantage HMO membership in the Las Vegas area by more than 25,000 members.

The U.S. Department of Justice said the transaction, as originally proposed, would have created a combined entity that controlled 94% of the Medicare Advantage HMO market in the Las Vegas area, resulting in higher prices, fewer choices and a reduction in the quality of Medicare Advantage plans

See **UNITEDHEALTH** page 25

NYNJ PORT AUTHORITY

A federal judge last month limited potential insurance recoveries that would help rebuild the World Trade Center site.

Court limits coverage in WTC owner's policy

Rare clause excludes cover for leased properties

By DAVE LENCKUS

NEW YORK—In the latest insurance ruling stemming from the destruction of the World Trade Center, a federal judge has barred the complex's owner from tapping its coverage under an unusually constructed policy to fill gaps in the WTC leaseholders' coverage.

Several policyholder lawyers say they have never seen a policy provision structured like the one contained in the policy for the Port Authority of New York and New Jersey but differed over whether the judge correctly interpreted the provision.

Under the Feb. 22 ruling, the Port Authority can file claims for only one of six buildings and a commuter train terminal that were destroyed in the Sept. 11, 2001, terrorist attacks.

The cost of rebuilding the remainder of the complex must be borne by WTC leaseholders' insur-

See **WTC** page 24

crain Entire contents copyright © 2008 by Crain Communications Inc. All rights reserved.

INDEX

Advertiser Index 24
Business Resources 20
End Page 27
International 21
Letters 8
Opinions 8
Paul Winston 6
Products & Services 22
Professional MarketPlace 20
Stocks 26

Are you ready to take control of your risk and claims data?

Ask Aon.

Now is the time to use the only internet-based risk management solution that combines the industry's best claims management and risk management platforms. Aon has created an end-to-end, on-demand product suite that combines iVOS (claims management) and RiskConsole (risk management) to deliver enterprise data visibility and risk analysis in an all-in-one solution.

Go to **www.aon.com/ask** and get ready to take control.

KATHY BURNS

CEO of Aon's eSolutions Group
Aon Risk Services – Americas

On the Web

CAPTIVES 2008

Captive Solutions extras online

To hear more about the development of captives, listen to podcasts with John Wilson of Three Rivers Insurance Co. and Jack McCarthy of CRICO/Risk Management Foundation. Directories of captive managers and domiciles are at *www.businessinsurance.com/captive2008.*

Mr.Wilson

Mr.McCarthy

THIS WEEK IN BI

Podcast takes listeners behind the *BI* headlines

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

BI DIRECTORIES

BI's digital 2008 Market Sourcebook online

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

BI PHOTO GALLERIES

Share your industry news through photos

Is your business or organization involved in charitable endeavors, or do you have awards and other highlights you'd like to share? Submit photos to *Business Insurance*'s online photo galleries. For guidelines, go to *www.BusinessInsurance.com/submitphoto.*

Business Insurance®

REPORTING ON CORPORATE RISK AND EMPLOYEE BENEFIT MANAGEMENT NEWS

Business Insurance (ISSN 0007-6864) Vol. 42, No. 09, is published weekly by Crain Communications Inc., 360 N. Michigan Ave., Chicago, Ill. 60601-3806. Periodicals postage is paid at Chicago and at additional mailing offices. POSTMASTER: Send address changes to Business Insurance Circulation Department, 1155 Gratiot Ave. Detroit, Mich. 48207-2912. $5 a copy and $97 a year in the U.S. $130 in Canada and Mexico (includes GST). All other countries, $230 a year (includes expedited air delivery). Canadian Post International Publications Mail Product (Canadian Distribution) Sales Agreement No. 40012850, GST No. 136760444, Canadian return address: 4960-2 Walker Road, Windsor, ON N9A6J3. Printed in U.S.A. Copyright © 2008 by Crain Communications Inc.

Criminal convictions pose hiring dilemma

Employers must weigh risks to their business of hiring ex-cons to avoid running afoul of bias laws

By JUDY GREENWALD

An applicant apparently meets the qualifications to be an administrative assistant, but a background check finds a 10-year-old conviction for sexual abuse of a child. Is the employer obligated under law to offer him the job?

That would depend on the type of business, observers say. If it were a day care center job, the employer would have a legally defensible reason to reject the applicant. But an employer could be on shakier ground if the job were in a shoe factory, and it could depend on the state where the factory is located.

The issue is one that employers face frequently. On one hand, federal and state laws may bar employers from rejecting applicants based on arrests or convictions unrelated to the job. On the other hand, employers risk being accused of negligence if they hire someone convicted of a crime who subsequently causes job-related problems.

Observers say the issue has taken on greater urgency for employers given last year's initiative, Eradicating Racism and Colorism from Employment, by the Equal Employment Opportunity Commission. The EEOC said studies have shown that employers make hiring decisions based on convictions, arrests and other factors that "may disparately impact people of color."

Under E-RACE, which is designed to ensure that workplaces are free of race- and color-based discrimination, the EEOC will "develop and implement investigative and litigation strategies to address selection criteria and methods that may foster discrimination," the agency said.

Source: U.S. Justice Department

A spokesman said the EEOC does not track how many charges it has filed related to the issue of criminal background checks under E-RACE.

In a 2004 survey by the Society for Human Resource Management, the Alexandria, Va.-based organization found that 87% of employers occasionally conduct criminal background checks on job applicants, including 68% that always do so. But 54% said they sometimes or always find inconsistencies between the record and what the applicant reported.

At the end of 2006, the Justice Department said more than 5 million U.S. residents were on parole or probation, and observers say the prospect of hiring discrimination against those convicted of crimes is one the EEOC will pursue.

"My guess is they're going to go after employers aggressively," said Michael S. Cohen, an employer attorney with Wolf, Block, Schorr & Solis-Cohen L.L.P. in Philadelphia.

"I do think we will see more cases

See **BIAS** page 23

Supreme Court ruling lowers bar for ADEA lawsuits

Justices say claimants' ability to bring bias suits not tied to EEOC's response to filed charges

By MARK A. HOFMANN

WASHINGTON—A Supreme Court decision last week that makes it easier for employees to sue their employers for alleged discrimination under the Age Discrimination in Employment Act could have been worse for employers, say employment law experts.

That's because the majority opinion in *Federal Express Corp. vs. Paul Holowecki et al.* made clear that the decision applied to ADEA cases, and enforcement mechanisms and statutory waiting periods for actions brought under the Civil Rights Act of 1964 and the Americans With Disabilities Act differ in some respects from those under the ADEA. Nevertheless, the Feb. 27 decision may mean more litigation, they warn.

The case involved an ADEA requirement that a plaintiff file a "charge"—which the high court found that the ADEA does not clearly define—at least 60 days before filing a discrimination lawsuit. When the Equal Employment Opportunity Commission receives the charge, it notifies the employer, investigates the allegations and offers to mediate.

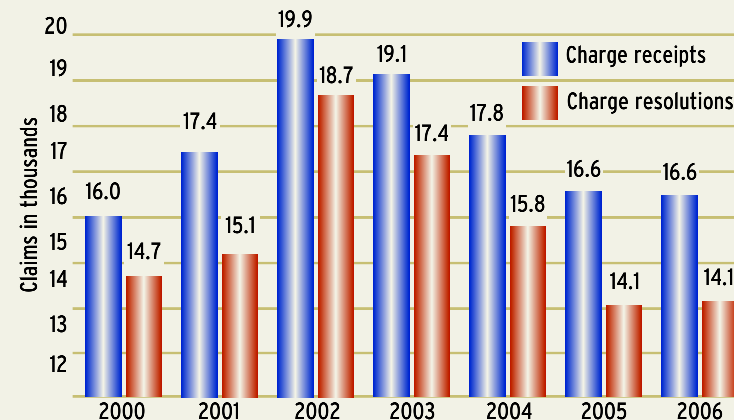
The case began in 2001 when Patricia Kennedy, a FedEx courier, submitted a so-called intake questionnaire to the EEOC, providing information about allegations of age discrimination at her employer. The EEOC did not take action on the questionnaire, which FedEx argued does not constitute a charge as required to pursue an ADEA claim.

The next year, a group of current and former FedEx employees, including Ms. Kennedy, filed suit in a federal district court in New York, alleging that FedEx had initiated policies, such as performance standards, that effectively discriminated against older workers and thus violated the ADEA. Ms. Kennedy also filed a formal charge with the EEOC after she had initiated the suit. The district court dismissed the case

See **ADEA** page 26

AGE DISCRIMINATION CLAIMS

Total number of charge receipts filed and resolved under the ADEA, in thousands



Source: Equal Employment Opportunity Commission

Court says Mesirow contingents suit can proceed

State court allows fiduciary duty claim but bars fraud charge

By SALLY ROBERTS

CHICAGO—An Illinois Appellate Court has ruled that a lawsuit against Mesirow Insurance Services Inc. alleging breach of fiduciary duty in connection with undisclosed contingent commissions can proceed.

Crystal Lake, Ill.-based DOD Technologies Inc. sued Chicago-based Mesirow in March 2005, alleging breach of fiduciary duty, unjust enrichment and consumer fraud in connection with Mesirow's practice of accepting contingent commissions, among other charges.

The circuit court in Cook County dismissed all charges against Mesirow in October 2006, ruling that Illinois' insurance code precludes claims for breach of fiduciary duty and that the plaintiff did not prove actual damages to prove consumer fraud.

While a three-judge panel of the First District Illinois Appellate Court, Fourth Division, in Chicago upheld the lower court's ruling on the consumer fraud and common law fraud counts, it ruled that producers breach their fiduciary duty of acting in their clients' best interest when they steer business to insurers that pay the broker undisclosed contingent commissions.

"It is not the undisclosed incentives that constitute misappropriation," the appellate panel concluded in its Feb. 18 ruling. "Rather, the undisclosed incentives, as alleged in the complaint, were what led defendant to place certain policies without regard for the customer's needs and in breach of its fiduciary duty. We hold that a producer misappropriates premiums within the terms of (the Illinois Insurance Code) when it directs a premium to an insurer, the price or coverage is not in the consumer's best interest, and the placement earns the producer undisclosed contingent incentives."

In a statement, David S. Klevatt of Klevatt & Associates L.L.C., which represented DOD Technologies in the suit, said the ruling is a victory for Illinois consumers and small businesses that rely on midsize insurance brokers such as Mesirow to act in their best interests.

The case was remanded to the lower court.

In a statement, Richard Price, president of Mesirow's Insurance Services Division, said: "We are pleased that the appellate court rejected the plaintiff's baseless theory that the mere receipt of contingent commissions is unlawful. Given our business methods and structure, we are confident that we have not breached any fiduciary duty. We look forward to once again prevailing in the trial court."

Supreme Court to rule on punitives in Exxon Valdez case

Arguments hinge on whether maritime law allows $2.5 billion award

By MARK A. HOFMANN

WASHINGTON—The Supreme Court is weighing the question of whether a $2.5 billion punitive damage award stemming from the 1989 Exxon Valdez oil spill should be allowed to stand.

The justices last week heard arguments in *Exxon Shipping Co. vs. Grant Baker,* which arose from the massive oil spill that resulted when the vessel struck a reef in Prince William Sound, Alaska. The accident occurred after the captain of the vessel, Joseph Hazelwood, violated company policy by both leaving the bridge and by drinking. Among the key questions before the court is whether the punitive damages award—half the sum originally assessed but still the largest punitive award upheld by a federal court—is permitted under maritime law.

During last week's oral arguments, Exxon's attorney, Walter Dellinger, a partner in the Washington office of O'Melveny & Myers L.L.P. and a former acting U.S. solicitor general, said "this court has never affirmed an award of punitive damages under maritime law," according to transcript of the proceedings. "It has never held that punitive damages are available for unintended conduct in maritime law. It has never held that they were available for oil spills," he said. He added that before the enactment of the Clean Water Act, U.S. courts had awarded punitive damages under maritime time law only four times. The largest award was $500,000, he said.

In its brief seeking review of the punitive damage award, the company, now called Exxon Mobil Corp., asked whether under federal maritime law punitive damages can be imposed on a shipowner for the conduct of ship's captain even when that conduct—in this case intoxication—was contrary to company policy; whether federal judges can expand the penalties provided under the Clean Water Act—which governs oil spills and which does not provide for punitive damages—to include punitive damages under maritime law; and whether the $2.5 billion award would be permitted

See **EXXON** page 26

AP PHOTOS

Exxon Mobil is appealing a $2.5 billion punitive damages award that stemmed from a 1989 Alaska oil spill from the tanker Exxon Valdez.

N.Y. regulator eyes ways to cut health care costs

Backs prior approval of health cover rate hikes

By GLORIA GONZALEZ

NEW YORK—New York Insurance Superintendent Eric Dinallo said he hopes a planned lawsuit against UnitedHealth Group Inc. will lead to greater disclosure of health care reimbursement rates but said other changes are needed to drive down health care costs in the state.

Earlier this month, New York Attorney General Andrew Cuomo announced plans to sue Minnetonka, Minn.-based UnitedHealth and several of its subsidiaries, charging they have dramatically underreimbursed out-of-network medical expenses using data provided by the company's Ingenix unit. He also issued 16 subpoenas to other health insurers as part of an investigation into the reimbursement system, which is used by most health insurers and self-funded employers for out-of-network services.

Mr. Dinallo

"I'm not sure I would have done it by action, but that's the attorney general's job," Mr. Dinallo said, noting that he is somewhat concerned about the amount of change the litigation could force on the industry.

The ideal outcome from the lawsuit will be more disclosure on so-called "usual, customary, reasonable" pricing, although it is unclear whether greater disclosure would result in better UCR rates, he told attendees of an event hosted by *BI'*-sister publication *Crain's New York Business* in New York on Feb. 27.

Bridging the gap between in-network and out-of-network payment levels is part of the solution to the problem of skyrocketing health care costs, which the regulator can help accomplish, he said.

Prior approval on rate increases is an unpopular notion with health insurers because of timing issues, but that needs to be part of the discussion, Mr. Dinallo said. "I do think prior approval will make a huge difference and smooth out the spikiness…of out-of-control health care costs."

While health insurers are currently experiencing strong levels of profitability, observers tend to forget that many of them were on the brink of bankruptcy a few years ago, he said.

"They're not the problem," Mr. Dinallo said. "I'm not exempting the health insurers" from blame for rising costs, he said, but he added

See **DINALLO** page 6

Errors and Omissions

- A story in the Feb. 11 issue, "Nearly One-quarter of Employers Offer Voluntary Life Cover," contained two errors. The percentage of employers offering voluntary life insurance was 23% in 2006 compared with 28%, not 22%, in 2002, according to LIMRA International. In addition, 13, not 18, of 28 voluntary life insurers reported growth of at least 5% in the first nine months of 2007.
- A story in the Feb. 25 issue, "Captive Industry Hails IRS Tax Plan Reversal," misidentified the Captive Insurance Cos. Assn. and misspelled part of the name of law firm LeBoeuf & Dewey L.L.P.

Smaller firms face data theft risks

Hackers try new targets as big companies tighten security: FTC official

By COLLEEN McCARTHY

NEW YORK—Identity theft and data security breach incidents are on the rise, but many companies are not prepared to deal with this risk, according to an official with the U.S. Federal Trade Commission.

"This is a very serious risk that can expose you to tremendous losses," Leonard Gordon, New York-based Northeast regional director of the FTC, told attendees of the Eastern Claims Conference, held in New York Feb. 25-26.

Small and midsize companies are the most vulnerable, Mr. Gordon said.

"Bigger companies have gotten the message and stepped up their efforts. Now the thieves are working their way down the food chain, and small- and medium-size companies are being targeted," he said.

The FTC estimates that as many as 9 million Americans have their identities stolen each year. In addition, a 2007 FTC report estimates that identity thieves steal $48 billion from businesses and $5 billion from consumers annually.

Identity theft and security risks impact a variety of industries, but the retail industry is particularly vulnerable, Mr. Gordon said.

"When a company experiences rapid growth, very often their systems cannot keep pace, and as a result they open themselves up to hackers," he said.

PRESCRIPTION ABUSE: Insurers realize massive losses due to illegal use of prescription drugs, page 22.

That was the case at shoe retailer DSW Inc., where hackers in 2005 obtained information on more than 1 million debit and credit card accounts and nearly 100,000 checking accounts, Mr. Gordon said. Columbus, Ohio-based DSW disclosed that three months' worth of personal data had been stolen, affecting customers in 25 states.

In addition to facing FTC sanctions, the company has been hit with numerous lawsuits related to the incident, Mr. Gordon said.

A 2005 settlement with the FTC required DSW to implement new computer security features and to be audited every two years for the next 20 years by a private security firm.

Similarly, Boston-based retailer Life is good Inc. in 2006 disclosed a security breach in which hackers accessed a database of more than 9,000 customers' credit card numbers.

The FTC later charged the company with failing to safeguard consumers' sensitive information in violation of federal law, noting that the company also had misled customers to believe its Web site was secure. According to the FTC's complaint, the site claimed "all information you share with us is kept in a secure file."

A 2008 settlement with the FTC bars Life is good from making deceptive claims about its security policies and requires the retailer to

See **SECURITY** page 22

Pension funding revisions proposed

Labor Department considers speeding up employee contribution transfers

By JERRY GEISEL

WASHINGTON—The Labor Department has proposed a revised rule that would require small employers to speed up the transfer of employee contributions to pension and welfare plans and said it is considering doing the same for large employers.

Under current rules, employers—regardless of size—must transmit employee contributions to pension plans as soon as the contributions can be reasonably segregated from general employer assets, but no later than the 15th business day after the month in which the contributions are received or withheld by the employer.

In the case of welfare plans, the latest date to forward employee contributions is 90 days from the date the amounts are received or withheld by the employer.

Under the proposed rule, which was published in last Friday's Federal Register, employers that sponsor pension and welfare plans with less than 100 participants would automatically be considered in compliance with the law only if pension and welfare contributions are deposited with the plans within seven business days of receipt or withholding.

The proposed seven-day safe harbor would benefit both employees and employers, said Assistant Secretary of Labor Bradford Campbell.

"Our proposal will protect workers by encouraging employers to deposit participant contributions to small pension and welfare plans in a timely manner. It also will provide employers with a higher degree of compliance certainty," Mr. Campbell said in a statement.

The Labor Department also said it is seeking information regarding the current contribution practices of large employers to determine how a contribution safe harbor could be fashioned for them.

TO EASE THE PAIN IN HER BACK, WE REMOVED THE HEAVY LOAD FROM HER SHOULDERS.

When a working mom with a back injury could no longer do her job, she worried about how to support her family. Our Group Disability claims expert partnered with her and her doctor to get an accurate picture of the situation and developed a plan to return her to the workforce. With more than 95 years of managing disabilities, it's no wonder we've received a 97% satisfaction rating from our customers. Whether it's providing timely and accurate payments and claims status updates or creating unique return-to-work solutions, we focus on doing the right thing for both you and your employees. That's our policy. For more information, visit libertymutual.com/groupbenefits.

