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OBAMA SHIFTS GEARS IN HEALTH REFORM DRIVE / PAGE 3

MERGER OF MAX CAPITAL, HARBOR POINT TRIGGERS M&A PREDICTIONS / PAGE 3

WILLIS CHIEF PLUMERI: BROKERS CAN'T TAKE CONTINGENTS / PAGE 8



In Brief

COBRA subsidy law extended again

President Barack Obama last week signed into law legislation that provides a 31-day extension of federal subsidies of COBRA health care premiums. The measure, H.R. 4691, extends the 65%, 15-month premium subsidy to employees involuntarily terminated from March 1 through March 31. This week, the Senate is expected to resume consideration of legislation, H.R. 4213, which would extend the premium subsidy to employees laid off through Dec. 31.

Greenberg says finite charges time-barred

Former American International Group Inc. chief Maurice Greenberg says any possible charges he may face related to sham finite reinsurance transactions are time-barred. As a result, according to a motion filed

See **IN BRIEF** page 22



REUTERS/LANDOV

Firefighters clear debris after an 8.8 magnitude earthquake struck Chile, killing more than 200. Insured loss estimates range from \$2 billion to \$8 billion.

CATASTROPHES

Chile quake losses to hit global market

By **MICHAEL BRADFORD**

CONCEPCIÓN, Chile—Reinsurers are bracing for claims from the devastating earthquake in Chile that killed hundreds and caused widespread property damage.

Global reinsurers are expected to bear the largest portion of insured losses from the magnitude 8.8 quake for which catastrophe modeling companies have estimated insured losses ranging from \$2 bil-

lion to \$8 billion.

Initial death tolls were reported as high as 805, but a Chilean official last week said in a published report that the death toll was much lower, at 279.

The Feb. 27 quake off the coast of Chile caused extensive property damage, particularly in Concepción and Santiago. Economic damage is expected to range from \$15 billion

See **QUAKE** page 18

MERGERS & ACQUISITIONS

AIG makes dent in debt with sale of prized unit

\$35.5 billion deal viewed as precursor to other dispositions

By **JUDY GREENWALD**

NEW YORK—American International Group Inc.'s move to sell its Asian life insurance unit to London-based Prudential P.L.C. for \$35.5 billion will help build momentum for AIG to sell its remaining noncore assets, putting it in a better position to repay its government debt, say observers.

Observers point out the sale price is significantly more than the unit, AIA Group Ltd., would have fetched only several months ago, and describe it as a ringing validation of AIG President and CEO Robert M. Benmosche's policy of not rushing to dispose of its noncore assets.

It remains unclear, however, how many more assets New York-based AIG will have to sell or spin off to repay its government debt and whether it will be able to retain its Chartis Inc. property/casualty unit. Late last week, though, AIG was reportedly close to agreement on the sale of another life insurance unit, American Life Insurance Co., to MetLife Inc. for \$15 billion.

In addition, last week AIG said it



REUTERS/LANDOV

AIG chief Robert Benmosche is traveling through Asia to talk to employees about the sale of AIA.

will sell its remaining ownership in reinsurer Transatlantic Holdings Inc., which analysts say could bring up to \$500 million. AIG said it owns roughly 13.8% of Transatlantic and it would sell its shares in a public offering by March 9.

According to AIG's 2009 10-K, of the \$182.3 billion government package, which includes \$87.5 billion of debt and \$94.8 billion of equity, there is a remaining balance

See **AIG** page 20



SPOTLIGHT

CAPTIVES: LEADING DOMICILES

In a tough economy, captive closures, formations run at same pace; employers grow more interested in benefits captives; owners leverage captive assets to offset expenses; managers cut staff as recession continues to bite; plus *BI* ranks largest captive managers. **PAGE 9**

WORKERS COMPENSATION

Medicare changes may be costly for insurers, employers

By **ROBERTO CENICEROS**

A major compliance change that makes insurers responsible for reporting claims involving Medicare-eligible claimants may result in

increased costs and more burdensome administration for insurers and employers using large-deductible programs, observers say.

The change marks a fundamental reversal by the Centers for Medicare

Act, they say.

The move also may lead to longer claims durations and higher costs, said Jeffrey Hames, assistant vp and implementation project manager in Memphis, Tenn., for Sedgwick Claims Management Services Inc.

CMS, which is a government agency, announced in a Feb. 24 alert that insurers are the responsible reporting entity for deductible insurance programs.

The announcement is a complete reversal from CMS' past statements that policyholders, not insurers, would be the RRE under deductible policies, sources said.

See **CMS** page 22

WHAT HAPPENED

- The Centers for Medicare & Medicaid Services announced that insurers are responsible reporting entities for deductible programs.

WHAT'S NEXT

- Insurers, rather than employers, must notify CMS when workers comp and other claims involve Medicare-eligible beneficiaries.