GROUP BENEFITS: LIFE | STD | LTD

Group products offered by Liberty Life Assurance Company of Boston, a member of the Liberty Mutual Group.

Responsibility. What's your policy?

© 2008 Liberty Mutual Group.

Dinallo: Eyes ways to cut health care costs

CONTINUED FROM PAGE 4

that there needs to be an acknowledgement of the role that the aging population and technological advances play into double-digit medical costs increases.

A critical part of the solution is getting the uninsured population of New York—currently estimated at more than 2.5 million people—into the insurance system, he said. The costs will be driven down if those fairly healthy people who cannot afford health insurance are able to obtain coverage, he said.

In addition, he said that New York is on the path toward medical malpractice reform. The Medical Malpractice Reform Task Force is examining 20 different proposals relating to litigation, improving patient safety, the actual costs of medical malpractice, and spreading the risk and "creating a healthy and competitive insurance market, which we do not have right now," he said.

Gov. Eliot Spitzer announced the formation of the task force in July 2007 to identify the fundamental causes of high medical malpractice costs and propose solutions.

Mr. Dinallo declined to address any specific recommendations that may come out of the task force.

Although there has been no agreement yet, he expects the task force will release its recommendation by the middle of the year, because rates must be set in June. "I think we're going to come out with a hugely well-received set of reforms," he said.

'I do think prior approval will make a huge difference and smooth out the spikiness...of out-of-control health care costs.'

Eric Dinallo, New York Insurance Superintendent

The parties, including trial lawyers, have an incentive to reach agreement on medical malpractice reform because "no one is going to stand for double-digit increases every year," he said.

Meanwhile, Mr. Dinallo said he is "very excited" about the possibility of reviving the New York Insurance Exchange, a reinsurance marketplace that opened in 1980 and ceased operations seven years later. The exchange failed because of soft insurance markets and because it was "ahead of its time," but backers of the effort hope to get work started as soon as this year, he said.

Reviving the insurance exchange would be a great way for New York to become a leader in the insurance and reinsurance markets and "take some of the business away from Bermuda" and Lloyd's of London, Mr. Dinallo said.

You're Unique.

We notice.

PINNACLE
ACTUARIAL RESOURCES, INC.
The Firm of Choice

• Predictive Modeling
• Litigation Support
• Enterprise Risk Management
• Alternative Markets

thefirmofchoice.com

Bloomington • Chicago • Columbus • Des Moines • Detroit • Indianapolis • New York • San Francisco

Commentary

Greater transparency needed to heal industry

PAUL WINSTON

Associate Publisher and Editorial Director
Paul Winston's commentary appears monthly. E-mail: pwinston@crain.com

The guilty verdicts in two closely watched trials in recent weeks—one accusing brokers of improperly rigging bids for excess liability insurance programs and the other alleging executives at General Re and AIG conspired to create a fraudulent finite risk transaction—are yet another set of black eyes for the insurance industry.

And while the blow to the head that causes a black eye is painful, as is the shame of the all-too-visible result, it eventually will heal and disappear (or it will once regulators are done punching the insurance industry in the face).

Both cases arose from the increased scrutiny of insurance industry practices begun in 2004 by then-New York Attorney General Eliot Spitzer. These trials show the industry is not out of the fight yet.

Not only are many defendants still awaiting trial, but these verdicts could well embolden prosecutors to seek new ones. It is hard to imagine that the kind of practices alleged in these cases were limited to only a few. Also, now confronted with the very real prospect of going to prison, some of these defendants—particularly in the General Re and AIG case—could start to name more names in exchange for more favorable sentencing.

Accounting and regulatory examination of finite risk transactions also will continue. These products generated controversy well before Spitzer: Recall, for example, the HIH collapse in Australia, which regulators blamed on a finite re deal with General Re. Such problems will continue until regulators establish clear rules on how transactions qualify as risk transfer.

It is clear from the insurance industry's ongoing trials—literally and figuratively—that it needs a better defense than "you don't understand how insurance works," or "our jargon and processes are too complex to explain," or "but we've always done it that way."

If the industry's traditions and practices are so complex and opaque that they invite the kind of legal and regulatory intervention we've seen, then it has a problem. If policyholders and shareholders can't tell if they are being treated fairly and properly, there's another problem. The solution is greater transparency by the industry for all—regulators, policyholders and shareholders. With greater transparency, there is less room for charges of collusion or self-dealing. The industry also needs to identify those areas where it *is* different from other businesses and analyze whether such differences are necessary—and if they are able to explain why.

The sooner the industry can do all this, the sooner it will begin to heal from the blows it has taken, and restore the trust of customers, shareholders and regulators. It also will help the industry's many honest and hardworking employees—people who did no wrong but have seen their industry tarnished by the actions of a few—to recover their pride in their companies and their profession. This is critical not only for all of those stakeholders, but also for the industry's ability to attract a talented workforce in the future. It's awfully hard to attract the best and the brightest to insurance when it is in the headlines for the wrong reasons.

These trials show the industry is not out of the fight yet.

The bald truth

Meanwhile, there are many people in the industry who deserve recognition for their good deeds. I want to salute the many industry executives who are raising funds to research a cure for children's cancers by shaving their heads this month on behalf of the St. Baldrick's Foundation. Some of these individuals include: Chuck Chamness, president of the National Assn. of Mutual Insurance Cos.; Michel de Lecq Marguerie, deputy chairman of Beach & Associates; David Clark, property treaty underwriter at Canopius Managing Agents; Phil Markey, chairman of Aon (Bermuda) Ltd.; Michael Morrill, president and CEO of AXIS Re U.S.; and Tim Hegarty Jr., president and CEO of Norfolk & Dedham Mutual Insurance.

You can show your support for their efforts by looking them up at *www.StBaldricks.org* and making a donation on their behalf. Even better: Sign up online to join them as a shavee!

CREATE A BRIGHTER FUTURE.

MAKE PROGRESS.

Let ACE take on the responsibility of risk. Our expert underwriting, superior claims handling and local-market experience free you to focus on the possibilities, not the liabilities. Learn more at **insuringprogress.com**

▲ PROPERTY & CASUALTY ▲ ACCIDENT & HEALTH ▲ LIFE

INSURING PROGRESS®

© 2007 ACE Coverages underwritten by one or more of the ACE Group of Companies. Not all coverages available in all jurisdictions.

Business Insurance OPINIONS

Courts should overturn San Francisco health law

THE ARCHITECTS of San Francisco's health care spending ordinance may have thought the measure would reform the system, but at least one provision may result in just the opposite.

Under the law, which a restaurant trade group is challenging in court, employers must make what the ordinance calls "health care expenditures." The amount depends on employer size. Employers, for example, with at least 100 employees this year will have to spend $1.76 per hour per employee, up to a maximum of about $3,600 a year.

It is up to employers to decide where they want their money to go. The requirement can be met through paying health insurance premiums, by making contributions to health savings accounts or health reimbursement arrangements, or by paying the money to the city.

What is outrageous—and that word is not an exaggeration in this case—involves the application of the health care spending requirement in situations where employees decline coverage through their employer because they are covered by the health care plan offered by their spouse's employer.

As San Francisco regulators interpret the law, the fact that the employee has health care coverage does not relieve the employer of its spending requirement. Translation: Employers would have to shell out $3,600—probably in the form of an annual HRA contribution—for that employee.

The implications should be obvious. Hit by such a requirement, employers undoubtedly would have to scale back their health care benefit plans to pay for it.

Hit by such a requirement, employers undoubtedly would have to scale back their health care benefit plans to pay for it.

Providing windfall benefits to the few at the expense of the many surely isn't what health care reform is about, and we hope for that and other reasons that the courts strike down the San Francisco law.

States learning the value of welcoming captives

NOT THAT LONG ago, a company or trade group operating in the United States had to go offshore to set up a captive insurer.

The reason was simple: No state had an attractive captive statute.

Those days are gone. Today, the fastest growing domiciles in the world are in the United States, with several states racking up double-digit increases last year in new captive formations.

If those trends continue, within a year at least six states will each have more than 100 captives, and Vermont will likely have nearly 600 captives.Well over 1,400 captives now are based in the United States—close to 10 times more than there were two decades ago.

Why the huge increase? Certainly, the dominant reason is that states are eager to replicate the success of Vermont, the first state to have an appealing captive law. It took time, but states now see the financial advantages captives bring, chiefly creating high-paying jobs.

And with that growth comes clout. When the Internal Revenue Service last year proposed rules to strip away tax advantages many captives have enjoyed—perhaps tilting the playing field in favor of offshore domiciles—governors and lawmakers rushed in to protest, and those politically powerful voices perhaps were a factor in the IRS' decision to withdraw those rules.

We now hope that the remaining states become just as accommodating to the captive industry as those that have already welcomed captives within their borders. It certainly would be in their financial interest to do so.

Letters

Healthcare portability can be a win-win for everyone

TO THE EDITOR: It was interesting to read the strategic implications for employer benefit plans in two stories that ran in the Feb. 4 *Business Insurance* issue: the article "Big Employers Retool Retiree Medical" and the sidebar "NBGH Supports Mandate for Individuals."

The obvious reason for support of individual insurance mandates by the NBGH is evident in the first story: the limitations and eventual elimination of health coverage by employers.

One does question the reliance on employers as the source of health care coverage. Trends indicate employers themselves question this tradition, and increasing numbers of them are eliminating the benefit altogether.

Back in 1985, as a benefit administrator, we raised the question of company-paid retiree benefits in light of Medicare. Today the move is to cap or eliminate this benefit altogether.

With the NBGH's efforts to create a mandated individual market, thereby reducing employer benefit costs, we can now see the advantages predicted for some time:

1. Employers will stabilize their costs by providing supplemental, nonrisk bearing benefits and,

2. True insurance portability will allow employees greater freedom of employment.

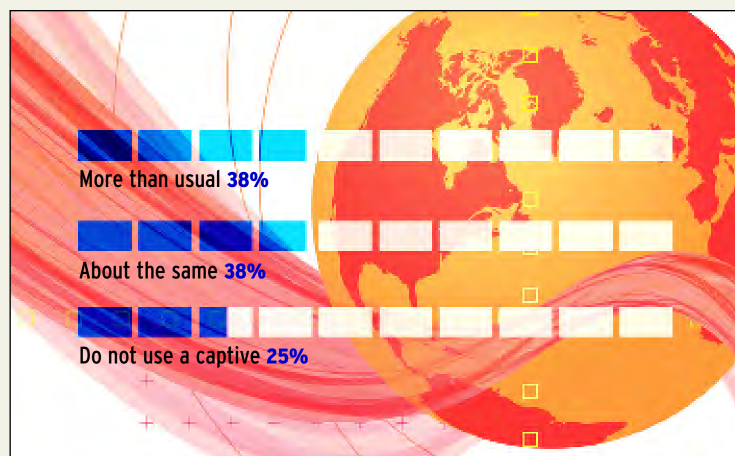
Hank Kearney
PHM International

Write us

Business Insurance welcomes letters to the editor. The section is intended to be a forum for readers' opinions and comments. We reserve the right to edit letters for clarity or space. We will not publish unsigned letters. Please send your letters to: Letters to the Editor, Business Insurance, 360 N. Michigan Ave., Chicago, Ill. 60601-3806; fax: 312-280-3174; e-mail: rcoccia@businessinsurance.com

Online Poll at www.businessinsurance.com

In the current soft market, how much premium do you plan to fund through a captive?



NEXT WEEK'S POLL: *Do you agree with the jury verdict finding the five defendants in the General Re finite trial guilty of fraud and conspiracy?*

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

Vice President/Publisher: Martin J. Ross III (*New York*)

Associate Publisher/Editorial Director: Paul D. Winston (*Chicago*)

Editor: Regis J. Coccia (*Chicago*)
Editor-at-Large: Jerry Geisel (*Washington*)
Managing Editor: Gavin Souter (*Chicago*)
Assistant Managing Editor - Graphics: Kathy L. Barnes (*Chicago*)
Assistant Managing Editor - News: Matt Scroggins (*Chicago*)
Senior Editors: Roberto Ceniceros (*Boise*); Meg Fletcher, A.R.M. (*Chicago*); Judy Greenwald (*San Jose*); Mark A. Hofmann (*Washington*); Dave Lenckus (*Tucson*); Douglas McLeod (*New York*); Sally Roberts (*Denver*); Joanne Wojcik (*Denver*); Rodd Zolkos–*Industry Focus* (*Chicago*)
New York Bureau Chief: Gloria Gonzalez (*New York*);
Associate Editor: Kristin Gunderson Hunt (*Chicago*) Colleen McCarthy *(New York)*
Staff Reporter - Interactive: Jeffrey Casale (*Chicago*)
Deputy Graphics Editor: William Murphy (*Chicago*)
Copy Editors: Charmain Benton (*Chicago*); Carrie A. Peinado (*Chicago*); Joe Walker (*Chicago*)
Research Director: Kevin P. Edison (*Chicago*)
Research Editor: Karen Brown Tucker (*Chicago*)
Online Editor: Katherine Downing (*Chicago*)
Online Producer: Amy R. Curtis (*Olathe*)
Editorial Cartoonist: Roger Schillerstrom (*Chicago*)

Advertising Director: Robert A. Raidt Jr. (*New York)*

Director - Business Development: Robert L. Niesse (*Chicago*)
Regional Sales Managers: Russell J. Carpel (*Chicago);* William J. McGuire (Chicago); Ron Kolgraf (*Boston*); Todd D. Lockwood *(New York);* Robert B. Murray (*New York*)
Classified Advertising Manager: Tina Vasilakis (*Chicago*)
Assistant to the Publisher: Pat Ghazvini (*New York*)
Advertising Traffic: Monique Murray (*New York*)
Sales Assistant: Mike Tsikoudakis (*Chicago*)
Production Manager: J. Thomas Janka (*Chicago*)

Circulation Manager: William O'Driscoll (*New York*)
Circulation Coordinator: Craig Bowman (*Detroit*)

Promotion Manager: Michael Ambrosio (*New York*)
Promotion Coordinator: Barbara O'Brien (*New York*)

EDITORIAL: Boise: 208-286-1425; Chicago: 312-649-5200; Denver: 303-282-4260; London: 44-207-457-1400; Los Angeles: 323-370-2455; New York: 212-210-0100; San Jose: 408-774-1500; Tucson: 520-579-1937; Washington: 202-662-7200

ADVERTISING: Boston: 617-292-4856; Chicago: 312-649-5276; Los Angeles 323-370-2405; New York: 212-210-0133

SUBSCRIPTIONS: Detroit: 888-446-1422

Business Insurance is published by Crain Communications Inc.

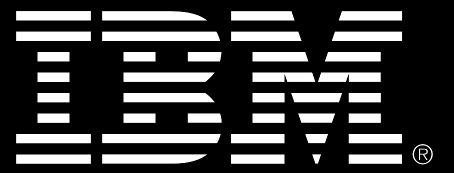
Chairman: Keith E. Crain
President: Rance Crain
Secretary: Merrilee Crain
Treasurer: Mary Kay Crain
Executive Vice President/Operations: William A. Morrow
Senior Vice President/Group Publisher: Gloria Scoby
Group Vice President/Technology, Circulation, Manufacturing: Robert C. Adams
Vice President/Production & Manufacturing: Dave Kamis
Crain's Corporate Circulation Director: Patrick Sheposh
Chief Information Officer: Paul Dalpiaz

G.D. Crain Jr. Founder (1885-1973)
Mrs. G.D. Crain Jr. Chairman (1911-1996)
S.R. Bernstein Chairman-executive committee (1907-1993)

Published weekly at 360 N. Michigan Ave., Chicago, Ill. 60601-3806, Fax: 312-280-3174, *biweb@crain.com*. Offices: 711 Third Ave., New York, N.Y. 10017-5806, Fax: 212-210-0704; Suite 814, National Press Building, Washington, D.C. 20045-1801, Fax: 202-638-3155; 6500 Wilshire Blvd., Suite 2300, Los Angeles, Calif. 90048-4947, Fax: 323-655-8157; 967 Bermuda Court, Sunnyvale, Calif. 94086-6750, Fax: 408-774-1155; 21 St. Thomas St., London SE1 9RY, U.K. Fax: +44-(0)20-7457-1440; 7300 N. San Anna Drive, Tucson, Ariz. 85704, Fax: 520-579-3476; 1746 Cole Blvd., Suite 150, Golden, Colo. 80401, Fax: 303-733-9941; 12524 Acuff Court, Olathe, Kan. 66062, Fax: 312 280-3174. 77 Franklin St., Suite 809, Boston, Mass. 02110-1510; Fax: 212-210-0704. $5 a copy and $97 a year in the U.S., $130 in Canada and Mexico (includes GST). All other countries, $230 a year (includes expedited air delivery). Four weeks' notice required for change of address. Send subscription correspondence to Circulation Department, *Business Insurance*, 711 Third Avenue, New York, N.Y. 10017-5806. Microfilm copies available: University Microfilms, 300 Zeeb Road, Ann Arbor, Mich. 48013. Microfiche copies: Bell & Howell, Micro Photo Division, Old Mansfield Road, Wooster, Ohio 44691. Portions of the editorial content of this issue are available for reprint or reproduction in other media. For reprints or reprint permission: The YGS Group, 1808 Colonial Village Lane; Lancaster, PA 17601; 800-290-5460, ext. 160; *BusinessInsurance@ reprintbuyer.com.*

To subscribe, Call 888-446-1422,or 313-446-0450 outside the U.S.
www.businessinsurance.com

BPA WORLDWIDE
AMERICAN BUSINESS MEDIA The Association of Business Media Companies



STOP
SELLING WHAT YOU HAVE.
START
SELLING WHAT THEY NEED.

IBM helps major insurance companies develop flexible operations so they can offer clients personalized, dynamic services, and bring down processing costs at the same time. Start exceeding expectations at ibm.com/do/insurance STOP TALKING **START DOING**

IBM, the IBM logo and ibm.com are registered trademarks or trademarks of International Business Machines Corporation in the United States and/or other countries. Other company, product and service names may be trademarks or service marks of others. © Copyright IBM Corporation 2008. All rights reserved.

WHATEVER, WHEREVER, WHENEVER THE RISK, THERE'S A STARR SOLUTION.

Whether it's a construction project in San Francisco, a container ship on the North Sea, a petrochemical plant in a developing country, or a company jet soaring over the Pacific coastline, no one can match our ability to expertly assess complex risk. No one offers the depth of experience of our specialized teams of experts, or the level of service we bring through close customer relationships. With more than 55 years as leaders in specialized risk, you can count on the deeply knowledgeable companies of Starr Underwriting Agencies, LLC.

STARR UNDERWRITING AGENCIES, LLC

C.V. STARR & CO / STARR AVIATION / STARR GLOBAL ACCIDENT & HEALTH / STARR MARINE / STARR TECH

cvstarrco.com

Members of the C.V. Starr & Co., Inc. family of companies.

COUNTING CAPTIVES

World's largest captive domiciles ranked by number of licensed captives.