& Medicaid Services on compliance with Section 111 of the Medicare, Medicaid and SCHIP Extension

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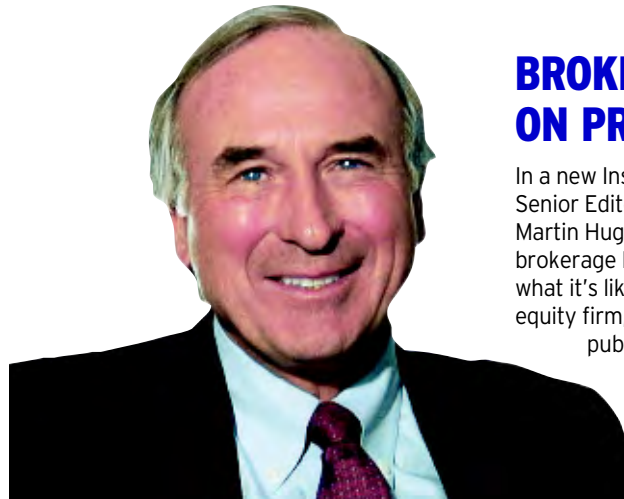


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BROKER INSIGHTS ON PRIVATE EQUITY

In a new Insurance Broker Insights video, Senior Editor Sally Roberts speaks with Martin Hughes, chairman and CEO of brokerage Hub International Ltd., about what it's like to be owned by a private equity firm, how it compares with being publicly traded and how both ownership structures compare with being privately owned. Click through the Video Reports tab.

COBRA SUBSIDY FAQ

Experts say employers should brace for another extension of the federal subsidy of COBRA health insurance premiums for laid-off workers. Editor-at-Large Jerry Geisel answers frequently asked questions about the COBRA provisions online. Go to the Online Features section of the home page.

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MOST POPULAR STORIES

Week of March 8, 2010

1. Obama signs stopgap COBRA subsidy extension
2. Wal-Mart to pay \$11.7M in EEOC gender bias suit
3. COBRA subsidy expiration would affect millions: DOL
4. House approves stopgap COBRA subsidy extension
5. AIG seeks to cut payouts to former employees
6. National Flood Insurance Program extended
7. House passes agent/broker reform bill
8. CMS shakes up definition of responsible reporting entity
9. Insurers don't pose systemic risk: Execs
10. Senate bill to extend COBRA subsidy introduced

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BROKER BUZZ

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MERGERS & ACQUISITIONS

Max, Harbor Point merger fuels consolidation talk

By COLLEEN MCCARTHY

HAMILTON, Bermuda—The merger of Max Capital Group Ltd. and Harbor Point Ltd. will result in a more diverse, financially stronger company with an improved competitive position, particularly in reinsurance, observers say.

The deal also could fuel further consolidation in the Bermuda market, some observers say.

The combined entity, which will be renamed Alterra Capital Holdings Ltd., will have shareholder equity of approximately \$3 billion, the firms said.

Under terms of last week's all-stock transaction, already approved by both companies' boards of directors, Harbor Point shareholders will

receive 3.37769 of Max common share for each Harbor Point share. After the merger, Harbor Point shareholders will own approximately 52% of the combined company, with Max Capital shareholders owning approximately 48%. The companies described the deal as a "merger of equals."

The combined company will trade on the NASDAQ stock exchange.

"We're very excited about our future prospects, and we truly feel this is a winning combination," W. Marston Becker, chairman and CEO of Max Capital, said during a conference call. After the transaction is complete, Mr. Becker will be president and CEO of Alterra and serve as a director.

John R. Berger, director, president

COMBINED ENTITY

Gross written premiums for 2009, in millions of dollars

Max Capital Group Ltd. \$1,375

Harbor Point Ltd. \$608

Alterra Capital Holdings Ltd. \$1,983

Source: Alterra Capital Holdings Ltd.

and CEO of privately held Harbor Point, will be CEO of reinsurance of Alterra and vice chairman of the board of directors.

The deal came after Max Capital's bid last year for Bermuda-based IPC Holdings Ltd. was derailed by Validus Holdings Ltd. after a long bidding

war—raising speculation that it may seek another merger partner.

Observers say the transaction is largely favorable and would create a more diversified, multiline reinsurer and insurer. In addition, the combined company is expected to have little overlap in lines of business, which makes it a complementary transaction, analysts said.

Max Capital, founded in 1999, is a specialty insurer and reinsurer that has been diversifying its underwriting risk portfolio while reducing asset exposures. It underwrites excess liability, professional liability, property and aviation coverage primarily for Fortune 1000 companies, as well as property/casualty and excess-of-loss and quota-share specialty reinsurance.

Max Capital has platforms in Bermuda, Ireland, the United States and Lloyd's of London, and it recently established a Latin America reinsurance operation. Max Capital reported \$1.37 billion in gross written premiums in 2009 with a market capitalization of \$1.34 billion, according to NASDAQ.

Harbor Point, founded in 2005 by a group of investors led by Chubb Corp. and private equity firm Stone Point Capital L.L.C. from the spinoff of Chubb Re, underwrites property/casualty and specialty reinsurance. Harbor Point wrote approximately \$607.5 million of gross written premiums in 2009 with shareholders' equity of \$1.89

See **MAX** page 18

HEALTH CARE REFORM

Health reform passage looks more likely

President, Democratic leaders embrace using reconciliation bill as vehicle

By JERRY GEISEL

WASHINGTON—Health care reform legislation will move to a different congressional track, which observers say increases its chances of passage even though significant opposition remains.