Domicile	2007	2006
Bermuda	958	989
Cayman Islands	765	740
Vermont	567	563
British Virgin Islands	409[1]	400[1]
Guernsey	368	381
Barbados	256	235
Luxembourg	210	208
Turks & Caicos Islands	173[1]	169[2]
Hawaii	163	160
South Carolina	158	146
Isle of Man	155	161
Dublin	131	154[3]
Nevada	115	95
Arizona	108	83[3]
Utah	92	30
District of Columbia	77	70
Singapore	62	60
Switzerland	48	48
New York	44	39
Labuan	31	26[1]
Kentucky	31	10
Montana	30	21
Bahamas	28[1]	26
British Columbia	19	18
Gibraltar	19	14[4]
Netherlands Antilles	15[1]	17
Georgia	14	17[1]
Jersey	13	15
Mauritius	13[1]	13[1]
Delaware	10	6
Colorado	6	8
U.S. Virgin Islands	6	6
Malta	5	5
Panama	4[1]	4[1]
Tennessee	3	3
Hong Kong	2	2
Illinois	2	3
Missouri	2	0
Alabama	2	1
Arkansas	1	1
Guam	1[1]	1[1]
Kansas	1	1
Oklahoma	1	1
South Dakota	1	1
Maine	0	0
Rhode Island	0	0
Puerto Rico	0	0

1 BI estimate. 2 Excludes credit life insurers. 3 Restated. 4 Pure captives only.

ONLINE EXTRA: The complete directory of 2008 captive domiciles can be found online at *www.businessinsurance.com/directories.*

Seasoned owners look to expand range of coverages in captives

Increased benefits business seen as key area for potential growth

By GLORIA GONZALEZ and DAVE LENCKUS

Many owners of long-established captives have grown comfortable with expanding the risk profiles of their captives, pulling third-party risks such as employee benefits into their facilities as well as retaining much more of their own risk.

The evolution of those older captives is something every owner of a new captive or one that has been around only a couple of years should study—and then set aside for a few years, captive owners and consultants agree. Captive owners should first become comfortable with their rate-setting abilities and the capital structure of their facilities before expanding into areas that are advantageous but financially dicey if not managed properly.

Writing benefits business has attracted many owners of captives with a solid record of retaining risk, because writing enough of that third-party business enables a captive owner to deduct the cost of its premiums for its own risk. In addition, that coverage—typically long-term disability and group life insurance—is a nonvolatile risk, experts say.

"We're seeing, certainly, an increase in the interest level and a large increase of captives writing benefits," said Michael Cormier, a managing director in the Captive Solutions Group unit of Marsh Inc. of New York.

For example, Vermont-domiciled captive Three Rivers Insurance Co. has assumed tax-advantageous third-party business by reinsuring benefits—including group life and personal lines coverages—for the domestic and international employees of parent company Pittsburgh-based Alcoa Inc.

TO HEAR MORE ABOUT THE DEVELOPMENT OF CAPTIVES: Listen to podcasts with John Wilson, president of Three Rivers Insurance Co., and Jack McCarthy, president of CRICO/Risk Management Foundation, at *www.businessinsurance.com/captive2008*

See **EVOLUTION** page 13

Captive Solutions

SPOTLIGHT

LARGEST CAPTIVE MANAGERS RANKING PAGE 12

HEALTH CARE CAPTIVES AID SAFETY, CLAIMS PAGE 15

E.U. CAPTIVE OWNERS PLAN FOR RULE CHANGE PAGE 16

TOP DOMICILE PROFILES:

OFFSHORE
- Bermuda p 17
- Cayman Islands p 17
- British Virgin Islands p 17
- Guernsey p 18
- Barbados p 18

ONSHORE
- Vermont p 18
- Hawaii p 18
- South Carolina p 18
- Nevada p 18
- Arizona p 18

NEXT SPOTLIGHT March 17: Reinsurance Opportunities

TOP U.S. CAPTIVE DOMICILES

Ranked by captives in onshore domiciles

Domicile	2007	2006
Vermont	567	563
Hawaii	163	160
South Carolina	158	146
Nevada	115	95
Arizona	108	83
Utah	92	30
District of Columbia	77	70
New York	44	39
Kentucky	31	10
Montana	30	21

Source: BI survey

LARGEST MANAGER IN SINGLE DOMICILE BY CAPTIVES

Ranked by captives managed at year-end 2007

Manager	Captives
Marsh-Captive Solutions (Bermuda)	290
Aon Insurance Managers (Bermuda) Ltd.	258
Aon Insurance Managers (Guernsey) Ltd.	230
Aon Insurance Managers (Vermont) Inc.	206
Marsh-Captive Solutions (Vermont)	196

Source: BI survey

LARGEST PROTECTED CELL MANAGERS

Ranked by cell companies managed

Manager	Cell companies
Aon Global Insurance Managers	46
Marsh-Captive Solutions	37
HSBC Insurance Management	25
JLT Risk Solutions Management	16
Willis Management	14
USA Risk Group	14

Source: BI survey

Largest captive managers worldwide

Ranked by captives managed worldwide in 2007

Rank	Company/Address	Phone/Web site	Parent	Captives 2007	Captives 2006	Domiciles	Captives formed in 2007	Total staff	Principal officer
1	**Aon Global Insurance Managers** St. George Court, Upper Church St., Third Floor, Douglas, IM1 1EE, Isle of Man	44-1624-692-400 *www.aon.com*	Aon Corp.	1,348	1,386	33	61	463	Stephen Cross, CEO
2	**Marsh-Captive Solutions** Victoria Hall, 11 Victoria St., Hamilton, HM 11 Bermuda	441-292-4402 *www.marsh.com*	Marsh & McLennan Cos. Inc.	1,131	1,120	35	47	460	Andrew D. Carr, managing director -Global Captive Solutions practice leader
3	**Willis Management** 1 Lawson Lane, Suite 410, Burlington, Vt. 05401	802-658-9466 *www.williscaptives.com*	Willis Group Holdings Ltd.	286	256	20	28	115	James Girardin, executive vp
4	**USA Risk Group** P.O. Box 306, Montpelier, Vt. 05601	800-872-7475 *www.usarisk.com*	–	239	209	16	27	62	Gary Osborne, president
5	**IAS Global Captive Group Ltd.** 44 Church St., Hamilton, HM 12 Bermuda	441-295-3688 *www.ias.bm*	–	198	194	4	15	98	David Ezekiel, president/ managing director
6	**HSBC Insurance Management** 8 Canada Square, Level 16, London, E14 5HQ England	44-207-991-0273 *www.insurancemanagement.hsbc.com*	HSBC Holdings P.L.C.	184	168	7	31	96	Peter Walker, chief executive
7	**Atlas Insurance Management** Sajicor House, 198 N. Church St., George Town, Grand Cayman, KYI-1107 B.W.I.	345-945-5556 *www.atlascaptives.com*	Atlas Group Ltd.	154	121	5	33	17	Nicholas Leighton, managing director
8	**Beecher Carlson Holdings Inc.** 2002 Summit Blvd., Suite 925, Atlanta, Ga. 30319	404-460-1400 *www.beechercarlson.com*	–	101	101	10	14	31	Tom Golub, CEO
9	**AMS Insurance Management Services Ltd.** Sea Meadow House, P.O. Box 116, Road Town, Tortola, British Virgin Islands	284-494-4078 *www.amsbvi.com*	AMS Group	98	88	2	0	11	Derek Lloyd, director/insurance manager
10	**AIG Insurance Management Services** 175 Water St., New York, N.Y. 10038	212-458-3451 *www.aigcaptives.com*	American International Group Inc.	91	91	11	13	45	Paul Obolensky, president
10	**Quest Management Services Ltd.** F.B. Perry Building, 40 Church St., P.O. Box HM 2062, Hamilton, HM HX Bermuda	441-295-2185 *www.questgroup.bm*	–	91	91	1	4	17	Nicholas S. Dove, president/principal

Source: *BI* survey
Researched by Kevin Edison and Karen Tucker

Visit *www.businessinsurance.com/directories* for more information and to access the full searchable Directory of Captive Managers. *Business Insurance* now offers the option to purchase the entire online directory as an Excel file or as a PDF.

Evolution: Seasoned captive owners look to expand range of coverages

CONTINUED FROM PAGE 11

The captive, which Alcoa formed in 1983 to assume business from an older Bermuda-based captive that eventually closed, originally wrote windstorm insurance for Alcoa facilities located in areas where commercial coverage was expensive or unavailable, said John Wilson, president of Three Rivers in Burlington, Vt. The captive also covers general liability, workers compensation and management liability risks for Alcoa.

Many captive owners, though, have found opportunity for third-party business beyond long-term disability and group life insurance.

For example, New York-based Verizon Communications Inc. can take tax deductions on the premiums it pays its main captive to cover several of the company's property, casualty, crime and patent risks because of the amount of nonbenefits third-party business the facility writes.

The captive, Vermont-domiciled Exchange Indemnity Co., writes non-Verizon risk that Sheila Small, Verizon's assistant treasurer-risk management and insurance, describes as "related third-party business" because of the familiarity and comfort that Verizon has with the risk.

Exchange Indemnity, which opened in 1995, reinsures a portion of the cell phone insurance that Verizon offers customers; it reinsures part of a package of personal lines insurance that the company offers its own employees; and it writes an owner-controlled insurance program that covers the general liability and workers comp risks of construction contractors who work on Verizon's building maintenance and remodeling projects.

Third-party business accounts for around 70% of the captive's premium volume, Ms. Small said.

Boeing Co. of Chicago has funneled significantly more risk into its two captives over the past 10 years as the company has become more comfortable with retaining risk and as the commercial insurance market has moved through various cycles, said Mark Meyerhoff, senior director-risk management and insurance. Boeing formed its Bermuda-domiciled Astro Ltd. captive in 1969 and its Vermont-domiciled Astro II captive in 1984.

Among the risks the captives cover are aviation product liability, insurance deductible buydowns for its commercially placed property and directors and officers liability insurance, workers comp and the terrorism coverage that is backstopped by the federal government. In addition, Astro Ltd. has assumed third-party risk by participating in the Green Island Reinsurance Pool. About 20 employers pool their workers comp risks through the pool, which is managed in Bermuda by Marsh Management Services (Bermuda) Ltd.

Alcoa's Three Rivers captive also is involved in a property/casualty and marine pooling arrangement with Cayman Islands-based United Insurance Co.

Captive owners also are beginning to look at benefits business beyond long-term disability and group life insurance and are considering funding post-retirement medical benefits, said Nancy Gray, the Burlington, Vt.-based executive director-North America of Aon Insurance Managers USA Inc., a subsidiary of Aon Corp.

No captive has received approval to cover those benefits, "but we're working on a couple and expect them to go before the (Department of Labor) in the next couple months," she said.

Under those arrangements, companies that finance retiree health care through a tax-exempt voluntary employees' beneficiary association would pay a premium to the captive to assume some of the retiree health care risk. The advantage for captive owners is that a facility would be able to apply the premium to its capital structure. Any capital contributed to a VEBA is locked into that trust.

'We had a run of six or seven years where we paid a lot less than market rates for reinsurance as a result of taking more of the risk into the captive.'

Jack McCarthy,
CRICO/Risk Management Foundation

Meanwhile, captives that traditionally covered general liability and professional liability risk for health care-related entities are expanding into other types of liability as well as property coverage.

After more than a decade in operation, Harvard Medical Institutions began providing directors and officers liability coverage for the boards of directors and senior executives of its member organizations in the early 1990s. Its captive—Controlled Risk Insurance Co. Ltd.—was the first captive formed by a health care organization in the Cayman Islands when it was created in 1976. It was established to cover the general liability and professional liability risks for the physicians and hospitals in the organizations, said Jack McCarthy, president of the

See **EVOLUTION** next page

Allianz Global Corporate & Specialty

Totally in tune.

Today's risk managers demand a more collaborative relationship. One in which their carrier makes recommendations, rather than issuing orders. At Allianz Global Corporate & Specialty North America, they find the perfect note. A real partnership. *Now that's more rewarding.* **Allianz Global Corporate & Specialty North America. A more rewarding approach to risk.**

Start a more rewarding relationship by calling John White, VP Market Management, 1.312.224.3312 or email at ContactAGCS@aic-allianz.com.

Allianz

Evolution: Longtime captive owners look to add more coverages

CONTINUED FROM PREVIOUS PAGE

CRICO/Risk Management Foundation in Cambridge, Mass.

When coverage through the captive was expanded, "I think it was to get more flexibility of coverage terms, and I suspect there was a hard market for D&O in those days so it made more sense to bring it into the captive," Mr. McCarthy said.

Recent insurance market cycles, though, mainly have affected its reinsurance retentions, Mr. McCarthy said. Several years ago, Harvard Medical decided to retain more of its risks due to significant increases in reinsurance premium pricing despite its good claims experience. It created a "swing plan" deal with Hannover Re that achieves a lower premium for the captive based on its experience. In a "swing plan arrangement," a captive pays a reinsurer a lower premium based on its good loss history, but the captive will pay a higher price if losses surpass a certain threshold.

Below-market rates

"We had a run of six or seven years where we paid a lot less than market rates for reinsurance as a result of taking more of the risk into the captive," Mr. McCarthy said.

Some longtime captive owners, though, have maintained their risk profile because they have found that the commercial insurance market can sufficiently handle the exposures they have not retained. In 1984, Carle Risk Management Co. established a Cayman Islands captive to cover general liability and professional liability for its physicians, hospital, clinics and related health care businesses. The organization has chosen not to add other risks such as auto, workers comp and D&O liability, said Laurence J. Fallon, vp and chief risk/quality officer for the Urbana, Ill.-based organization.

"We've not added any additional risks…because we've been able to get favorable terms in the commercial market," he said. "We've just kind of kept it status quo."

Longtime captive owners advise companies with new or younger captives to proceed cautiously when taking on new risks.

Getting too aggressive with third-party business right away, for example, could lead to early and large financial troubles for the captive if the facility was not created with a capital structure that accurately anticipated losses, Boeing's Mr. Meyerhoff said.

"Most risk managers are not underwriters, so you want to be careful about what you elect to write," because the captive's fortunes ultimately impact the parent company's financial condition, he said.

Writing employee benefits is a good plan, but it can be time consuming, and arranging payroll deductions to cover employees' premiums is not always easy, said Verizon's Ms. Small. Running a captive properly takes time and resources, she said, noting that Verizon commits a full-time employee to its captive in Vermont.

"People say it doesn't take time, it doesn't take a lot of work" to run a captive, Ms. Small said. "I don't think I agree with that."

W I F

WORLD INSURANCE FORUM™

West Meets East at the Gate

The Gate at the Dubai International Financial Centre

The World Insurance Forum March 17-20 2008 in Dubai will be the most important industry gathering of the year…

- An unprecedented gathering of insurance and reinsurance leadership, the scientific community and Governmental leaders
- An innovative program debating the major issues facing the insurance sector: Globalization, Terrorism and Climate Change
- And 51 other reasons to attend... our unprecedented speaker line up

Please visit www.worldinsuranceforum.com for more details on the program, speakers, forum registration and hotel reservations.
Or contact us: info@worldinsuranceforum.com +441 292 6386 fax: +441 292 6990

We hope you'll join us at the 'Gate'

Purchase BI's online directories

Business Insurance's online directories are now available for purchase as Excel files or as PDFs in the directories area of *www.businessinsurance.com.*

The Excel spreadsheets will allow you to sort the information and provide reports and contacts that will be valuable to your sales and marketing staff.

The information that you have depended on for years is now available in a format that allows you to adapt it to your company's needs.

BusinessInsurance.com

Health care organizations tap captives to fund safety programs

By GLORIA GONZALEZ

Captives have become an important vehicle for health care organizations that are seeking ways to improve patient safety and claims experience.

While several health care organizations initially created captives in response to the hardening of the U.S. medical malpractice market, now they are utilizing their captives to fund risk management initiatives.

Irving, Texas-based CHRISTUS Health implemented a loss prevention initiative sponsored by its captive—Emerald Assurance Cayman Ltd.—that provides startup funds for innovative approaches to reduce claims frequency and size and to improve patient and employee safety, said Sheila Hagg-Rickert, Houston-based associate system director of risk management for the organization.

The captive provides funding for risk management initiatives at the organization's 40 facilities, most of which are in Texas and Louisiana, via direct grants, insurance premium discounts or a combination of the two, she said.

The organization has spent $4 million on risk management initiatives since establishing its captive in 2003.

TO HEAR MORE ON CAPTIVE HEALTH CARE COVERAGE: Listen to a podcast with Jack McCarthy, president of CRICO/Risk Management Foundation. at *www.business-insurance.com/captive2008*

"People say they want to fund loss prevention out of their captives, but it doesn't always happen," Ms. Hagg-Rickert said.

Initially, CHRISTUS used its captive to cover professional liability, general liability and self-insured workers compensation risks but expanded to other risks in subsequent years. The organization added property coverage to its captive in 2004 because the hospital system's facilities are in the Gulf of Mexico region, a decision that proved prescient because several facilities were damaged during Hurricane Rita in 2005, she said.

Another health care-related captive, Controlled Risk Insurance Co. Ltd. set up by Harvard Medical Institutions, has produced positive financial returns for the system and has a philosophy of reinvesting the funds with its insured physicians and hospitals, said Jack McCarthy, president of the CRICO/Risk Management Foundation in Cambridge, Mass.

The captive launched a program about four years ago that provided obstetricians a 10% premium discount if they went through team and simulation training. The program resulted in the obstetrical claim rate dropping by 50%, Mr. McCarthy said.

"So we've made an investment in them and then we've actually gotten a return because the care has been safer and there have been fewer claims," he said.

The organization plans to expand the program to ambulatory care and anesthesiology, he said.

In addition to funding these risk management programs, the captive offers $500,000 grants to researchers in the Harvard system for projects and initiatives that focus on patient safety, Mr. McCarthy said.

CRICO was the first health care captive formed in the Cayman Islands in 1976. The captive provides general liability and professional liability coverage for 11,000 doctors and 18 hospitals. Directors and officers liability coverage for the boards of directors and senior executives of its member organizations was added in the early 1990s.

Having a captive enhances the focus on quality and risk management, said Alan Greghorn, chief executive officer for Champaign, Ill.–based Christie Clinic, which formed a Cayman Islands captive when the Illinois medical malpractice market hardened five years ago. The captive insures more than 100 medical professionals and several outpatient facilities.

Once the clinic's health care professionals realized that the organization had formed its own insurance company, they became more engaged in risk management, he said.

Elsewhere, Hallmark Health Indemnity Professional Services Ltd. was formed in October 2005 in response to a "fairly hard professional liability market in Massachusetts," said Charles Whipple, general counsel and chief compliance officer for the Melrose, Mass.-based health care organization. The captive funds general liability and professional liability for two hospitals and about 75 medical professionals, he said.