Ending weeks of speculation, President Barack Obama last week endorsed a procedure that would allow the Senate to vote on the measure with only a simple majority needed for passage.

"We have debated this issue thoroughly, not just for the past year but for decades. Reform has already passed the House with a majority. It already has passed the Senate with a supermajority of 60 votes," President Obama said during a White House speech to health care providers.

Health care reform "deserves the same kind of up-and-down vote" that was cast on other major legisla-



REUTERS/LANDOV

President Obama urged Congress to approve his health care reform plan.

tive initiatives, including the COBRA health care law and tax cuts passed during the prior administration, he said.

While he did not use the word "reconciliation," the president clearly backs that legislative process. Under reconciliation, budget-related bills require only a majority in the Senate. By contrast, other measures require 60 votes to end debate.

Until mid-January, neither congressional Democrats nor the administration had little reason to consider the reconciliation process. That is because with 60 certain votes—from 58 Democrats and two independents—Democrats had the supermajority needed to stop a Republican filibuster. But the election of Republican Sen. Scott Brown in Massachusetts ended that filibuster-proof majority.

In addition to the president, top Senate Democrats last week also embraced the reconciliation bill track. As envisioned, the House

See **REFORM** page 21

CATASTROPHES



LANDOV

Windstorm Xynthia, which hit five European countries, caused the greatest damage and insured losses in France.

Insured Windstorm Xynthia losses could reach \$4 billion

By MICHAEL BRADFORD

PARIS—Windstorm Xynthia, which claimed at least 62 lives and caused widespread damage in several European countries, is expected to cost insurers up to €3 billion (\$4.09 billion), catastrophe modeling company AIR Worldwide Corp. estimated.

The late February storm has been compared with Windstorm Klaus, which battered Europe last year and caused \$3 billion in insured damages. Xynthia hit France particularly hard and caused deaths and property damage in parts of Belgium, Germany, Portugal and Spain. With winds of more than 100 mph, the storm damaged buildings, downed power lines and overturned vehicles.

Insured losses likely will range from €1.5 billion (\$2.04 billion) to €3 billion, Boston-based AIR said in a statement. The estimate does not include business interruption or infrastructure losses.

Allianz S.E. expects its losses to be "in the low triple-digit millions" of euros, a spokeswoman for the Munich-based reinsurer said.

Fitch Ratings Ltd. said it expects Xynthia losses to be material but

manageable for French insurers, which are expected to benefit from a state-backed natural disaster compensation program covering hard-to-insure perils such as floods, earthquakes and droughts, the rating service said in a statement. The program was set up in 1982.

The program allows primary insurers to cede coverage for such risks to the state-owned reinsurer Caisse Centrale de Reassurance S.A., Fitch said. The Paris-based company's reinsurance policies are backed by a guarantee from the French government.

Fitch said it expects the majority of insured losses in France to be from flooding, which means a significant amount will be recoverable through the reinsurance program. "Primary insurers are also likely to benefit from reinsurance protection purchased from independent reinsurers," Fitch said in a statement.

In a news conference, French Prime Minister François Fillon called the storm a "national catastrophe." He also said the government will develop a plan to

See **STORM** page 18

HEALTH CARE BENEFITS

Gay marriage law prompts benefits cut

By JOANNE WOJCIK

WASHINGTON—In response to the legalization of same-sex marriage in the District of Columbia, the Catholic Charities of the Archdiocese of Washington will bar all spouses of employees from enrolling in its benefits plan, regardless of their sexual orientation, the organization said last week.

"The change to our benefits package allows us to remain in compliance with District of Columbia law; adhere to the teachings of the Catholic Church on marriage, defined as solely between a man and a woman; and allow us to con-

tinue our partnership with the district in serving more than 68,000 people last year in need," a spokesman said.

The move does not affect benefits offered by other Catholic Charities offices, which operate independently, the spokesman said. The ban also does not extend to coverage for dependent children, and does not affect coverage for any spouses already enrolled in the plan.

The Washington arm of Catholic Charities employs approximately 850 people, about 10% of whom have spousal coverage, the spokesman said.

The District of Columbia's Religious Freedom and Civil Marriage

Equality Amendment Act, which expands the definition of marriage to include same-sex couples, took effect last week after the U.S. Supreme Court declined to hear a challenge of the law. The District of Columbia joins Connecticut, Iowa, Massachusetts, New Hampshire and Vermont in allowing same-sex couples to marry.

Employee benefits experts say the Washington Catholic Charities office may have decided to take the drastic step of excluding all spouses from coverage because, unlike private, self-funded employers that are governed by the Employee Retire-

See **BENEFITS** page 22

INTERNATIONAL

Convictions may expand liability

Italian court finds Google execs guilty in media liability case

By MICHAEL BRADFORD

MILAN—The conviction of three Google executives resulting from an online video showing an autistic schoolboy being bullied has sparked concerns about expanding media company liability in Italy and beyond.

A judge in Milan on Feb. 24 convicted three of four accused Google Inc. executives of violating Italy's privacy code. Google said it will appeal the convictions. The judge,

however, acquitted all four on criminal defamation charges.

The boy's father and an advocacy group sought the charges based on a video shot by pupils at a Turin school. The video was uploaded to Google Videos in 2006.

"The video was totally reprehensible and we took it down within hours of being notified by the Italian police," Matt Sucherman, Google's vp and deputy general counsel for Europe, the Middle East and Africa, said in a statement reacting to the verdict.

Google helped police identify the person who uploaded the video, and she and several classmates were sentenced to 10 months of community service for their involvement in

the bullying, Mr. Sucherman said.

"In these rare but unpleasant cases, that's where our involvement would normally end," he said.

The executives—David Drummond, Arvind Desikan, Peter Fleischer and George Reyes—had nothing to do with the video, according to Google. Mr. Reyes left the company in 2008.

"They did not appear in it, film it, upload it or review it," Mr. Sucherman said. "None of them know the people involved or were even aware of the video's existence until after it was removed."

The conviction has proved surprising to media liability experts.

See **GOOGLE** page 6



REUTERS/LANDOV

Bill Echikson, Google Inc.'s senior manager of communications, said executives convicted in Italy had nothing to do with a video of a schoolboy being bullied. Google is appealing the convictions, which have raised media liability concerns.

REINSURANCE

Insurance exchange backers eye tax break

Industry reaction will set tone: Superintendent Wrynn



Mr. Wrynn

NEW YORK—Regulators and industry officials trying to revive the New York Insurance Exchange may seek a lower federal corporate tax to enhance its appeal, Insurance Superintendent James J. Wrynn said.

Speaking at a membership meeting of the Assn. of Insurance & Reinsurance Run-Off Cos. in Manhattan last week, Mr. Wrynn said he does not want the proposed exchange to be tax-driven. "I want it to provide a real benefit to the industry from a business point of view," Mr. Wrynn said. "With that said, (competitive tax treatment) is something we're definitely exploring."

The department has established working groups of primarily of industry officials to discuss how a revived exchange would operate.

If the working group on taxes recommends it, the department would consider seeking a federal corporate tax rate as low as 20%. If the New York Insurance Exchange reopened today, members would pay a corporate tax rate of about 35%, depending on income, deductions and other factors. London's corporate tax rate is 28% but could decrease to 20% depending on the results of

elections this spring, said Mr. Wrynn, who added that Ireland's rate is 12.5% and Bermuda's is zero.

Mr. Wrynn said the department wants competitive tax treatment for the exchange, rather than tax advantages over other jurisdictions.

He reiterated his belief that a revived exchange in New York would not compete with Lloyd's of London and he said he hoped Lloyd's members would participate in the New York Insurance Exchange. "I'd love Lloyd's to be able to use this, again to complement what they're doing—not compete with what they're doing," Mr. Wrynn said. "I do get a sense from the industry there that they would be interested in a platform" in New York.

He also said if the exchange lacks sufficient industry support, the department would drop the idea.

"As much as I'd like to see something come about as a result of all of our efforts, if in the end it turns out that there is no real need in the industry for this type of facility at this time, we're ready to fold up our tent and move on," Mr. Wrynn said. "There are many, many other issues we have to deal with."

Errors & Omissions

■ A chart on page 10, "Total Captives Worldwide," shows the correct number for captives in 2009, but the bar graph incorrectly indicates that there has been a decline in the number of captives since 2008.

■ An article in the Feb. 15 edition, "Risks for LGBT Population Even Greater," incorrectly reported that Chubb Group of Insurance Cos. would begin covering reassignment surgeries for transgendered employees in 2011. Chubb is considering covering the procedures.

■ In a *Business Insurance* Special Report, "Guide to Global Programs," in an article titled "Cost-Conscious Buyers Tap Broker Resources More Selectively," Jardine Lloyd Thompson Ltd. is incorrectly identified as being a member of the EOS RISQ broker network. JLT maintains its own global network called JLT Network.

INTERNATIONAL

BMW U.K. pension liabilities swapped

By STUART COLLINS

LONDON—The transfer of £3 billion (\$4.57 billion) in U.K. pension plan liabilities of BMW (U.K.) Ltd. is the largest "longevity swap" since the first deal last year and experts say more deals are expected.

However, reinsurers' appetite for backing the deals is limited, experts say.

The United Kingdom is ahead of the game in pension risk management and the availability of risk-transfer products and advice, said David Ellis, head of longevity risk management at Mercer L.L.C. in London.

Many U.K. pension plans have experienced shortfalls in funding. As more transparent accounting

standards have exposed the cost and size of pension plan liabilities, U.K. companies have been eager to tackle the risk of unexpected cash calls from their pension funds, Mr. Ellis said.

As pension fund risk management has improved, sponsors have been looking to "derisk their balance sheets" and are willing to transfer risks to capital markets and insurers, said Sean Kurian, London-based senior investment consultant with Towers Watson & Co.

Pension fund trustees, who commonly hedge risks such as interest rates and inflation, have turned their attention to longevity exposures, he said.

Until longevity swaps were developed last year, the main option for

pension funds wanting to transfer a significant amount of risk was buying what is known as a bulk annuity from an insurer, said Mr. Ellis. Since 2006 at least 44 deals valued over £50 million (\$76.2 million) transferred about £11 billion (\$16.77 billion) in liabilities through bulk annuities, he said.

But providers may struggle to raise capital to back bulk annuity deals if demand increases significantly, he said. An alternative emerged last year with the development of longevity swaps, which enable a pension fund to hedge investment and longevity risks separately, experts say.