Hallmark Health built risk management grants into its captive program to allow departments to undertake projects that will result in a reduction of risk, he said. The organization hired a director of risk management who is a nurse and an attorney with experience on both sides of medical malpractice litigation. All employed physicians must participate in risk assessments, he said.

"We're proactive in our risk management," Mr. Whipple said. "If we make investments in risk management, it's going to pay off in the captive program and we've seen that so far."

Advertisement

6 REASONS WHY YOU SHOULD TAKE A HARD LOOK AT CAPTIVES IN A SOFT MARKET – AND ANY OTHER TIME.

Why are captives established and, more importantly, why do they flourish in a soft market? The key reason is risk managers' determination to advantageously position themselves for the inevitable upswing. Coupled of course with the fact that captives are a great decision in any market. But that's just the start. Other reasons include:

Control – many captive participants value control over risk retention, claims handling, risk management and coverage. Thus their insurance program becomes an investment, not just an annual expense or commodity.

Frictional cost – prospective captive owners who take the long view see today's market as an ideal time to cost-effectively establish and commit to a captive for the future.

Expanded coverage – potential access to expanded lines of coverage normally excluded in the standard market.

Stability in an unstable market – eliminates the instability and volatility of market cycles and can provide insureds with greater alternatives and leverage as the market changes.

Long-term reward – a way of controlling losses regardless of the ups and downs of the market.

Balance – captive participants can balance their risk appetite with an appropriate and commensurate price for their excess risk transfer. They can then stabilize their results by sharing with their captive partners.

THE TOP REASONS WHY DISCOVER RE IS THE CAPTIVE PROVIDER FOR YOU IN ANY MARKET.

At Discover Re our sole focus is Alternative Risk Transfer. This singularity of purpose allows us to approach every opportunity differently, customizing programs according to varying risk appetites. This approach can be especially advantageous in a soft market – for all the same reasons you commit to a captive in any market. Reasons that at Discover Re, we are totally committed to.

In addition, we bring a depth of experience that comes from our 17 years in the industry and a focus on writing captives since 1996. Hence our ability to execute programs with precision and insight. And while we offer the inherent flexibility of a small, dynamic organization, we have the financial backing and support of our parent – Travelers.

Finally, our experienced and dedicated captive unit, Specialty Marketing Group, approaches the captive market on an exclusively unbundled basis. Which is why our reputation is one of delivering results via creative problem solving, regardless of the state of the market.

DISCOVER RE

5 Batterson Park | Farmington, CT 06032
www.discover-re.com

A Travelers company

Captives urged to take steps now to comply with Solvency II

Domiciles assess how change in capital requirements may affect different insurance entities owned by E.U.-based parents

By MICHAEL BRADFORD

European captive owners that face big changes in their operations under proposed changes to European capital rules have a chance to smooth the way to the new regulatory environment if they take steps now to determine how it will affect their operations, experts say.

The Solvency II directive, planned for implementation in 2012, calls for regulators to evaluate insurers' financial soundness under an approach that includes risk-based capital adequacy guidelines. The directive, as drafted, applies to European Union-based captives with more than €5 million ($7.4 million) in annual premiums.

While Solvency II's implementation is still some time away, now is the time for owners to analyze how it will affect their captives and, if the new rules call for boosting capital, figure out how they will inject additional funds, experts say.

Not all captives will face higher capital requirements. Those that can demonstrate under Solvency II that less capital would be adequate in relation to their exposure may well end up with lower requirements, said Ming Roest, senior consultant with Towers Perrin in London.

But most captives likely will see their capital requirements increase, experts agree, and they can wait until 2012 to close a funding gap with an infusion of capital or use the next four years to gradually increase it to their best estimate of Solvency II's requirements.

Markus Mende, managing director at Aon Global Risk Consulting in Basel, Switzerland, said captive owners should familiarize themselves with the directive's requirements.

When they understand how it will apply to their operations, they can then begin to estimate additional funding that may be needed and determine how to best adhere to other requirements in the directive, such as those dealing with corporate governance, he said.

The complexity of an analysis of capital needs will vary according to the size of the captive and whether it writes a single line of coverage or many, said Mr. Mende. For those that cover just one, getting a handle on future capital requirements is pretty straightforward, he said.

"Do a dry run," Mr. Mende advised. "Understand where the framework applies and where you stand in terms of capitalization. Should I wait until 2012 and inject it or does my plan allow me to grow capital?"

Owners of captives with premium volume of more than €5 million should have their managers develop a simplified roadmap to assess the potential impact of the directive, said Mr. Roest. They should consider what type of model the insurer will use to determine its capital requirements, as well as potential changes to the captive's risk management and reporting procedures, he said.

"There are a lot of changes and you cannot leave them until 2011," said Mark Spurlock, manager - business consulting, for London-based SMART Business Advisory & Consulting L.L.C. "A lot of these things captives should be doing anyway. And there is no time like the present to start."

Novartis International A.G., a Basel, Switzerland-based pharmaceutical company, is taking the growth approach to raise the additional capital it calculates will be required for its Gibraltar-based captive under Solvency II.

Test run

"We have run a model on our captive and the outcome is that we would have a relatively small gap at the end of the day," said Claude Breutel, head of insurance management at Novartis. "We identified at an early stage the expected capital requirements under Solvency II," he said, and the company decided to make up the shortfall by increasing premiums in the insurer, which writes mostly liability coverages.

"The worst-case scenario would have been to switch to Solvency II and then have to add millions in capital," said Mr. Breutel. "This approach gives us four years to slowly build up capital."

Solvency II is expected to cause higher administrative costs for captives, experts say. Operating costs will rise around 10%, said Mr. Mende. Part of the increase will come from increased expenses charged by auditors and appointed actuaries to ensure captives are compliant, he said.

Additional expenses will depend partly on how local regulators implement the regulations, Mr. Breutel said. Novartis does not expect its operational or administrative costs in Gibraltar to dramatically increase, he said.

Enhanced risk management requirements and additional financial analyses required under Solvency II will generate more work for captive service providers and that will increase expenses, said Jerome Lecoq, senior manager with Deloitte S.A. in Luxembourg.

The new regulations—and the additional expenses they bring—have some non-E.U. domiciles touting their attractiveness as an alternative to operating under Solvency II.

"My take is that Solvency II could provide some significant opportunities for offshore domiciles," said Derek Patience, chairman of the Manx Insurance Managers Assn. in Douglas, Isle of Man. "For those with a reinsurance vehicle in the European Union, they may find the increased level of regulation to be more prohibitive."

E.U. captive parents are likely to find domiciles such as Isle of Man less expensive places to operate after the implementation of Solvency II, said Mr. Patience. "That is something we use as an advantage of an offshore domicile. Perhaps the gap will grow with the increased burden of compliance with Solvency II," he said of the cost of maintaining an E.U. presence versus locating a captive offshore.

The E.U.'s Solvency II directive, which may require some captives to increase their capital levels, is expected to be implemented in 2012.

Diane Colton, director of insurance at the Guernsey Financial Services Commission, said in an e-mail that potential captive owners will weigh the requirements under Solvency II closely when deciding where to locate an insurer.

Solvency II may not address the specific nature and risks of captives as closely as it will for conventional insurers, she noted. "We may take advantage of the Solvency II requirements," Ms. Colton said, "by promoting our specialist knowledge and regulatory approach to captives."

Tightening regulations

Captives may not be able to entirely escape tightening regulatory demands by moving to a non-E.U. domicile, according to Mr. Mende. If such captives apply to write coverage for risks within the European Union, local regulators will be required to make sure that the regulatory system of their home domiciles are as stringent as Solvency II, he said.

"They will be asking how you are regulated," said Mr. Mende. "If it is not comparable, you might have a problem getting a license."

"I would guess that we are not going to see the redomiciling of captives," said Mr. Spurlock. "We have already seen a leveling off of captives established in the European Union. If you see a tailing off, I think it will be questionable whether Solvency II was the main driver."

The directive will give the European Union the most modern and advanced solvency framework in the world, comparable to standards established by Basel II for banks, Mr. Lecoq said. That creates a competitive advantage, he noted, with greater emphasis on risk management, regulatory issues and transparency.

inspiration \ĭn'spə-rā'shən\

n: a medium that prompts action or invention

Find your inspiration at **RIMS 2008 Annual Conference & Exhibition in San Diego on April 27-May 1** and take home the tools to **transform your risk program into a masterpiece**. Join some 10,000 risk professionals at this stimulating annual event that is jam-packed with 130+ educational sessions, "hot topic" sessions, special events and some 400 speakers that are sure to spark innovation in your risk program. What's more, the Exhibit Hall has everything you need to position your company for long-term security and success. **RIMS 2008—it's where risk professionals become inspired**.

Don't be left with a blank canvas. Online registration closes March 28th!

San Diego
April 27 - May 1

CHANGE THE WAY YOU TALK ABOUT RISK

www.RIMS.org/RIMS2008

Most offshore domiciles see moderate growth in 2007

1 BERMUDA

Captive count: 958
New captives in 2007: 32
Captives closed in 2007: 63

As the longtime captive leader, Bermuda remains the world's largest captive domicile. In 2007, however, Bermuda saw a net decrease in captives of 31 as competition increased from the commercial market and other domiciles.

In addition, over the past several months, the Bermuda Monetary Authority has more actively sought to eliminate inactive captives from its captive count, a spokeswoman for the regulator said.

The domicile is home to captives from numerous jurisdictions, with companies based in the United States making up the largest portion of captive parents. Significant numbers of captives with European parents also are licensed in the domicile. Bermuda's captive rolls include single-parent captives, association captives, group captives and rent-a-captives.

Unlike most other domiciles, Bermuda also is home to a sophisticated insurance and reinsurance market, which captive managers on the island cite as a key attraction that allows risk managers to visit several other insurance providers when they visit Bermuda for captive business.

The domicile's longevity as a captive center means it has a well-established network of service providers on the island, including more than three dozen captive managers.

Increased competition from both new and established U.S. domiciles is cited by observers as a drag on captive growth in Bermuda, which also is viewed as a more costly location for captives. In addition, softening in the commercial market has curbed captive formations in several domiciles, they say.

—By Gavin Souter

2 CAYMAN ISLANDS

Captive count: 765
New captives in 2007: 46
Captives closed in 2007: 21

The Cayman Islands continues to be the domicile of choice for health care organizations with 36.4% of all Cayman Islands captives covering health cares risks, namely medical malpractice/professional liability. As health care captives mature, though, owners are looking at using their captives to fund risks other than health care, such as property, directors and officers liability risks and errors and omissions deductibles.

Cayman Islands is also a leading domicile for the formation of special purpose vehicles issuing catastrophe bonds. The domicile licensed 13 in 2007, with more business expected in 2008, according to Dean Wickens, deputy head of insurance at the Cayman Islands Monetary Authority.

About 90% of Cayman Islands captives originate in North America and the domicile has seen a slowdown in captive growth as the U.S. commercial market has softened.

The domicile continues to search for a permanent replacement for Morag Nicol, Cayman Islands' insurance regulator who left her post for personal reasons last year. Mary Lou Gallegos, who retired in 2006, returned on an interim basis. "Even with the turnover there, dealing with the regulator has still been very, very easy," said Charles Whipple, general counsel and chief compliance officer for Hallmark Health in Melrose, Mass., which started a captive in 2005.

An update to the domicile's insurance law is expected this year to ensure it continues to reflect best practices and in anticipation of a visit from the International Monetary Fund, which will assess the domicile's insurance regulatory practices against the 28 Insurance Core Principles established by the International Assn. of Insurance Supervisors, Mr. Wickens said.

ONLINE EXTRA: See charts of the world's top captive managers online at *www.businessinsurance.com/Captive2008.*

3 BRITISH VIRGIN ISLANDS

Captive count: 409

The British Virgin Islands attracts a diverse range of corporations from real estate developers to fast-food restaurant chains that cover risks such as medical malpractice and other liability risks. About 90% of its captives are owned by U.S.-based parents. The domicile had 22 insurance managers at year-end 2006, according to the British Virgin Islands Financial Services Commission.

Continued on next page

OLD REPUBLIC INSURANCE COMPANY FINANCIAL RATINGS
A.M. Best A+X (Superior), Moody's Aa2 (Excellent), Fitch AA (Excellent), Standard & Poor's AA (Excellent)

accessibility. At Old Republic Risk Management, we understand that excellent service is one of the most vital resources you need from your insurance carrier. Our organizational structure and outstanding underwriting team, give you direct access to the decision makers responsible for your risk management program. We're prepared to handle the sudden, urgent issues that arise in any insured's program. Our model is built to expect the unexpected.

We know this is important to you.

OLD REPUBLIC RISK MANAGEMENT, INC.

www.orrm.com

Business Insurance
www.BusinessInsurance.com

Editorial Reprint Fact Sheet

The YGS Group, formerly RMS Reprint Management Services, is the official and exclusive service provider for reprints of editorial content published in print and online by *Business Insurance* and *BI*'s *Industry Focus.*

All YGS products comply with U.S. copyright laws.

For information, to obtain a quote, or to place an order contact:
The YGS Group
phone: 800-290-5460 ext. 160
e-mail: *BusinessInsurance@ReprintBuyer.com*

CONTINUED FROM PREVIOUS PAGE

The soft market in the United States and uncertainty about a long-anticipated update to the domicile's insurance law limited captive formations last year, managers say.

While the updated insurance law passed last month, implementation is on hold indefinitely until accompanying regulations are developed and released. The legislation is designed to enhance the domicile's ability to deal with emerging issues such as bonds, derivatives and reinsurance swaps, but captive managers say it is impossible to determine the revised legislation's affect on captive formations until the clarifying regulations are released.

The domicile has experienced stable leadership at the Financial Services Commission with Michael Oliver heading the division as director of insurance for more than four years.

The commission, though, is seeking to fill a vacancy at its insurance division, according to a notice posted on its Web site. Mr. Oliver referred inquiries to a spokeswoman who did not respond to repeated requests for comment.

—By Gloria Gonzalez

4 GUERNSEY
Captive count: 368.

The island has long been favored by parent companies in the United Kingdom and mainland Europe as a domicile in which to form captives. In recent years, Guernsey has begun to attract captives from Bermuda, which was the domicile of choice for many U.K. companies before Guernsey developed its infrastructure and management experience. Now it is recognized as a top-flight domicile with convenient access to the London insurance and reinsurance market.

Guernsey pioneered the protected cell company concept and now is home to 69 such companies that house 257 cells. One incorporated cell company operates from Guernsey with seven cells.

The domicile touts its infrastructure of services as a main attraction for captives shopping for a home. Apart from services provided by large-broker management companies and independent firms, Guernsey also offers a variety of legal, accounting and actuarial services, its promoters say.

The domicile continues to attract formations despite a soft traditional insurance market that generally dampens interest in forming new captives.

Guernsey recorded a couple of notable formations in 2007. A captive created by the Gold Coast City Council in Australia covers local government risks, according to the Guernsey Financial Services Commission. In addition, White Rock Insurance (Guernsey) ICC Ltd. set up its first cells in an incorporated cell company.

Guernsey amended its insurance law earlier this year to allow regulators to take a closer look at insurers, brokers and captive managers applying for licenses in the domicile. All conduct and activities of the applicants can now be taken into account, whereas regulators previously were allowed to consider only conduct related to business or financial matters when evaluating potential license holders.

The amendments also removed a requirement that the Guernsey Financial Services Commission consider the economic benefit an insurance-related business would bring to the island as part of the licensing application process.

—By Michael Bradford

5 BARBADOS
Captive count: 256

Barbados has long been a captive center for organizations based in Canada, due in part to the favorable tax treatment for captives under tax agreements between the two countries. While renegotiation of the Canada-Barbados tax treaty remains under consideration, the domicile continues to attract captives mainly with Canadian parents. Some of those captives are established as "qualifying insurance companies," which are permitted to write local risks in addition to international risks, as a hedge against any changes in the tax treaty.

While the domicile has been long-favored by Canadian companies, it also attracts companies from other jurisdictions, including the United States, said Kate Westover, vp at Innovative Captive Strategies Inc. in Colchester, Vt. Unlike many other domiciles, Barbados does not require captive owners to hold annual board meetings on the island, she said.

The domicile had a net gain of 21 captives last year, and while the figure for new formations is "not overwhelming," existing captives in Barbados are covering a wider variety of risks, said Ricardo Knight, president of Towner Management Group and head of the Barbados International Business Assn. In particular, more captives are covering employee benefits risks, he said.

Captive entities permitted by Barbados include single parent captives and segregated cell companies.

—By Gavin Souter

Onshore domiciles continue to see growth in captives

1 VERMONT
Captive count: 567
New captives in 2007: 32
Captives closed in 2007: 28

Vermont is one of the nation's smallest states, but it towers over its U.S. competitors as a captive domicile.

Four years after its captive law passed, Vermont became the largest domestic captive domicile in 1985 and has held that title since then. It also is the world's third-largest domicile.

Part of the reason captive formations have boomed in Vermont is timing, captive managers say. Its first growth spurt occurred during the 1980s liability insurance crisis when it was the only domicile in the continental United States to have an attractive captive law. It has continued to grow more recently despite increased competition.

The experience and ability of its regulators are cited as other reasons for its growth.

"They try to understand your business needs. They are straightforward, while also being thoughtful and highly accessible," said Pamela Davis, president and chief executive officer in Santa Cruz, Calif., of Alliance of Non-Profits for Insurance Risk Retention Group, which is licensed in Vermont.

Vermont has kept its law up to date, making changes such as lowering premium tax rates and permitting branch captives, which enables employers with offshore captives to keep those while using their branch captives to fund employee benefit programs.

Its business mix includes captives for large and smaller companies. Just over 70% of its 567 licensees are traditional single-parent captives. It also has 82 risk retention groups; a dozen so-called special-purpose captives, which are entities that life insurers set up to meet reserving requirements; and 18 trade associations that sponsor captives in Vermont.

—By Jerry Geisel

2 HAWAII
Captive count: 163
New captives in 2007: 10
Captives closed in 2007: 7

Hawaii captive owners overwhelmingly come from the western United States, but the domicile also attracts some sponsors from the East Coast and the central United States, and it is home to 15 captives owned by Japanese companies or their U.S. subsidiaries.

While Hawaii attracts captive owners from a wide range of industries, its largest share comes from the real estate-related sector, including real estate investment trusts and homebuilders.

Hawaii's captive count also includes many health related-organizations, such as doctor groups, community hospitals, medical schools, nursing homes and clinics that have formed captives in Hawaii to cover professional liability and other risks.

The state's captive industry began in 1986 when its captive law was approved. Its longevity has helped the domicile's regulators gain recognition for predictability and consistency in applying Hawaii's captive statutes and they are known for doing so with an "aloha attitude."

The Captive Insurance Administration Branch of the Hawaii Insurance Division includes eight surveillance and examination specialists overseen by Deputy Insurance Commissioner Craig Watanabe.

Hawaiian captive statutes allow the formation of various types of captives, including single parent captives, risk retention groups, leased facilities, reinsurance units and association captives. Among its captives, the two largest segments are single parent captives, which represent 86% of Hawaii's captives, and risk retention groups at 9%.