The February BMW pension fund

See **BMW** next page

LIABILITY & LITIGATION

Court reconsiders global warming ruling

By JOANNE WOJCIK

NEW ORLEANS—The 5th U.S. Circuit Court of Appeals' decision to rehear a case in which it previously allowed a global warming nuisance lawsuit to proceed suggests this traditionally conservative court may be rethinking its stance, environmental attorneys say.

Last October, a three-judge panel of the 5th Circuit allowed a group of Mississippi residents to sue a host of energy and chemical manufacturing companies for their alleged contributions to global warming that intensified the damage caused by Hurricane Katrina in 2005.

The 2006 suit, *Ned Comer et al. vs. Murphy Oil USA Inc. et al.*, alleging nuisance, trespass and negligence, was dismissed in 2007 by a federal judge in Mississippi, who held that global warming nuisance suits raised political questions that were

WHAT HAPPENED

■ The 5th U.S. Circuit Court of Appeals decided it will reconsider an earlier ruling by a three-judge panel that allowed residents to sue energy and chemical companies.

WHAT'S NEXT

■ The justices will hear arguments in May in the suit that alleges global warming exacerbated Hurricane Katrina losses.

ever, because seven of the 16 judges sitting on the 5th Circuit have recused themselves, only nine justices will hear the case. Oral arguments are scheduled for the week of May 24.

"The fact that they wanted to take a second look implies that there's some question about whether the ruling should stand," said John Nevius, a partner at Anderson Kill & Olick P.C. in New York, who has been following the case.

Mr. Nevius attributed the court's original finding to a 2007 decision by the U.S. Supreme Court in *Massachusetts et al. vs. the Environmental Protection Agency et al.*, which held that greenhouse gases are pollutants under the Clean Air Act. This was further supported by the EPA's 2009 declaration that greenhouse gases endanger human health.

not appropriate for judicial review.

The appeals court panel, however, reversed that ruling last October and said the residents and landowners had legal standing to sue the companies for their alleged contributions to global warming.

The defendants appealed, and the appeals court decided last week that it will rehear the case en banc. How-

See **CLIMATE** page 21

BMW: \$3 billion in pension liabilities transferred

CONTINUED FROM PREVIOUS PAGE

transaction, the fourth longevity swap to date, shows that very large pension funds can transfer risks but retain their assets, said Costas Yiasoumi, managing director of pensions at Swiss Reinsurance Co. in Zurich.

"The transaction is significant because it reinforces the trend for pension funds to hedge exposures associated with life expectancy and longevity swaps as an alternative to bulk annuities," said Mr. Yiasoumi, who led Swiss Re's 1.7 billion Swiss franc (\$1.58 billion) longevity swap with the Royal County of Berkshire pension fund in December, which is administered by the Royal Borough of Windsor and Maidenhead on behalf of the six unitary authority employers and nearly 100 other employers.

The BMW (U.K.) pension fund longevity swap, in which Abbey Life Assurance Co. Ltd. assumed the risk, was more innovative than the three previous deals, said Myles Pink, London-based business development director at Paternoster U.K. Ltd., which structured the transaction.

The swap, which is an insurance contract, transfers the inflation and longevity risk of some 60,000 pensioners, their spouses and children, he said. "The transaction was highly tailored to the BMW (U.K.) pension scheme's benefit structure," he said.

Pricing of longevity swaps is attractive at the moment because the mortality assumptions of pension trustees have been brought more in line with that of banks and reinsurers, said Martin Bird, London-based principal and head of longevity and risk solutions at Hewitt Associates Inc., which provided advice on the BMW (U.K.) pension longevity swap.

An estimated £15 billion (\$22.87 billion) of longevity risk is expected to be transferred from pension funds this year, said Wolf Becke, CEO of Hannover Life Re in Hanover, Germany, the lead reinsurer on the deal.

"The market is growing rapidly and we would expect to write more of this type of business," Mr. Becke said. "Already we have seen interest from a French corporation, but the next market likely to follow the United Kingdom will be the Netherlands."

Only a handful of reinsurers have underwritten longevity risk, but more are considering the line even though total appetite is limited, said Hamish Galloway, London-based senior vp of nontraditional and annuity business at RGA U.K. Services Ltd., a unit of Reinsurance Group of America Inc.

"There is likely to be more demand for longevity reinsurance than reinsurers can handle. The diversification benefits only go so far, and there is a natural limit before you are just adding risk to your portfolio," Mr. Galloway said.

U.K. corporate pension fund liabilities are estimated at more than £2 trillion (\$3.05 trillion), but reinsurance capacity for longevity risk is finite, Swiss Re's Mr. Yiasoumi said. "Even a small shift in demand will

start putting that capacity under stress," he said.

To address a possible capacity shortage for longevity reinsurance, insurers are keen to transfer the exposures to the capital markets, said Alison McKie, managing director of global life and health risk transformation at Swiss Re in London. In January, Swiss Re and seven insurers and banks formed the Life & Longevity Markets Assn. to develop standards, benchmarks and capital market appetite for longevity-linked securities, she said.