They can be structured as stock-owned companies, nonprofits, mutuals, reciprocals or limited liability companies.

—By Roberto Ceniceros

3 SOUTH CAROLINA
Captive count: 158
New captives in 2007: 27
Captives closed in 2007: 12

When South Carolina enacted captive legislation in 2000, it filled a void in the captive marketplace by creating a domicile in the Southeast with an attractive captive statute.

Since then, South Carolina has become the third-largest U.S. captive domicile.

Geography has helped fuel captive growth in South Carolina, but captive managers say the more important point is the experience and pro-captive attitude of its regulators.

"They are very approachable and readily available. They are always willing to try to find a solution" when considering an application, said Robert Johnson, a managing director with Marsh Management Services Inc. in Charleston.

Regulators understand the "corporate and risk management perspective," added John Weizel, managing director of captive manager Taft Cos. in Columbia and president of the South Carolina Captive Insurance Assn.

Single-parent captive sponsors include corporate giants such as Atlanta-based Coca-Cola Co. and Jacksonville, Fla.-based CSX Corp. But South Carolina's captive roster also includes 46 risk retention groups, second only to Vermont.

South Carolina has nearly two dozen special-purpose financial captives, more than any other state. Typically, life insurers establish SPFCs to meet reserving requirements for various life insurance policies. South Carolina passed legislation in 2004—the first state to do so—to permit SPFCs, which have average premium volumes that dwarf other captives.

—By Jerry Geisel

4 NEVADA
Captive count: 115
New captives in 2007: 20
Captives closed in 2007: 0

Captive insurance formations in Nevada this year appear to be on pace with regulators' informal goal after a slight decline in 2007, said Gary Cooper, deputy commissioner of the Nevada Insurance Division's captive insurance program.

Captive managers agree that the domicile continues to be attractive to captive insurance owners in Western states—particularly homebuilders that use their facilities to write warranty coverage as well as health care professionals who use them for general liability and professional liability coverage.

With 20 new licensed captives last year, the division did not reach its unofficial goal of licensing two captives per month, or 24 for the year. Mr. Cooper noted, though, that the division ended 2007 strongly, licensing 14 captives during the second half.

Mr. Cooper projected that six new captives would be licensed by the end of March. One was licensed in January, and eight were "in the pipeline" in February.

Of Nevada's licensed captives, 108 were active during 2007, though one inactive facility is the result of two association risk retention groups for long-term care facilities merging. Among active captives, the two largest segments were single-parent facilities, with 58 licensed, and risk retention groups, with 31 licensed.

Among changes during 2007, Mr. Cooper last June replaced Cliff King, who had been the division's chief administrator for the captive program. "I felt it was seamless," said Mr. Cooper, who had been chief of the Insurance Division's self-insured workers compensation section.

No major captive legislation was passed in 2007 and the legislature is not in session this year. No captive legislation currently is planned for 2009, Mr. Cooper said.

—By Dave Lenckus

5 ARIZONA
Captive count: 108
New captives in 2007: 25
Captives closed in 2007: 2

A little more than five years after it enacted its captive legislation, Arizona's captive count passed the 100 mark.

That growth is due in part to its proximity to captive owners based in Western states, captive managers say. In addition, Arizona has no premium tax, so captive owners must pay only a $5,500 annual license renewal fee.

Among active captives, 51 are single-parent facilities. The next-largest

Continued on page 20

ONLINE EXTRA: Charts of the top captive managers in the leading domiciles are available online at *www.businessinsurance.com/Captive2008.*

Things to do before RIMS 2008:

Call Business Insurance to place an ad and put our brand in front of 116,000 clients and prospects before, during and after the conference.

Get map of San Diego

Make hotel reservations

Don't forget business cards!

* Readership includes pass-along

FOUR ISSUES OF THE MOST NOTABLE RIMS COVERAGE

April 14 - **RIMS San Diego Conference Preview**
Ad close: April 2

April 28 - **Risk Manager of the Year®**
Ad close: April 16
Bonus Distribution at RIMS

May 5 - **RIMS Post-Conference - News**
Ad close: April 23

May 12 - **RIMS Post-Conference - Trends**
Ad close: April 30

If you need to reach the risk management community, advertising in *Business Insurance's* RIMS 2008 Issue Series should be at the top of your to-do list.

Call Bob Raidt, Advertising Director at 212-210-0133 or e-mail braidt@BusinessInsurance.com to reserve your space in the risk management news and information leader today.

Business Insurance

www.BusinessInsurance.com

TARGETED NEWS. TARGETED AUDIENCE. TARGETED REACH.

New York: 212-210-0133 | **Chicago:** 312-649-5275 | **Boston:** 617-292-4856 | **Los Angeles:** 323-370-2405

CONTINUED FROM PAGE 18

category is risk retention groups with 23. Among the 25 new captives last year, 17 were single-parent facilities and four were RRGs.

Two industries account for more than half of the captives and risk retention groups licensed in Arizona: health care-related risks—including hospitals, long-term care facilities and physicians—at 34%, and real estate and construction risks at 22%.

The domicile is searching for a new top captive administrator since Rod Morris resigned in early February to return to the U.S. Overseas Private Investment Corp. Despite that change, Insurance Director Christina Urias says the captive application and approval process will continue unabated.

Last year the state enacted several changes to its captive law.

For example, Arizona now allows branch captives. Branch captives in the state may cover only employee benefits, but that gives captive owners with offshore facilities, which are barred from writing U.S. benefits risks, another domestic option.

Other changes included allowing group captives to cover controlled unaffiliated business and reducing the minimum capital requirement for a protected cell captive by 50% to $500,000.

The only captive insurance legislation this year would correct an oversight in last year's legislation by amending the state's corporation code to allow pure captives to form as limited liability corporations. The measure is expected to pass easily.

—By Dave Lenckus

Business Insurance

SINGLE-COPY SALES

To order any current or back issue of Business Insurance by phone, or to subscribe, call our circulation customer service department at: **1-888-446-1422** (outside the U.S. call 313-446-1662).

CHANGE OF ADDRESS?

If you have moved recently and would like to change your subscription address, or if you would like to report a delivery problem, please call us at 1-888-446-1422 toll-free or e-mail us at *subs@crain.com*

PROFESSIONAL MARKETPLACE

To place your ad, contact **Tina Vasilakis** at (312) 649-5340 / fax: (312) 649-7937 / E-mail: tvasilakis@BusinessInsurance.com

Business Insurance, Classified Department, 360 N. Michigan Ave., Chicago, IL 60601-3806. Call for details on blind box and internet advertising

HELP WANTED | HELP WANTED | HELP WANTED | HELP WANTED

Finance Specialist in Health Insurance for International Organization

The Pan American Health Organization (PAHO) is an international public health agency with over 100 years of experience working to improve health and living standards of the people of the Americas. PAHO is currently searching for a highly qualified Finance Specialist who will be responsible for the management of the Staff Health Insurance (SHI) operations and ensure the proper implementation of the PAHO/WHO Health Insurance plan in the Washington, D.C. office and the offices throughout Latin America and the Caribbean. The successful candidates will have:

- A university degree in business administration, finance, accounting, insurance, public health administration or a field related to health insurance and accounting courses including intermediate-level accounting courses.
- Seven years of national and international experience in analysis and finance with emphasis in insurance administration in the private or public sector, including at least two years of supervisory experience
- Very good knowledge of Spanish or English with a working knowledge of the other language.

PAHO/WHO offers an internationally competitive compensation package, including six weeks' paid vacation, excellent pension plan and health insurance. For detailed vacancy notice and application information, please visit our website at: **www.paho.org**, job opportunities, Vacancy No. PAHO/08/FT69 by 31 March 2008.

RMA
RICHARD MEYERS & ASSOCIATES, INC

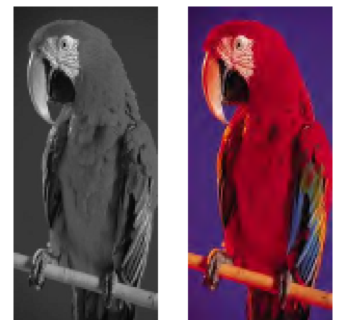
(888) RMA-Search
INFO@RMAINC.COM
WWW.RMAINC.COM

Building on Our Trusted Reputation in Executive Recruitment

TALENT ACQUISITION
- *Executive Search*
- *On-Boarding*
- *Contract Labor*
- *Salary & Comp Surveys*

TALENT MANAGEMENT
- *Executive Coaching*
- *Leadership Development*
- *Culture Assessment*
- *CompetencyModels*

Risk · Brokerage · Sales · Safety · Claims · Underwriting
Loss Control · RMIS/HRIS · Finance · Human Resources



Some things just work better in color.

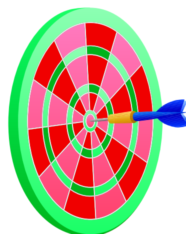
Like your PROFESSIONAL MARKETPLACE ad in *Business Insurance.* Contact Tina Vasilakis at 312-649-5340.

Have a job opening?
Call 312-649-5340 to place your ad in *BI's* PROFESSIONAL MARKETPLACE.

BUSINESS RESOURCES

SPECIALTY RISKS

Guards • Investigators • Alarms
WC • GL/Professional • Umbrella
1-800-665-7304
www.brownyardprograms.com



BULLS EYE!
Hit your target audience in *BI's*
BUSINESS RESOURCES
Call 312-649-5340 for details.

Mark your Calendar...

Reinsurance is complicated.
***Business Insurance* helps you figure it out.**

March 17
Reinsurance Opportunities:
Bonus distribution at World Insurance Forum
Ad Closing March 11.

Contact Tina Vasilakis at 312-649-5340 For Details

Searching for the missing link?

Use *BI's* Industry Links at www.BusinessInsurance.com/Links to find web site listings of:

Agents/Brokers, Associations, Claims Services, Educational, Employee Benefits, Employment Services, Environmental, Insurers, Legal/Actuarial, Miscellaneous, Reinsurance, Risk ManagementServices, Services for Insurers intermediaries, Software/Technology, Workers Compensation.

For details on listing your company, contact Tina at 312-649-5340 or tvasilakis@BusinessInsurance.com.

International NEWS

Italy changes tort law to allow new mass suits

Law not expected to have huge liability impact

By MICHAEL BRADFORD

ROME—A new law in Italy that broadens plaintiffs' access to the courts for class action lawsuits is a toned-down version of the legislation consumer advocates had supported—and not the liability bombshell risk managers and insurers had feared.

The legislation was passed in January and opens the way for more types of plaintiff classes to file claims in Italy.

NEWSCOM

Italy's Parliament passed a law that broadens plaintiffs' access to the courts for class action lawsuits.

Under previous law, 16 consumer organizations recognized by the state were the only groups allowed to file class action litigation. Now, classes can be recognized as long as their claims have some tie to consumer interests.

"The proposal that was in the Senate was a real class action law. What came out of Parliament is quite different," said Paolo Landi, secretary general of Rome-based Associazione Difesa Consumatori e Ambiente, the 130,000-member consumer group better known as Adiconsum. "I think it will change very little. It is not what we wanted," he said.

While the impact of the new legislation is still being studied, it does not appear to broaden liability as much as risk managers and insurers had feared, said Paolo Rubini, vice chairman of the Associazione Nazionale dei Risk Manager e Responsabili Assicurazioni Aziendali, Italy's risk management association. "The impact on liability insurance will not be that high, probably," he said.

Even so, employers could face an increase in lawsuits under the law. One group already has plans to sue Italian banks after the law becomes effective July 1.

Consumer group Associazone Difesa Utenti Servizi Bancari Finanziari Postali E Assicurativi—known as Adusbef—plans to file a class action complaint under the new legislation after it becomes effective this summer. The group wants Italy's banks to change the way they charge interest on loans.

Mr. Landi said the new law makes the process of filing a suit so rigorous that it could take more than a year for claims to be heard.

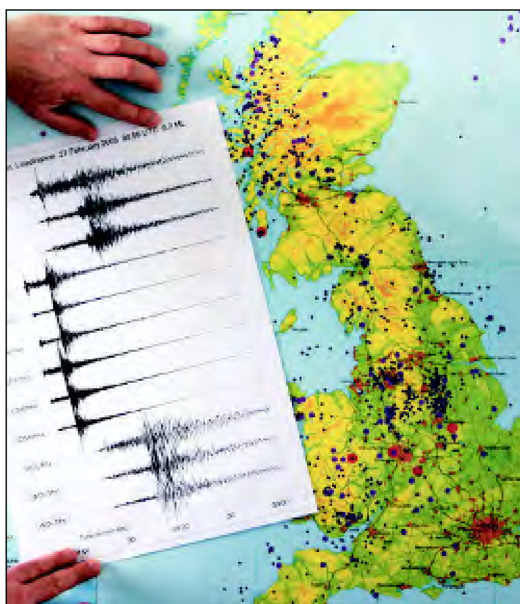
Class members will have to be identified before a judge determines whether a claim can proceed, Mr. Landi explained. If a claim is deemed admissible, the defendant can appeal that decision, a process that may take months to resolve, he said.

"It can be a long, long procedure," said Mr. Landi. He said there is a chance that the new law may prompt companies to settle cases before the long judicial process begins. "That is what I hope," he said.

Mr. Rubini said the intent behind the law is to allow class actions only when there are very strong reasons of public interest.

Insurers, like risk managers, are studying the law's potential impact and are trying to put together projections on how the liability insurance market should react, said Mr. Rubini.

U.K. quake claims could hit $60 million



REUTERS

A scientist holds a seismogram readout of the quake that hit the United Kingdom last week.

MARKET RASEN, England—Insured losses from the earthquake that struck the United Kingdom last Tuesday could reach £30 million ($59.4 million), according to initial estimates.

Catastrophe modeling company Risk Management Solutions Inc. said last week that insured losses from the quake would likely fall in the £15 million to £30 million ($29.7 million to $59.4 million) range. Boston-based AIR Worldwide Corp., meanwhile, said losses could run into tens of millions of pounds.

Earthquake insurance is included as standard in most commercial and homeowners policies in the United Kingdom, so much of the damage caused by the quake will be covered by insurance, Newark, Calif.-based RMS said.

The British Geological Survey based in Nottingham, England, issued a preliminary estimate that put the earthquake's strength at a magnitude of 5.2.

The epicenter of the earthquake was near Market Rasen, in Lincolnshire, England—a largely rural area. The quake was felt widely across England and Wales.

—By Sarah Veysey

Cat bond deals increase in '07: Study

By JUDY GREENWALD

NEW YORK—Catastrophe bonds have become an integral part of catastrophe risk management, with 2007 marking the third consecutive year that cat bond transactions set a record in terms of size and the number issued, a report shows.

"Cat bonds have moved from the exotic to the expected, from niche to mainstream," says the report, which was issued last week by the investment banking arm of New York-based reinsurance intermediary Guy Carpenter & Co. L.L.C.

A total of $7.0 billion in publicly disclosed transactions were issued last year, up 49% from $4.7 billion in 2006 and a 251% increase from $2.0 billion in 2005, according to the report.

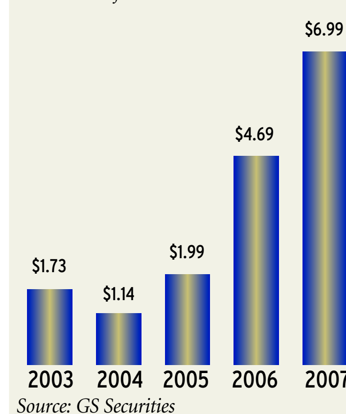
There were 27 transactions completed in 2007, compared with 20 in 2006. Total outstanding cat bond risk capital stood at $13.8 billion at year-end 2007, up 63% from $8.5 billion in the prior year and nearly triple the $4.9 billion outstanding at year-end 2005, according to the report.

"The record market activity of 2007 demonstrates a fundamental shift in the perception of the capital markets as a risk transfer solution," the report states.

"During the year, the paradigm shifted away from the idea that sponsors were seeking capital markets protection as a defensive tactical measure" to the view that "the capital markets represent a valuable source of significant amounts of high-quality risk transfer capacity."

ANNUAL RISK CAPITAL ISSUANCE

In billions of dollars



"In fact, several large sponsors that were unwilling to purchase expensive protection during the hard market of 2006 turned to cat bonds during 2007, even with additional traditional capacity available," says the report.

Christopher McGhee, GS Securities managing director, said there is now a general acceptance of these tools by the largest insurers and reinsurers. While these companies will continue to use traditional reinsurance, they are also likely to enter into cat bond deals, which are multiyear, he said.

"They want to be able to use both marketplaces," and will look carefully every year at each to decide the best approach.

The report notes also that while last year U.S. earthquake and hurricane continued to dominate transactions both in terms of peril and geography, issuance across all perils increased dramatically, including European windstorm, Japanese earthquake and Japanese typhoon perils. That trend signals the capital markets' "true arrival" as a "source for consistent access to capacity," the report states.

Once the technology to address these risks has been developed, there is a "natural impetus" on the part of investors to diversify the risk among the different types of potential catastrophes and to match up with ceding companies seeking to transfer risk, Mr. McGhee explained.

The report also provides data on cat bond issuance by trigger type, including indemnity cat bonds, which are triggered by the particular insurer's losses, and nonindemnity bonds, such as those triggered by parametric factors including earthquake magnitude.

Copies of the report, "The Catastrophe Bond Market at Year-End 2007: The Market Goes Mainstream," are available for download at *www.guycarp.com*.

Complete coverage.

The only newspaper dedicated to corporate risk managers, insurers, reinsurers and brokers in Europe.

Subscribe today
visit www.BIEurope.com/subscribe

In Europe we have it covered

Business Insurance EUROPE™

Products & Services

AI Risk Specialists offers excess auto liability

NEW YORK—AI Risk Specialists Insurance Inc., a wholly owned brokerage subsidiary of American International Group Inc., has introduced LexExpress, excess auto liability insurance developed to address the needs of small to midsize fleets in the trucking industry.

LexExpress is designed to provide limits of $1 million excess of a $1 million primary placement. In addition to standard excess auto liability coverage, the policy also provides pollution and accident and health coverage. AI Risk can address the exposures of long- and short-haul truckers, flatbed haulers, dry bulk garbage, and moving and storage.

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

LexExpress can be accessed via AI Risk ProgramConnect at *www.programconnect.com*, allowing the product to be quickly quoted and bound online.

For more information, contact Sandi McCabe at 518-220-7336 or *sandi.mccabe@aig.com*.

AAIS revises, expands fire protection classification

WHEATON, Ill.—A national insurance advisory organization is updating the classifications it provides to insurers in assigning fire protection rating factors for buildings.

The American Assn. of Insurance Services develops policy forms and rating information used by more than 600 property/casualty insurers throughout the United States.

Since its introduction in the late 1970s, the AAIS method has allowed insurers to place a risk in one of three fire protection classifications:

- Protected, which refers to buildings located within 1,000 feet of a fire hydrant and within five road miles of a responding fire department.
- Partially protected, which refers to buildings located more than 1,000 feet from a fire hydrant but still within five road miles of a responding fire department.
- Unprotected, which refers to buildings that are not classified as protected or partially protected.

With the revision now being filed nationwide under the AAIS Commercial Properties Program, the "protected" classification is being replaced with five separate tiers, such as Protected 1 and Protected 2 that correspond to the distance of a risk from a responding fire department.

The commercial properties filings have a proposed effective date of Sept. 1. Revised fire protection classifications will be filed over coming months under other AAIS insurance line programs that provide property coverage.

For information on AAIS commercial lines programs, contact Rick Maka, director of marketing, at *rick@aaisonline.com* or by calling 800-564-2247.

AIG Executive Liability enhances counsel cover

NEW YORK—AIG Executive Liability has enhanced its Corporate Counsel Premier insurance policy.

Partially because of the Sarbanes-Oxley Act, corporate counsels are at greater risk of being named in securities litigation and unprecedented liability exposure from a variety of claimants. These liabilities may result from legal services provided for their employers, as well as pro bono and moonlighting services. Because the role of corporate counsel continues to change, the CCP policy has been enhanced to protect the personal assets of corporate counsels and their staff.

CCP is available in all 50 states, with policy limits of up to $25 million. It provides legal liability protection to corporate counsels and legal staff in a manner that complements many directors and officers liability policies.

Additionally, CCP has a number of enhancements as part of the standard policy, including: incorporation of D&O terms and conditions to reduce the risk of gaps in coverage, particularly for securities claims; nonrescindable coverage for corporate counsels and their staff; an expanded definition of claim; and a reduced insured vs. insured exclusion.

For more information, go to *www.aigexecutiveliability.com*.

Zurich increases capacity for political risk coverage

WASHINGTON—Zurich Financial Services Group has increased its political risk insurance capacity to $125 million per risk, with a maximum policy term of 15 years.

This increase will enable Zurich to respond to increasing demand for coverage by multinational companies, project developers, contractors, exporters and financial institutions that confront political risks often found in emerging markets.

Zurich's coverage includes expropriation, political violence and currency inconvertibility due to political instability.

In addition to political risk insurance, Zurich offers trade credit insurance that protects financial institutions, exporters and commodity traders against payment defaults by companies located in emerging markets. Zurich policies offer up capacity up to $35 million per transaction, and policy terms between one and seven years.

For more information, contact Daniel Riordan, executive vp and managing director for Zurich's emerging markets unit, at 202-585-3100 or at visit *www.zurichna.com*.

TO SUBMIT ITEMS

Please send announcements to: Joe Walker, *Business Insurance*, 360 N. Michigan Ave., Chicago, Ill. 60601-3806; *jwalker@businessinsurance.com*.

Security: Small firms face data theft risks

CONTINUED FROM PAGE 4

establish and maintain a comprehensive security program.

"Companies need to create a culture of data security, they need to understand the flow of information running through their company, and they need to have an effective plan to safeguard it," Mr. Gordon said.

Businesses should take key steps to safeguard their customers' personal information, according to the FTC.

Effective data security starts with assessing what information the company has and identifying who has access to it, he said. This includes taking inventory of all computers, laptops and other equipment to learn where the company stores sensitive data.

In addition, companies should keep only information they need for their business. "If you don't have a legitimate business need for storing personal information, get rid of it," Mr. Gordon said. "Too often companies are retaining this information in their systems, leaving it vulnerable to hackers."

Companies also need to develop a way to "lock up" and protect the information that they keep, he said. Effective programs deal with four key elements: physical security, electronic security, employee training and the security practices of contractors and service providers, Mr. Gordon said.

Businesses also need to develop a system for proper disposal of sensitive information. The FTC recommends companies dispose of material by burning, shredding or pulverizing the documents. Employees who work from home should comply with the same policies, he said.

Finally, companies need to prepare in advance by creating a plan for responding to security incidents.

Claims event draws 670

NEW YORK—About 670 people attended the 2008 Eastern Claims Conference in New York Feb 24-26.

The event featured discussions on health care claims management, life insurance, accidental death and dismemberment, health insurance fraud and current legislation.

Next year's event is scheduled for March 1-3 in New York. For more information go to *www.easternclaimsconference.com*.

—By Colleen McCarthy

Prescription fraud losses escalate

Insurers, third-party payers urged to step up efforts against drug abuse

By COLLEEN McCARTHY

NEW YORK—The illegal use of prescription drugs is reaching epidemic levels and health insurers are only beginning to realize their losses associated with this, according to the author of a recent report by the Washington-based Coalition Against Insurance Fraud.

The abuse and/or resale of prescription drugs, a crime known as drug diversion, is a rapidly accelerating trend, with about 15.2 million Americans admitting to abusing prescription drugs in 2005, notably Vicodin and OxyContin, according to the report.

"Insurance companies are the funding source for a major portion of prescription drugs in this country. They are essentially financing this epidemic," William Mahon, the study's author and a Washington-based health care consultant with the Mahon Consulting Group L.L.C., told attendees of the Eastern Claims Conference in New York Feb. 25-26.

Prescription fraud losses alone for insurers or third-party payers could range from $6.9 billion to $23 billion annually, according to the report.

However, the total price tag is even more alarming when related medical costs associated with prescription drug addiction are factored into the estimates, according to the report. For example, an addicted person likely will have more office visits and medical tests performed, may have more emergency room visits or even require a liver transplant, Mr. Mahon said. When considering these associated expenses, insurers could lose up to $79 billion a year, he said.

"If you're just looking at the drug costs alone, you're missing the boat," he added.

Doctor shoppers, people who visit several physicians to get multiple prescriptions or have prescriptions filled at multiple pharmacies, are a major source of illicit prescription drug costs, the report said.

Some insurers are responding to such abuse by terminating benefits for abusers, Mr. Mahon said. Others are beginning to take a hard line with claims for "off-label" prescriptions, in which Food and Drug Administration-approved drugs are prescribed for purposes other than those approved by the agency. For example, Actiq, a painkiller intended for cancer patients, is now one of the more commonly prescribed painkillers for workers compensation injuries, Mr. Mahon said.

According to the report, WellPoint Inc. tracked 100 suspected doctor-shopping plan members over a 90-day period as part of a 2005 pilot program. The Indianapolis-based insurer found that for every $1 in narcotics prescription costs, it paid an additional $41 in related medical claims.

The findings led WellPoint to implement new measures and stricter controls, including forcing flagged members to use only one pharmacy, and developing a new policy contract with members that gave the payer the right to deny benefits for members practicing fraudulent behavior. Within a year, they reduced claims costs by more than $300,000 for the same 100 members.

In addition, insurers are potentially vulnerable to liability lawsuits for failing to prevent fraud schemes that kill and injure people, Mr. Mahon said. Drug manufacturers and pharmacies already face such lawsuits, and insurers could be next, he said.

The report cited a 2006 Florida case where two pharmacies were found negligent after a patient died of an overdose due to a combination of drugs. The Florida Supreme Court ruled that the pharmacies had a legal duty to warn a patient when presented with prescriptions for dangerous quantities or combinations of prescription drugs.

"When will a plaintiff charge that a claim payer was negligent? If the pharmacy was a passive dispenser, the claim payer could be viewed as a passive paying agent," Mr. Mahon said.

Current efforts by insurers to combat drug diversion have been "inconsistent," he said. Insurers should consider ramping up their responses at many levels because insurers that adopt well-run diversion programs can realize potentially significant savings over time.

The report suggests insurers become more active when it comes to prescription drug abuse. They need to create better systems to profile losses and exposures to develop effective counter-strategies, he said.

Payers also should develop standard investigative protocols and systems for comparing prescription and medical claim data, which requires an effective working relationship with the payer's pharmacy benefit manager, Mr. Mahon said.

Some simple initiatives include establishing more point-of-sale controls, such as requiring photo IDs and dates of birth to verify certain prescriptions.

Insurers also should support the continued creation of state prescription monitoring programs, which can be an effective early warning system. These programs consist of databases of controlled-substance prescriptions dispensed within the state that can reveal patterns of illicit use and distribution.

"There are so many red flags, but because there are no systems in place, all too often we find those claims going through," he said.

The Stamford, Conn.-based Eastern Claims Conference sponsors educational forums in the life, disability, accidental death and dismemberment and health claims management sectors.

Bias: Employers must weigh findings from background checks

CONTINUED FROM PAGE 3

in the future initiated by the EEOC regarding an employer's use of criminal background checks," said Susan M. Corcoran, a White Plains, NY.-based attorney with Jackson Lewis L.L.P.

"This is a good opportunity to go back and review your (job) applications in general" to make sure they are "legally defensible," said Cheryl L. Behymer, an attorney with Fisher & Phillips L.L.P. in Columbia, S.C.

"A lot of states do not want you to ask about arrest records," on the theory a person is innocent until proven guilty, she said. The application should state that an applicant who indicates he or she has been convicted of a crime is not automatically disqualified from employment, Ms. Behymer said.

Observers say the Federal Credit Reporting Act applies when the employer uses public records or a background check. Mr. Cohen said the FCRA requires employers to get applicants' written authorization for a criminal background check and provide them an opportunity to dispute its findings, among other requirements.

"An employer kind of needs to think it through and make a decision (on conducting a criminal background check) based on the job duties whether it's appropriate," Ms. Behymer said.

She warned, however, there could be consequences if it turns out a check would have been appropriate but was not conducted. "If there's a problem down the road that could have been foreseen by someone," such as an employee involved in a violent incident who had a conviction that suggests violent tendencies, the employer could be found liable for negligent hiring.

"More and more employers are conducting criminal background checks" out of concern "they could be on the hook in the event of a workplace violence issue," said Tanya A. Salgado, an attorney with White & Williams L.L.P. in Philadelphia.

"Make sure you do it consistently," said Ms. Behymer. "You definitely don't cherry-pick the people that you do a criminal background check on." If it is decided to do background checks for a certain job, then "you need to do it for every single candidate for that particular job," she said.

Sara Goldsmith Schwartz, an employer attorney with Schwartz Hannum P.C. in Boston, recommends that companies develop written guidelines in advance, "so that the employer's not getting background check information and then individually making decisions about what to do with it."

The EEOC's compliance manual says an employer must consider three factors in deciding whether to exclude someone given their criminal background: the "nature and gravity" of the offense, time passed since the conviction and/or completion of the sentence, and type of job sought.

"You need to make sure you have some kind of business purpose for the convictions that you're considering a disqualifying factor," said Jonathan T. Hyman, an employer attorney with Kohrman Jackson & Krantz P.L.L. in Cleveland. For instance, an employer could justify disqualifying someone from a financial position if they have been convicted of passing bad checks, robbery or burglary, he said.

"I think where the employers are going to run into problems with the EEOC is where employers can't tie the conviction that they're using to something to do with the position applied for," said Mr. Hyman.

Ms. Schwartz strongly recommends that disqualifications on the basis of criminal convictions be job-related. "Some employers like to take a more aggressive position and, in certain circumstances, that's defensible, but it's not broadly defensible," she said.

> **'You need to make sure you have some kind of business purpose for the convictions that you're considering a disqualifying factor.'**
>
> Jonathan T. Hyman,
> Kohrman Jackson & Krantz P.L.L.

State laws vary on the extent to which there must be a connection between the job and the conviction in rejecting job applicants. "Some states have laws that really require a really close connection for the disqualifying conviction with the job," said Ms. Behymer, pointing to Wisconsin as example. In others, "it is left more to the employer's discretion."

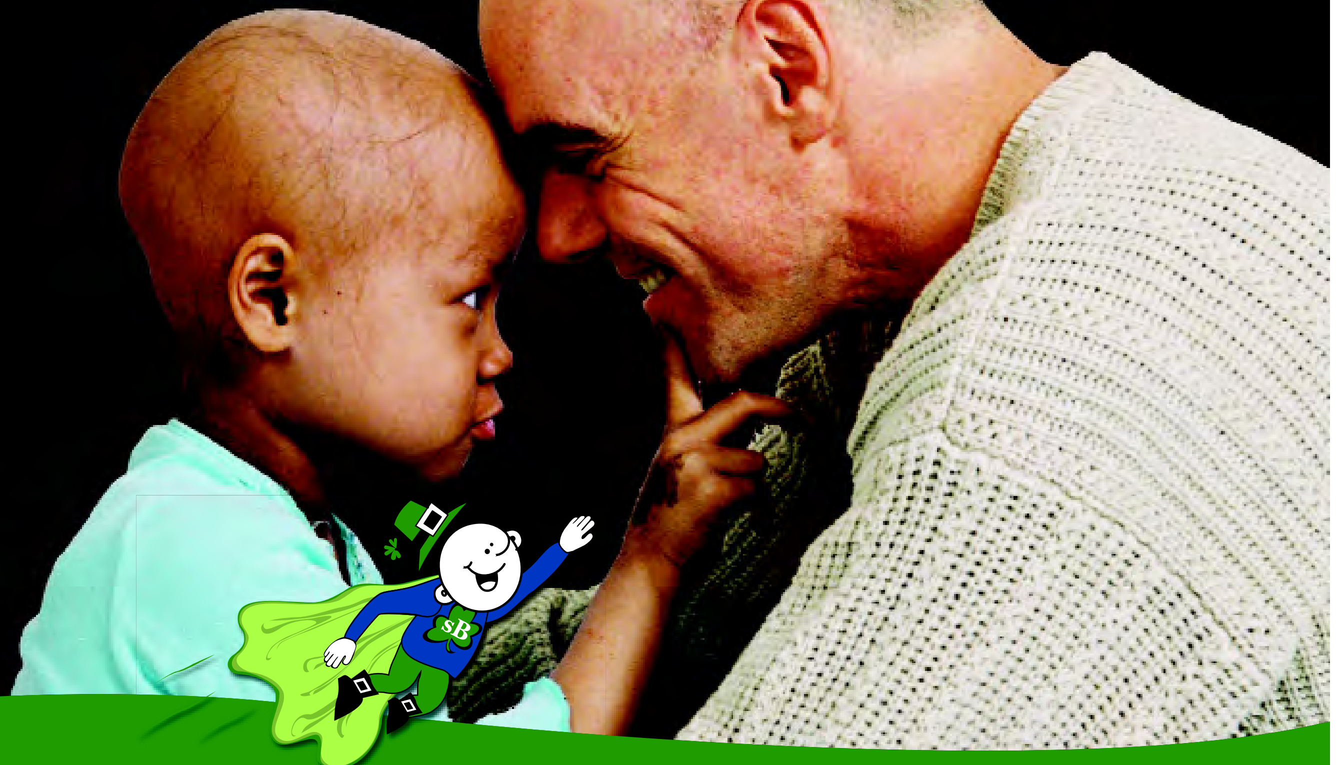
The different rules, regulations, law and case law among the states "can be a real puzzle" for multistate employers, said Ms. Schwartz.

Even so, sometimes employers "will take the business risk and make the decision not to hire the person," Mr. Cohen said.

"You just might make the decision, 'I'm going to assume the risk of a lawsuit, but I'm not going to have to deal with the employee-relations issue of bringing that person in,'" Mr. Cohen said. The "likelihood of a claim is pretty remote" because the applicant would have to disclose the conviction.

"The law is still the law, but in certain situations, the likelihood of claims actually being brought is not as significant as in others," he said.

be a HERO
for kids with cancer



www.StBaldricks.org • 1.888.899.BALD

Shaving the Way to Conquer Kids' Cancer

shave
volunteer
donate
tell a friend

the head-shaving event for childhood cancer research

WTC: Federal court limits coverage in owner's property policy

CONTINUED FROM PAGE 1

ance and the leaseholders themselves as required by separate indemnification agreements with the Port Authority, Judge Barbara Jones in New York ruled.

In the case, the Port Authority sought coverage from its insurers, which had bound the coverage but had not issued final policy wording before the WTC was destroyed. The Port Authority's policy provides $1.5 billion of limits, but the dual-state agency is attempting to tap its coverage twice, arguing that two separate occurrences destroyed the complex.

Lloyd's of London underwriters wrote the biggest piece of the coverage—approximately $527 million in total on various layers, according to court papers. Lloyd's broker Willis Ltd., a subsidiary of London-based Willis Group Holdings Ltd., placed the coverage.

Meanwhile, WTC leaseholders also have waged their own coverage battles.

Most notably, Silverstein Properties Inc. last year resolved its coverage dispute in a settlement that brought its total recovery to $4.55 billion—almost $2.5 billion short of the amount Silverstein sought (*BI*, June 4, 2007).

A Port Authority spokesman would not comment on whether the agency has sufficient insurance recoveries from all parties to rebuild.

However, Judge Jones said in her ruling that Silverstein's settlement does not fully cover the loss.

In its claims, the Port Authority sought coverage for the entire complex, not just the building and train terminal that it had not leased out.

The insurers filed suit, arguing that because of a policy exclusion relating to other insurance and leaseholder indemnification agreements, their policy covered only the single building, 6 World Trade Center, and train terminal.

The Port Authority contended that an exception clause in the exclusion obligated the insurers to supplement the leaseholders' insurance if it did not fully cover the loss.

The insurers argued that the exception applied only to other insurance that covers the property and not to the indemnification agreements.

Judge Jones agreed with the insurers, ruling that the Port Authority's argument would make the indemnification portion of the exclusion meaningless. She said that the use of a semicolon, rather than a comma, between the exclusionary wording of the provision and its exception demonstrated that the exception applied only to other insurance (see excerpt).

Because of the indemnification agreements, case law considers that the Port Authority has been fully indemnified for the loss of the complex, regardless of whether leaseholders have fulfilled their obligations, Judge Jones ruled.

The Port Authority is deciding whether to appeal, its spokesman said.

While so-called other-insurance provisions are common in insurance policies, they are not usually contained in exclusions, and they do not usually refer to indemnification agreements, according to policyholder attorneys. Their purpose is to establish which policies respond first, not to exclude coverage, they say.

But the Port Authority's exclusion restricts the agency's ability to recover insurance, said policyholder attorney John Ellison, a partner with Reed Smith L.L.P. in Philadelphia. "On its face, it's hard to find fault with what the judge did here."

The Port Authority would have had a stronger argument if the exclusion did not refer to the leaseholders' indemnification agreements, said policyholder attorney Robert M. Horkovich.

"But it still starts off in trouble, with an other-insurance clause in an exclusion," said Mr. Horkovich, a partner with Anderson Kill & Olick P.C. in New York.

While including the other-insurance provision in an exclusion was odd, the judge erred, said policyholder attorney Matthew L. Jacobs, a partner with Jenner & Block L.L.P. in Washington.

Insurers can invoke an exclusion like the Port Authority's "only if they can prove the terms of the exclusion are being met," Mr. Jacobs said. The wording is intended to bar double recoveries, he said.

But broker Henry Daar said including an other-insurance provision in an exclusion rather than in a policy's coverage section "is a distinction without a difference."