LONGEVITY RISK TRANSFERS

Since longevity swaps were developed in 2009, allowing U.K. pension funds to transfer their exposures while retaining the fund's assets, four such deals have been announced. They are:

Sponsor	Counterparty	Reinsurer	Transfer value	Date	Pensioners
Babcock International Group P.L.C.	Credit Suisse Group A.G.	N/A	\$1.14 billion	May 2009	1,400
RSA Insurance Group P.L.C.	Rothesay Life Ltd., a unit of Goldman Sachs Group Inc.	Pacific Life Re Ltd.	\$2.93 billion	July 2009	15,000
Royal Borough of Windsor and Maidenhead	Swiss Reinsurance Co.	Swiss Re	\$1.58 billion	Dec. 2009	11,000
BMW (U.K.) Ltd.	Abbey Life Assurance Co. Ltd., a Deutsche Bank A.G. subsidiary	Hannover Reinsurance Co., Pacific Life Re, PartnerRe Ltd.	\$4.57 billion	Feb. 2010	60,000

*Amounts converted to U.S. dollars. Source: Company announcements

Captive insurers also can play a role in transferring pension fund risk, said Mitchell Cole, a senior consultant in Towers Watson's

retirement risk solutions investment practice in Stamford, Conn. Towers Watson advised on the first transfer of pension risks from a

French corporate pension fund to a captive, and is working on a similar deal in the United Kingdom and Ireland, he said.

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DISCOVER RE

Google: Convictions may expand liability

CONTINUED FROM PAGE 4

"It's certainly something that changes the pattern of the risk," said Paolo Rubini, director of risk management at Telecom Italia S.p.A. in Milan and chairman of Italy's risk management association, the Associazione Nazionale di Risk Manager e Responsabili di Assicurazioni Aziendali. "We are concerned."

"We have to hope that it is an isolated case and does not become a habit," Mr. Rubini said of the convictions. "Otherwise, it will be really difficult for us to manage this new risk from the lack of control of content."

Nick Lockett, a senior partner at DL Legal L.L.P., a London firm that specializes in commercial and technology-related litigation, said the ruling, if upheld, "certainly has the capability" to broaden media company liability.

If it stands, the ruling leaves video site operators in a quandary, Mr. Lockett said. If they monitor uploads and an inappropriate posting makes it online, "they can no longer use the defense that as soon as they knew about it they took steps to take it down," he said. If they don't monitor content to preserve that defense, they risk being held liable for something that appears on their site and is deemed inappropriate, Mr. Lockett said.

The ruling states that the autistic pupil did not consent to have the video uploaded, which puts companies in the position of having to determine how far to go to protect an individuals' privacy on the Inter-

net and other media, he said.

"They will be working in an area where they have to say, 'Where are we safe in putting anything up?' It certainly creates an area of significant uncertainty," Mr. Lockett said.

Risk managers at media companies, familiar with the privacy issue concern, are not entirely surprised, Mr. Rubini said. "We were already concerned about this risk."

"You have to monitor it, demonstrate that you have a controlling system in place," he said of Internet

'You have to be able to control the content, which is not easy.'

Paolo Rubini, Telecom Italia S.p.A.

content. "You have to be able to control the content, which is not easy."

Mr. Lockett said the ruling has implications beyond Italy.

"If this judgment stands, we may well find other European countries saying, 'If the Italians can have tighter controls over this, we can, too,'" he said.

If other courts in Europe follow Italy's lead, media and technology companies should be concerned, said Ian Birdsey, technology and media claims manager at Hiscox Ltd. in London. "It is hard to see what Google could realistically have done differently in the circum-

stances, and a number of media and technology companies would grind to a halt if they were to be required to monitor all user-generated content," he said in an e-mail.

Mr. Birdsey said it would be "extremely surprising" if English courts took an approach similar to Italy's, because responsibility for user-generated Internet content in England generally rests first with users and then with companies that have procedures to remove inappropriate content after receiving complaints.

Whether Google or another media company hit by such a ruling has insurance in place that would respond depends on how the coverage is written and whether monetary damages are assessed, said Luca Franzi, a board member with Milan broker RVA Rasini Viganò S.p.A.

"If it was demonstrated that you created (monetary) damage owed to someone, I think professional liability insurance should apply," Mr. Franzi said. If the damage is "moral," resulting from humiliating someone, there is no loss for a policy to indemnify, he said.

A media company could, however, have insurance to cover costs of defending itself against charges like those faced by Google, Mr. Franzi said.

Mr. Rubini said the Google ruling is so unique that, if upheld, it could create an opportunity for insurers.

"This means that they might have a new market," Mr. Rubini said. "Now that this risk is real, we might find a new market for professional liability."

Commentary

It's always earthquake season somewhere

Is it just me, or does 2010 seem to be an above-average year for earthquake losses?

In just this first quarter, two massive quakes have caused tragedy in Haiti and Chile, and elsewhere on the planet, such as Indonesia and Japan, strong temblors have hit. In Chile late last week, several strong aftershocks caused additional damage. Where will tectonic plates move next?

Seismologists note that earthquakes occur daily, but say most are so small that humans can't easily detect them. It takes a magnitude larger than about 3 to get our attention.

Several weeks ago, northern Illinois experienced a mild quake, of magnitude 3.8, and it shook my house in the suburbs of Chicago. To anyone who lives in a seismically active area and has experienced a quake of magnitude 5 or greater, a 3.8 is small potatoes. But those are relatively rare where I live, and it was unsettling. Fortunately, there were hardly any reports of damage. I can only imagine what it would be like to live through a quake such as the 1994 magnitude 6.7 quake centered in Northridge, Calif., or the recent temblors in Haiti and Chile.

The western United States has well-known geologic faults, and while there are faults in other regions, most people in the Midwest tend to worry more about tornadoes and hailstorms than earthquakes. According to the U.S. Geological Survey, though, about 75 million Americans are exposed to quake risk, and quakes have occurred in 39 of the 50 states.

It's interesting to me how people perceive risk and what actions they take as a result. Inevitably, it takes a catastrophe to demonstrate the downside to underestimating—and underinsuring against—the impact of such perils. How many times have we witnessed a hurricane or flood cause widespread damage for which some victims have no insurance?

Expense is an obvious objection to buying some kinds of coverage, but often prospective buyers don't factor in the cost of retaining the risk themselves. If you're insured and you don't have a claim, you're only out the premium you've paid. But if you lack insurance and experience a loss, well, you're on your own.

Earthquake insurance is expensive, no doubt about it. An average California homeowner



REGIS COCCIA

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

in, say, Riverside, east of Los Angeles, could pay more than \$500 in premium for a basic quake policy that carries a deductible of 15% of the insured value. Put that in perspective: On a home worth \$300,000, the deductible alone would total \$45,000.

Should I buy earthquake coverage where I live? Good ques-

If you're insured and you don't have a claim, you're only out the premium you've paid. But if you lack insurance and experience a loss, well, you're on your own.

tion, but because the risk of major damage from a quake in northern Illinois is quite low, and the coverage I have protects against the more common perils, I don't feel an urgent need to have it. And I don't lose any sleep about not having earthquake coverage. If I lived in Alaska, California or Washington state, though, I likely would feel differently.

Californians have been waiting for the "The Big One" for quite some time. Television programs point out that catastrophic earthquakes could occur any moment along the faults in California and the Pacific Northwest. Apocalyptic movies are popular lately, including the film "2012," about worldwide natural catastrophes, including a 10.9-magnitude quake calving Southern California from the continental United States like an iceberg.

While I sincerely hope we never see anything like that, one thing we have to remember is, it's always earthquake season.

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Business Insurance OPINIONS

Obama's involvement in reform a necessity

WE WELCOME President Barack Obama's direct involvement in fashioning health care reform legislation and hope it continues.

Until recently, the president was content to let lawmakers shape the legislation, offering only very broad principles and delivering what amounted to pep talks to the public and Congress.

The results of President Obama's distance were flawed bills that led to rising public distrust of those measures.

Some provisions were tucked in not because they were in the public interest, but to win support of lawmakers and interest groups. Perhaps the best example is a provision in the Senate bill that would give extra Medicaid money to the state of Nebraska, a provision added when Senate Democratic leaders were courting the support of Sen. Ben Nelson, D-Neb.

Health care reform is too important for the executive branch to play only a consulting role in its shaping.

Yet another deal—not formally incorporated in the legislation—would give health care plans negotiated as part of collective bargaining a multiyear exemption from a tax on the costliest plans. No other plans would have gotten such a pass.

The president said both provisions have to go, as they should. Neither has anything to do with health reform. Reform legislation would be improved, as the president has proposed, by making it clear that high-deductible plans linked to health savings accounts should continue to be a design option open to employers, as well as giving employers in high-turnover industries more time to cover their employees.

We hope President Obama's involvement will continue. Health care reform is too important for the executive branch to play only a consulting role in its shaping.

As the recent White House health care summit demonstrated, President Obama's understanding of health care issues may be unmatched by anyone in Congress.

NFIP needs to receive long-term extension

HERE WE GO again.

After several days of political theater, the U.S. Senate approved a bill extending the National Flood Insurance Program to March 28. The extra time was part of a larger measure to extend a variety of federal programs.

The catch was that the NFIP lapsed for a few days. But with another very short-term fix in place, there's no guarantee that the program won't slip into legislative limbo again in the future, something that lawmakers should avoid.

Any lapse, no matter how short, adds to policyholders' uncertainty as to whether claims would be paid. As we've argued before, the NFIP deserves a long-term solution.

The reason the program has been the subject of short-term extensions is simple: The House and Senate cannot agree whether the NFIP should be expanded to provide windstorm coverage.

Given the program's already precarious finances, it shouldn't be expanded to provide cover that's available in the private marketplace.

We believe the best approach is to extend the program in its current form for a reasonable period. That would give lawmakers time to make any needed reforms to the program. We've gone down the road of short-term fixes far too many times. The NFIP's policyholders don't need to go there again.



WRITE

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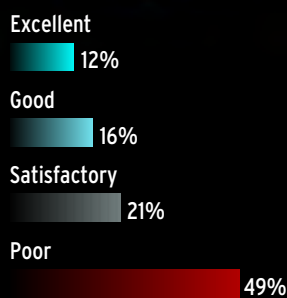
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THIS WEEK'S RESULTS

From a risk management perspective, how would you rate Toyota's response to its recall?