"For all intents and purposes, the other-insurance clause does the same thing" in either case, said Mr. Daar, an executive vp for Aon Risk Services, a unit of Chicago-based Aon Corp.

Certain Underwriters at Lloyd's et al. vs. the Port Authority of New York and New Jersey, Feb. 22; No. 1:05-cv-05239-BSJ-GWG.

> The Port Authority Insurance provided broad coverage to the real and personal property interests of the Port Authority as the "Insured," subject to several exclusions. Among the exclusions is Exclusion f. at issue here, which is located in the section of the manuscript policy form entitled "Property Excluded." In its entirety, Exclusion f provides:
>
> This policy does not cover loss or damage to:
> ***
> f. Any property at the described premises in respect of which any person, firm or corporation has [i]n force at the time of loss, pursuant to a lease or other written agreement, valid and collectible insurance in favor of the Insured or has otherwise indemnified the Insured against such loss or damage; except that if any person, firm or corporation is required pursuant to a lease or other written agreement to insure any property which would otherwise be covered by this Policy, and for whatever reason such property is not fully insured, then such property will be insured property under this Policy.
>
> Port Authority Manuscript Policy Form at 18-19 (Exclusion (1)(f)).

COURT DOCUMENTS

In her ruling on coverage for World Trade Center buildings, Judge Barbara Jones focused on the wording and punctuation of an unusual clause that was contained in the Port Authority of New York and New Jersey's policy.

UnitedHealth: Concessions win Sierra purchase approval

ACQUISITION APPROVED

UnitedHealth Group Inc. secured approval of its acquisition of Sierra Health Services Inc. with a series of concessions that include its agreement to:

- **Divest its individual SecureHorizons Medicare Advantage health maintenance organization plans in the Las Vegas area and not reacquire the divested business for 10 years. UnitedHealth also is barred from marketing certain Medicare products in the area for a one- or two-year period.**
- **Provide at least 60 days notice to small Nevada employers of rate increases and, in such cases, allow them to terminate their contracts without penalty.**
- **Cease using the Ingenix database to set reimbursement rates for out-of-network physicians in Nevada for two years. If the Ingenix system is declared unlawful, the company may not use it in the state.**
- **Refrain from using proprietary and confidential Nevada provider rate information that belongs to a self-insured employer to negotiate UnitedHealth provider rates.**
- **Abstain from enforcing several provisions relating to rates or network participation in provider contracts for two years.**
- **Contribute $15 million over five years to Nevada health care organizations, part of which will fund audits by the Nevada Division of Insurance of insurer performance.**

Source: U.S. Department of Justice and Nevada Attorney General's Office.

CONTINUED FROM PAGE 1

available to senior citizens.

"This shows that in the Medicare area, the antitrust agencies will take action where appropriate to ensure seniors continue to benefit from price competition," said Michael Cowie, a partner in the antitrust practice group of Howrey L.L.P. in Washington and a former assistant director of the Federal Trade Commission's Bureau of Competition. "Here, there was obviously overlap between UnitedHealth and Sierra in the Las Vegas market."

The size of the divestiture was unremarkable given the size of the acquired business, analysts say.

"It's not a huge chunk of business in the whole scheme of things," said Bradley Ellis, a director at Fitch Ratings in Chicago.

Sierra's total membership is 876,800, 56,600 of which are in Medicare HMO plans and 320,000 of which are commercial health plan members, according to the company's most recent earnings report.

For UnitedHealth—which has become the nation's No. 2 health insurer by membership through active acquisitions in the past five years—the broader issue is its ability to complete major future acquisitions, analysts say.

UnitedHealth would be forced to make significant divestitures if it tried to acquire any other major health insurers due to market share concerns, Mr. Ellis said. "It would just be too much concentration," he said. "I don't anticipate anything major for United."

Major acquisitions in most U.S. regions may be deterred by antitrust issues at this point, given UnitedHealth's size, said Shellie Stoddard, credit analyst with New York-based Standard & Poor's Corp. The Northwest is the only region where UnitedHealth does not have a major presence, she said.

In previous acquisitions, the Justice Department required UnitedHealth to sell portions of Cypress, Calif.-based PacifiCare Health Systems Inc.'s commercial health insurance businesses in Tucson, Ariz., and Boulder, Colo.

"As they get bigger, if they buy (companies) with overlapping markets, it could become an issue," said Sally Rosen, managing senior financial analyst with Oldwick, N.J.-based A.M. Best Co. Inc.

UnitedHealth should be able to complete smaller acquisitions, including those designed to improve its Medicaid business, Ms. Stoddard said.

Despite several concessions aimed at protecting the rights of Nevada health care providers (see box), physician groups denounced the department's decision last week to approve the Sierra transaction.

The American Medical Assn. called the decision a "step backward" that allows UnitedHealth to consolidate "unprecedented market power in southern Nevada."

The Justice Department, though, concluded the acquisition would not lead to undue power over providers that would affect physician reimbursement rates, Mr. Cowie said. "The Justice Department did not succumb to political pressure imposed by physician groups," he said. "If it had, there likely would have been a requirement for a broader divestiture."

The Chicago-based AMA, though, cited recent regulatory problems the company has experienced in other states, particularly in California related to its PacifiCare acquisition, as a sign of what will happen in Nevada.

California regulators issued a record $3.5 million fine against UnitedHealth's PacifiCare unit and are seeking up to $1.3 billion in penalties for alleged state law violations in handling claims and provider data (*BI*, Feb. 4).

"We urge (Nevada officials) to closely monitor United since its conduct in other states reflects a philosophy that it is more cost-effective to violate state laws and risk a possible fine than to comply with laws designed to protect patients, physicians and employers," William Plested, the AMA's immediate past president, said in a statement.

UnitedHealth officials probably are glad to have concluded the Justice Department negotiations to focus on a planned lawsuit by New York Attorney General Andrew Cuomo and the California regulatory issue, Ms. Stoddard said.

Mr. Cuomo said he plans to sue UnitedHealth and several subsidiaries for dramatically underreimbursing out-of-network medical expenses using data provided by Eden Prairie, Minn.-based Ingenix, a UnitedHealth unit. (*BI*, Feb. 18).

"We'll see if there were lessons learned in California to make the Nevada integration go smoothly," she said.

"Generally I think the approach to M&A is to always look at what may benefit and improve the health care delivery system and access and ease and usability for our members," a UnitedHealth spokesman said. "We're always looking to do that both within our business and with other businesses that make strategic sense."

ADVERTISER INDEX

Issue of March 3

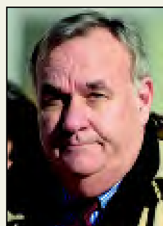
ADVERTISER	PAGE #
Ace Insurance	7
AIG	28
Allianz Global Corporate	13
Aon Corporation	2
Brownyard Programs	20
Business Insurance	19
CV Starr	10
Discover Re	15
IBM Corporation	9
Liberty Mutual	5
Old Republic Risk Mgmt	17
Pinnacle Actuarial Resources	6
Risk & Insurance Mgmt Society, Inc	16
St. Baldrick's	23
World Insurance Forum	14

Gen Re: All five defendants found guilty

DEFENDANTS FOUND GUILTY

Ronald E. Ferguson, Robert D. Graham, Christian M. Milton and Elizabeth A. Monrad, guilty on 16 counts:

Mr. Ferguson


Mr. Graham

Mr. Milton

Ms. Monrad

- One count of conspiracy
- Seven counts of securities fraud
- Three counts of mail fraud
- Five counts of making false statements to the SEC

Christopher P. Garand, guilty on 10 counts:

Mr. Garand

- One count of conspiracy
- Three counts of securities fraud
- Three counts of mail fraud
- Three counts of making false statements to the SEC

PHOTOS: BLOOMBERG NEWS/LANDOV

CONTINUED FROM PAGE 1

that has lingered since the case began more than two years ago: Are more indictments to come?

After the verdicts, prosecutors suggested that they may not be finished: "The investigation continues," said Paul E. Pelletier, principal deputy chief for litigation with the U.S. Justice Department's fraud section. "We have a lot of work to do to go up the ladder."

Mr. Pelletier declined to identify whom prosecutors may target.

Maurice R. Greenberg, AIG's former CEO, and Joseph Brandon, current CEO of Gen Re, both were identified during the trial as among five unindicted co-conspirators, and observers have long speculated about whether they might eventually be charged in the case.

A lawyer for Mr. Greenberg flatly denied that the former AIG chief is guilty of any wrongdoing. A call to Mr. Brandon was referred to a Gen Re spokesman, who declined to comment.

In a 2006 indictment, prosecutors charged that the five Gen Re and AIG defendants engineered a sham loss portfolio reinsurance deal to help inflate AIG's loss reserves starting in 2000 to quiet stock analyst concerns about AIG's reserve levels. While the deal appeared to transfer risk to AIG, the defendants secretly agreed that AIG would not be billed for any losses and that the insurer would "prefund" Gen Re's purported $10 million premium for the deal and pay Gen Re a $5 million fee, prosecutors charged.

> **'The investigation continues. We have a lot of work to do to go up the ladder.'**
>
> Paul E. Pelletier,
> U.S. Justice Department

Defense lawyers strenuously attacked the testimony of two cooperating government witnesses—former Gen Re executives John Houldsworth and Richard Napier, both of whom have pleaded guilty to conspiracy. The government also presented dozens of Gen Re e-mails and several recorded phone conversations among some of the defendants to bolster its case.

Jurors asked to see transcripts of several of those conversations, all involving Ms. Monrad, and returned the transcripts to Judge Droney shortly before returning with their verdicts.

Several observers expressed surprise that the jury found all five defendants guilty on all counts despite their varying degrees of involvement in the reinsurance deal, saying they had expected a split verdict, a hung jury or acquittals on some counts.

Defense lawyers expressed dismay at the verdicts.

"This is a very sad day, not only for Ron Ferguson, but for our criminal justice system," Clifford Schoenberg, a lawyer for Mr. Ferguson with Cadwalader, Wickersham & Taft L.L.P., said in a statement. "We can only hope that Judge Droney or the Court of Appeals will reverse this grave miscarriage of justice."

Further prosecutions?

While neither Mr. Greenberg nor Mr. Brandon has been charged with any wrongdoing, evidence at trial showed that Mr. Greenberg initiated the deal in an October 2000 phone call to Mr. Ferguson, while Mr. Brandon was consulted early in the deal's development and communicated with others at Gen Re as it progressed.

Mr. Greenberg has previously acknowledged calling Mr. Ferguson, but has said he left details of the transaction to subordinates and believed it to be legitimate.

"Mr. Greenberg was not a defendant in the Hartford action and he neither initiated nor participated in an improper transaction," said Nicholas Gravante, a lawyer with Boies, Schiller & Flexner L.L.P who represents the former AIG chief. "Mr. Greenberg acted responsibly, ethically and lawfully during his career at AIG."

Further charges may depend on the willingness of one or more of the five convicted defendants to cooperate with prosecutors in hopes of reducing potentially long prison sentences, several legal observers say (see related story).

Such cooperation may be vital to any potential case against Mr. Greenberg, since there was little documentary evidence produced at the trial regarding his involvement in the deal beyond phone calls with Mr. Ferguson, observers say.

Prosecutors may not move beyond the five defendants without winning such cooperation, but if they get it, "then all bets are off and the government proceeds forward," said Philip H. Hilder, a former federal prosecutor now with Hilder & Associates P.C. in Houston.

Corroborating evidence would be important in such a case because prosecutors would face the credibility problem of offering testimony from a convicted defendant who previously maintained his or her innocence, Mr. Hilder added.

Peter J. Henning, a professor at Wayne State University Law School in Detroit, expressed doubt about further prosecutions, though, because of the credibility problem and because prosecutors likely already have all of the documentary evidence that is available and have not used it so far to bring additional charges.

"Barring one of the defendants revealing something previously unknown to the prosecution, I think it's unlikely the government would charge either one of those two," Mr. Henning said, referring to Messrs. Greenberg and Brandon.

Mr. Gravante, Mr. Greenberg's lawyer, said testimony at the trial actually undercut any assertion that Mr. Greenberg knew the deal was a sham. The government contended that the alleged conspiracy began with Mr. Greenberg's October 2000 call to Mr. Ferguson; Mr. Napier, one of the cooperating witnesses, said in his plea agreement that Messrs. Ferguson and Greenberg discussed structuring the deal as a no-risk transaction during that call.

Under cross-examination during the trial, though, Mr. Napier admitted that his earlier statement was wrong, and that the no-risk structure evolved over the following three weeks at Gen Re.

"If it became a problem, it became a problem after Mr. Greenberg was done with it," Mr. Gravante said of the transaction.

Prosecutors, meanwhile, appear to have little interest in further investigating any role played in the transaction by Warren E. Buffett, chairman of Gen Re parent company Berkshire Hathaway Inc. While lawyers for Mr. Ferguson and Ms. Monrad argued that they relied on Mr. Buffett's approval of the deal—pointing to evidence that he okayed the fee to Gen Re—prosecutors told the jury there was no evidence that Mr. Buffett was aware the deal was a sham.

Sentences depend on calculation of loss

By DOUGLAS McLEOD

HARTFORD, Conn.—The defendants in the General Re Corp. finite trial are facing potentially long prison terms, but how long will depend in large part on a federal judge's view of how much financial damage resulted from the allegedly sham reinsurance deal at the heart of the case, lawyers say.

In reaching sentencing decisions, U.S. District Judge Christopher F. Droney will apply complex federal sentencing guidelines, a key element of which is a calculation of the monetary loss caused by the alleged fraud, lawyers familiar with sentencing procedures say. The guidelines are advisory, not mandatory, and Judge Droney could depart from them at his discretion, they add.

As the scheduled May 15 sentencing date approaches, prosecution and defense lawyers are expected to offer dueling recommendations to the judge about the size and nature of the loss caused by Gen Re's 2000 loss portfolio deal with American International Group Inc.

The prosecution's likely theory of the loss—tied to drops in AIG's stock price after scrutiny of the deal became public—could result in sentencing recommendations of 10 to 20 years or more, lawyers say.

While far less than the statutory maximum jail terms for the crimes charged in the case—which add up to 210 years for most of the defendants—the guideline sentences could still be severe for the former Gen Re and AIG executives, most of whom are in their late 50s or early 60s, lawyers note.

Convicted last week of conspiracy, fraud and other charges were former Gen Re Chief Executive Officer Ronald E. Ferguson; Christopher P. Garand, former senior vp in charge of U.S. finite underwriting for Gen Re; Robert Graham, former senior vp and legal counsel for the reinsurer; Elizabeth Monrad, Gen Re's former chief financial officer; and Christian M. Milton, AIG's former vp for reinsurance.

A jury found that the five former executives engineered the sham loss portfolio transaction in 2000 and 2001 to allow AIG to inflate its loss reserves by $500 million to counter stock analysts' concerns about AIG's reserve levels.

> **'There is no clear manner by which the loss can be calculated.'**
>
> Theodore T. Chung,
> Perkins Coie L.L.P.

Federal sentencing guidelines are designed to produce a recommended sentencing range based on several factors, key among them a "reasonable" estimate of the loss produced by a fraud and the number of victims of that fraud.

In complex financial cases, though, the guidelines aren't always easy to apply.

"There is no clear manner by which the loss can be calculated," said Theodore T. Chung, a lawyer with Perkins Coie L.L.P. in Chicago and a former federal prosecutor. As a result, the government will push for the highest possible loss figure while the defense tries to drive it down as close to zero as possible, he said.

"What constitutes a loss will be heavily litigated," said Philip H. Hilder, a former federal prosecutor now with Hilder & Associates P.C. in Houston.

During the trial, prosecutors produced evidence of a series of drops in AIG's stock price, from $73.12 to $61.92 per share between February and March 2005, following AIG's disclosure of federal and state investigations of the Gen Re deal and subsequent news articles.

Prosecutors are likely to use the share price decline as a basis for calculating the loss caused by fraud, producing a very high loss figure and a large number of AIG shareholder victims, lawyers familiar with the case say.

Defense lawyers, on the other hand, may argue that the drop in AIG's share price can't be attributed solely—if at all—to the Gen Re deal, and that the loss can not be reasonably calculated.

Prosecutors and defense lawyers declined to comment on possible sentencing arguments.

If the loss caused by a fraud cannot be calculated, courts have the option to consider the gain the fraud generates. In this case, that could be the $5 million fee that Gen Re collected for the deal.

Even if the $5 million figure is used, though, the defendants could face sentences of more than 10 years under federal guidelines, lawyers familiar with the guidelines say.

News In Brief

CONTINUED FROM PAGE 1

writedowns on AIG Financial Product Corp.'s super senior credit default swap portfolio. For the fourth quarter, AIG reported a $5.29 billion loss vs. $3.44 billion in profit for the prior-year period. AIG said in a statement it continues to believe that the unrealized market valuation losses on this portfolio "are not indicative of the losses AIGFP may realize over time."

Guy Carpenter taps Peter Zaffino as CEO

Peter Zaffino, executive vp and head of U.S. treaty operations for Guy Carpenter & Co. L.L.C., has been named chief executive officer of the New York-based reinsurance brokerage as part of a leadership reorganization by parent Marsh & McLennan Cos. Inc. Mr. Zaffino, who joined Guy Carpenter in 2001 from GE Capital Services, succeeds David Spiller, who has left the company, an MMC spokeswoman said. Mr. Spiller joined Guy Carpenter as president in 2006, after serving as president of Benfield Ltd. In addition, Britt Newhouse, president of Guy Carpenter's Americas broking operations, has been named chairman.

Willis COO Millwater named president

Willis Group Holdings Ltd. has named Grahame Millwater president of the London-based brokerage. Mr. Millwater previously was chief operating officer. Willis also created two group chief operating officer positions to succeed Mr. Millwater, appointing Tim Wright and Patrick Regan. Mr. Wright previously was head of United Kingdom financial services with Boston-based consulting firm Bain & Co., while Mr. Regan has served as Willis' chief financial officer, a position he will retain. Willis also said it has extended the contract of Chairman and Chief Executive Officer Joseph J. Plumeri by 18 months, to April 2011.

Commercial market outlook stable: Best

The U.S. commercial lines market outlook is stable despite the ongoing soft market, according to A.M. Best Co. Inc. The ratings agency said in a statement that commercial insurers "have bolstered their positions after robust earnings in recent years by investing in price-monitoring tools, predictive modeling, distribution channels and claims systems." In addition, insurers have embraced enterprise risk management, while the extension and permanency of the federal terrorism backstop "have removed uncertainty regarding this exposure." While profits are likely to deteriorate, "the commercial lines segment generally has positioned itself to meet the challenges of changing market conditions throughout the cycle," Best said.

Noted

Led by big cost increases for the Medicare and Medicaid programs, **health care spending** in the United States is expected to double to $4.3 trillion by 2017, a new study shows. Health care spending was expected to hit $2.2 trillion in 2007 and to increase by an average of 6.7% a year through 2017, according to a report released by the Centers for Medicare and Medicaid Services, exceeding the nation's growth rate by about 1.9 percentage points each year....H.J. Heinz Co. has received tentative authorization from the Labor Department to expand **benefit risks** funded through its Vermont captive. Heinz wants to use its captive to reinsure long-term disability policies written by Liberty Life Assurance Co., a Liberty Mutual Group Inc. company, and life insurance policies written by Connecticut General Life Insurance Co., a CIGNA Corp. unit.

ADEA: Ruling by Supreme Court lowers bar for lawsuits

CONTINUED FROM PAGE 3

because it found that the plaintiffs had not met the requirements for pursuing the action.

But in 2006, a three-judge panel of the 2nd U.S. Circuit Court of Appeals reversed the lower court, holding that the intake questionnaire satisfied the requirement that a charge be filed before a suit, even though the EEOC took no action on Ms. Kennedy's original questionnaire. FedEx appealed to the Supreme Court.

The Supreme Court rejected FedEx's argument by a 7-to-2 margin. Writing for the majority, Associate Justice Anthony Kennedy rejected the argument that the EEOC's failure to act upon a filing precludes a subsequent lawsuit. He called that argument "too artificial" a reading of the ADEA.

"The statute requires the aggrieved individual to file a charge before filing a lawsuit; it does not condition the individual's right to sue upon the agency taking any action," wrote Justice Kennedy. He added that because the filing of a charge determines when the ADEA's time limits and procedural mechanisms begin, "it would be illogical and impractical to make the definition of 'charge' dependent upon a condition…over which the parties have no control."

In a dissent, in which he was joined by Associate Justice Antonin Scalia, Associate Justice Clarence Thomas wrote that in its decision, the majority had decided that a charge of age discrimination under the ADEA "is whatever the EEOC says it is."

An employment law expert agreed. "A filing charge is whatever the EEOC says it is and when the EEOC says it's been filed. It's completely at the agency's whim," said Robin Conrad, executive vp at the National Chamber Litigation Center in Washington, which filed a brief supporting FedEx.

"It is a pro-employee decision," said Debra Friedman, a partner at Cozen O'Connor in Philadelphia. "I do believe that the court does open the door to increased litigation," she said, but the decision does not leave the door wide open.

"First, the court points out that its decision does not automatically apply to Title VII or the ADA. Second, the court points out that not all completed intake questionnaires will constitute a charge. Third, the court held that even if a complainant submits an affidavit in addition to a completed intake questionnaire, the total information provided does not automatically constitute a charge."

Gerald Maatman, a partner at Seyfarth Shaw L.L.P. in Chicago, said that the decision contained a "significant amount of criticism of the EEOC" but would apply to ADEA charges only.

"In essence, the impact will be to allow laymen unrepresented by counsel to more easily file what the EEOC will have to treat as a charge," he said. "If you're an employer, it eliminates some of the procedural defenses that previously existed when employees did not jump through the correct hoops to access the EEOC's machinery."

The Washington-based AARP, which filed a brief supporting the employees, hailed the decision.

"The court rejected out of hand FedEx's position that it can't be a charge until the agency takes some action on it," said Tom Osborne, a senior attorney with AARP Litigation. "Under the statutory language of the ADEA and the regulation, it seems to me a very fair decision."

"It doesn't essentially put the burden on a lay person to have to go through some sort of intricate legal reasoning to say: 'Have I done enough here?' They said it has to be friendly to the average person."

The EEOC also praised the decision, pointing out in statement that "as the Court noted, the EEOC has taken steps to ensure timely notification to respondents of receipt of intake questionnaires or other correspondence that constitute charges. We will continue to review our procedures as the Court has suggested to ensure that they are clear to the public and consistent with our statutes and regulations."

Federal Express Corp. vs. Paul Holowecki et al. U.S. Supreme Court. No. 06-1322. Decided Feb. 27, 2008.

Exxon: High court to rule on punitives in oil spill case

CONTINUED FROM PAGE 4

under maritime law.

Since the 1989 spill, Exxon has paid about $3.4 billion to cover liabilities, including cleanup costs, environmental and natural resource claims to the federal and state governments, private claims and other costs associated with the spill, according to its brief.

Associate Justice Stephen Breyer appeared particularly concerned about the consequences of allowing a punitive damage award under maritime law.

"If, in fact, it has not been normal in admiralty (law) until now to assess punitives against a corporation on the basis of the activity of, say, the ship's master, failures of responsibility, then it will now be a new world for the shipping industry and for those who work on ships," Justice Breyer said, according to the court transcript.

Even if punitive damages were awarded, they should only be twice what Exxon has paid to compensate claimants for economic losses—about $500 million—suggested both Associate Justices Anthony Kennedy and David Souter.

The very nature of the spill and its aftermath make the case unusual, said George T. Frampton Jr., a partner in the New York office of Boies, Schiller & Flexner L.L.P. and chairman of the White House Council on Environmental Quality during President Clinton's second term.

"It appears to me to be a somewhat unique situation," said Mr. Frampton, who oversaw distribution of funds from the Exxon Valdez Oil Spill Restoration Fund. "I don't think the issues that are present in the damages for most oil spills are really like this case. Here, the principal recovery was on behalf of the state and federal governments under environmental laws, so natural resource damage recovery was the $1.1 billion that Exxon paid to the governments."

"There's obviously been over time a move to limit punitive damages" by the Supreme Court, said Michael Raibman, a Washington-based policyholder lawyer with Reed Smith L.L.P.

But he noted the scope of the *Exxon Valdez* case is limited as it centers on punitive awards under maritime law.

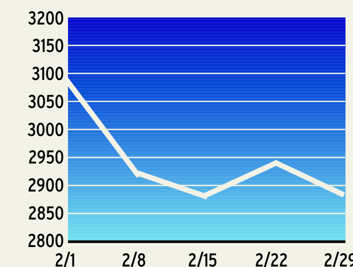
Exxon Shipping Co. et al. vs. Grant Baker, et al. U.S. Supreme Court. No. 07-219.

Stock Index

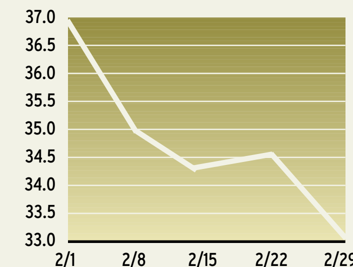
[2/18 - 2/22]

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

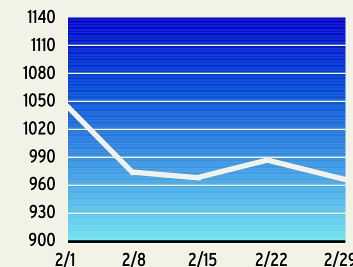
BI STOCK INDEX



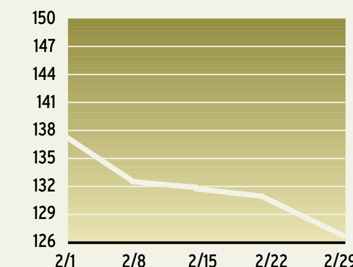
BI BROKERS INDEX



BI INSURER/REINSURERS INDEX



BI MANAGED CARE ORGANIZATIONS INDEX



Percentage change of BI Stock Index vs. key indicators

Index	Value	Change
BI STOCK INDEX	2888.57	-2.00%
DOW JONES	12266.39	-0.93%
S&P 500	1330.63	-1.66%

LARGEST GAINS

Company	Change
MBIA Inc.	6.49%
Navigators Group Inc.	4.77%
Ambac Financial Group Inc.	4.01%
PMA Capital Corp.	3.80%
Alleghany Corp.	2.47%

LARGEST LOSSES

Company	Change
Hilb Rogal & Hobbs	-6.50%
Health Net Inc.	-6.37%
Hartford Financial Services	-6.01%
CIGNA Corp.	-5.89%
ProAssurance Corp.	-5.64%

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

Business Insurance
END PAGE

Contributing:
Jeff Casale,
Mark A. Hofmann,
Douglas McLeod,
Joanne Wojcik

REUTERS

Congressman Rick Renzi faces fraud and other charges over alleged embezzlement at his family's insurance agency.

Politician runs into problems over campaign financing

Did a congressman embezzle money from his family's insurance agency to fund his political career?

That's a question a jury eventually may get to ponder concerning charges brought late last month against Rep. Rick Renzi, R-Ariz., and two associates. A federal grand jury in Tucson, Ariz., handed down a 35-count indictment against Rep. Renzi and his colleagues, charging them with wire fraud, extortion, money laundering and conspiracy, among other counts.

According to a statement by the U.S. Justice Department, the indictment also charges Rep. Renzi and one of his associates "with violations of federal insurance laws, by embezzling over $400,000 in insurance premiums from the trust account of the Patriot Insurance Agency Inc., a business owned by the Renzi family in Santa Cruz County, Ariz., to fund his first congressional campaign in 2001 and 2002, and by subsequently making false statements to influence state regulatory investigations."

Rep. Renzi's lawyer said the congressman will fight the charges.

But no matter the outcome, Rep. Renzi won't need campaign funds for this year's elections—he already announced his intention to retire from office before the indictment came down.

Coverage mess doesn't mar Silverstein, Willis relations

If World Trade Center developer Larry A. Silverstein was ever upset with Willis Group Holdings Ltd. over the coverage fiasco that followed the Sept. 11, 2001, terrorist attack, he appears to have gotten over it.

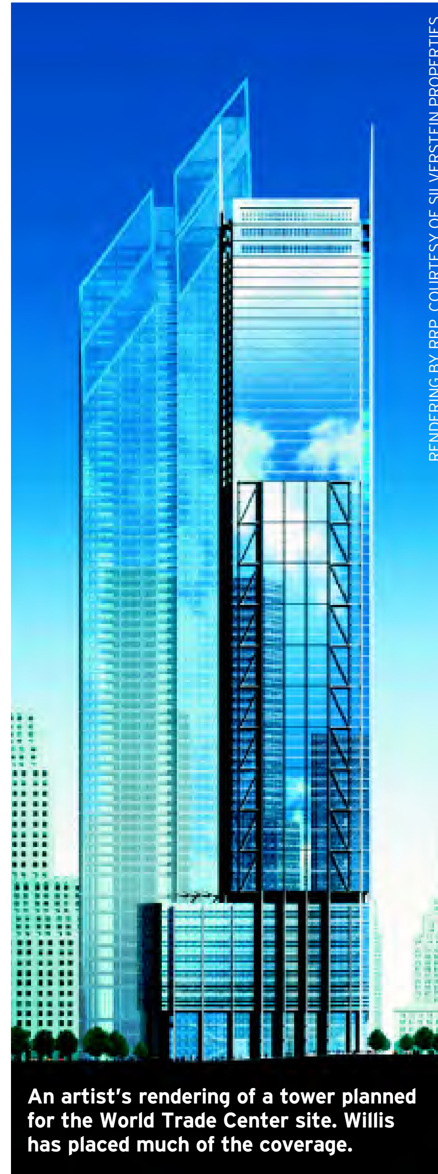
Mr. Silverstein last week announced that Willis has placed the liability, workers compensation and other coverage he needs to build three planned office towers at the former World Trade Center site. The site's owner, the Port Authority of New York and New Jersey, required the insurance placements before turning over the property for development, which is expected to begin this year.

Willis went to more than 60 insurers in the United States, London and Bermuda for the programs, according to the broker and Silverstein Properties. American International Group Inc. is providing primary workers comp, general liability and environmental liability coverage. ACE USA is leading an excess liability program that also includes units of Aspen Insurance Holdings Ltd., Allied World Assurance Co. Holdings Ltd. and XL Capital Ltd., all of Bermuda; and AIG's Lexington Insurance Co. unit. A Beazley syndicate at Lloyd's of London is providing other specialized coverage, according to Willis and Silverstein.

It wasn't that long ago that Mr. Silverstein was locked in a dispute with two dozen property insurers over the terms of the coverage Willis had placed for the WTC towers destroyed on Sept. 11. Few of the insurers had actually issued policies at the time of the attack, and terms governing the other placements were found to vary, resulting in a smaller recovery than Mr. Silverstein sought.

Observers at the time speculated that Mr. Silverstein might actually sue Willis after the coverage battle ended.

But that was then, and this is now.



RENDERING BY RRP, COURTESY OF SILVERSTEIN PROPERTIES

An artist's rendering of a tower planned for the World Trade Center site. Willis has placed much of the coverage.

Big Apple brings in more fruit to help fight flab

Produce peddler chants of "Strawberries, blueberries, cherries," and "Watermelon! Watermelon! Got 'em red to the rind!" may soon be heard again on the most impoverished streets of New York.

The City Council voted last week to issue 1,000 new permits to produce cart vendors as part of the city's larger campaign to increase fresh fruit and vegetable consumption among its inner-city residents.

"The communities in our city where obesity and diabetes continue to skyrocket are the same communities that lack even the most basic access to fresh fruit and vegetables," said City Council Speaker Christine Quinn in a statement announcing the vote.

"By putting green carts into neighborhoods with the lowest access to healthy foods, our bill will make fresh produce more available and help to save lives," she said.

The so-called "green cart" legislation was proposed by the Food Policy Taskforce ensure that affordable, convenient, healthy food is available by this summer in all New York's neighborhoods. That includes parts of Harlem, where only 3% of supermarkets carry leafy green vegetables.

The legislation also includes a provision for the city's health department to study the law's effectiveness.

Viewers say show reneged on deal

The home viewer Lucky Case Game portion of the popular NBC game show "Deal or No Deal" constitutes illegal gambling under Georgia law, argue players who want their money back.

Michael and Michelle Hardin filed a lawsuit last June against the producer of the show, NBC Universal Inc., and others, saying they spent 99 cents for each text message they sent in their failed efforts to win a briefcase awarded each week to one home viewer of the show with a prize of $10,000 to $100,000.

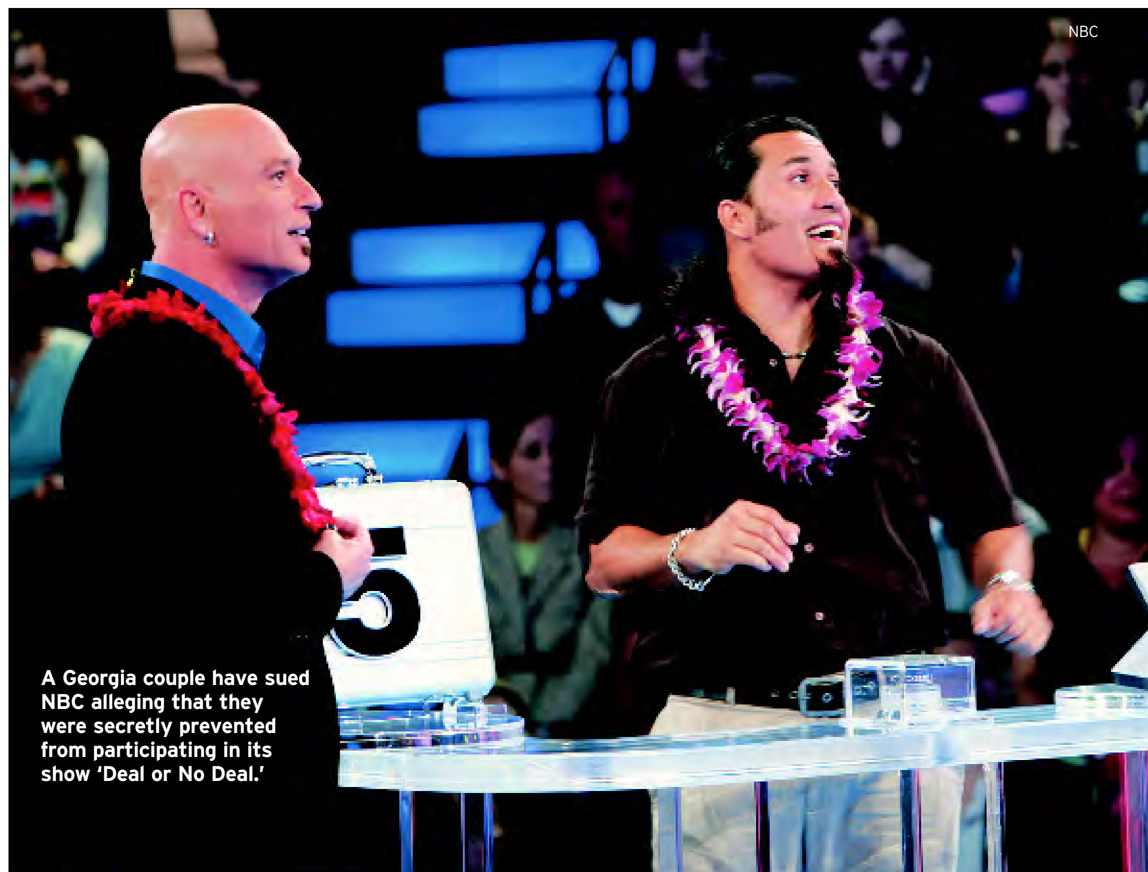
Their suit says "longstanding Georgia law" declares gambling contracts to be void. The suit also says if NBC solicited Georgia viewers to play the Lucky Case Game while "secretly denying them the opportunity to participate," all the money wagered by the couple and other Georgia participants is recoverable under fraud laws.

In an unusual step, the Georgia Supreme Court last week took up questions by the judge hearing the suit: whether Georgia law allows losers of an illegal lottery to recover the money they wagered and, if so, can they recover anything from the organizer.

NBC has argued that the Lucky Case Game is neither a promotional game nor a lottery, and that it does not keep the wagers of the "contestants."

It is unclear whether the Georgia suit and another action reportedly filed in California have already had an effect, though.

NBC's "Deal or No Deal" Web site last week said the Lucky Case Game "is taking a short break," while it promoted a new Online Skill Game with a $30,000 jackpot.



NBC

A Georgia couple have sued NBC alleging that they were secretly prevented from participating in its show 'Deal or No Deal.'

AIG RISK FINANCE…
BECAUSE COMPLEX RISKS NEED A HOME TOO.

Unique risks require unique solutions, which happen to be our specialty at AIG Risk Finance. We have more than 10 years of continuous commitment to helping clients mitigate complex risks that cannot be managed effectively with conventional insurance and financial products. Utilizing a combination of insurance, financial and capital market strategies, we offer a wide range of alternative risk programs that extend to virtually all types of exposures and industries. From structured insurance to programs for exotic buyouts, evolving risks or unusual risks related to mortality and longevity, AIG Risk Finance is home to countless solutions for a world of complex risk.

To learn more about our capabilities and the non-traditional risks we're skilled at managing, visit **www.aigriskfinance.com**

THE STRENGTH TO BE THERE.®

AIG Risk Finance is a division of the property and casualty insurance subsidiaries of American International Group, Inc (AIG). Insurance and other financial products are underwritten by subsidiaries of AIG. The description herein is a summary only and does not include all terms, conditions and exclusions of the products described. Please refer to the actual insurance policy or other legal documentation for complete details. Products may not be available in all jurisdictions.