NEXT WEEK'S QUESTION

Q: How will President Obama's direct involvement affect the passage of health care reform?

LETTERS

Trust, transparency and contingents

TO THE EDITOR: The major insurance brokers have spent five years in a contingent commissions detox program. In my opinion, this half decade of cleansing in retail insurance brokerage has led to better business all around.

During those years, buyers of insurance were the real beneficiaries getting, at last, the undivided loyalty of their brokers. Willis is healthier for having sworn off contingents voluntarily in 2004.

We've retained clients and won new ones for standing firm that these end-of-the-year payments and other thinly veiled forms of compensation create an irreconcilable conflict of interest.

The commissions at issue are those compensation arrangements between retail insurance brokers and insurance carriers in which payment is contingent upon such factors as the growth or profitability of a book

See **LETTERS** page 19

PERSPECTIVES

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COUNTING CAPTIVES

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

DOMICILE	2009	2008
Bermuda	885	960
Cayman Islands	780	777
Vermont	560	557
Guernsey	355	370
British Virgin Islands	285	332
Luxembourg	251	262
Barbados	225	230
Anguilla	209	200 ¹
Turks & Caicos Islands	203 ²	182 ²
Hawaii	162	165
South Carolina	161	156 ⁴
Utah	148	122
Isle of Man	145	156
Nevada	126	123
District of Columbia	116	90
Dublin	114	131
Kentucky	105	67
Arizona	99	106 ⁴
Singapore	63	63
Delaware	49	41
Montana	47	35
New York	47	50
Switzerland	42	42 ⁴
Labuan	32 ¹	30
New Zealand	22	20
British Columbia	18	17
Georgia	18 ¹	14
Gibraltar	17 ³	19 ³
Bahamas	15	16
Netherlands Antilles	14 ¹	15
Mauritius	12 ¹	13 ¹
Vanuatu	10	16
Malta	9	7
Colorado	6	6
Missouri	6	3
Alabama	5	3
Panama	5 ¹	5
Puerto Rico	5	0
Tennessee	4	3
Jersey	3	5
U.S. Virgin Islands	3	3
Hong Kong	2	2
Michigan	2	1
Arkansas	1	1
Illinois	1	1
Kansas	1	1
Oklahoma	1	1
South Dakota	1	1

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

Source: BI survey
Researched by Kevin Edison and Karen Tucker



Cost-conscious parent companies tap their captives to enhance corporate capital

By **RODD ZOLKOS**

The captive insurance market was a two-sided coin in 2009, with a healthy level of interest in new captive formations even as a sizable number of captives closed shop in many domiciles.

While 345 new captives formed around the world last year, roughly 300 gave up their licenses. Last year's captive activity brought the world's total number of captives to 5,390, according to *Business Insurance's* annual captive survey.

In mature captive domiciles, the trend often saw captive closures nearly equaling new formations and, at times, outpacing them.

Bermuda, for example, licensed an estimated 27 new captives in 2009 while 54 closed. In the Cayman Islands, 40 new captives were licensed and 37 closed. Guernsey issued 18 new licenses while 33 captives closed. The Isle of Man issued five licenses and saw 16 captives close, and Vermont licensed 39 new captives while closing 36.

"We're about on the same pace this year. So far, we're closing down as fast as we're opening them up," said David F. Provost, deputy commissioner in the Captive Insurance Division of the Vermont Department of Banking, Insurance, Securities & Health Care Administration.

"But when I look at what we closed down, two of them were companies that had two or more captives and merged their own captives," he said. "Another was one that had been dormant for years. It's not like we lost any business there."

"In a way it's growth," Mr. Provost said. "Even if we don't grow the total number of captives, we're still replacing stale old captives with fresh new growing ones. So it still amounts to growth."

"It was an interesting year," said Peter Willitts, president of Liberty Mutual Management (Bermuda)

Ltd. in Hamilton, Bermuda. "Corporately, it's rolled down—people's attention to capital, capital allocation and expenses. It's hit Bermuda."

Captive parents have been taking back capital from the captive where they can, Mr. Willitts said. In some cases where they weren't using a captive but keeping it alive against the possibility of using it again in the future, they've decided to shut the captive down, he said.

Nancy Gray, regional managing director at Aon Global Insurance Managers in Burlington, Vt., said many of the captives closed last year had been moving in that direction for some time.

"These captives were already in various stages of liquidation or in the process of getting dissolved," Ms. Gray said. "It's just that with the capital crunch, the need for capital at the parent company level, trying to release some of the collateral at some of these captives, it became more accelerated during 2009."

"We actually had quite a few close down at the end of the year," said Gary Osborne, president of USA Risk Group in Montpelier, Vt. "We had one that distinctly did it because they wanted the money. The liabilities are still there, but they needed the cash."

Despite the economy's effect on captive closures, its ultimate effect on captive business is mixed, said John Lochner, senior consultant in Towers Watson & Co.'s insurance consulting business in Weatogue, Conn.

"Clearly, companies are looking for ways to continue to reduce cost. Sometimes that means forming new captives or expanding existing ones; other times, it means closing down their one and only captive or closing down a couple of the captives if they had multiple operations," Mr. Lochner said.

Michael Bemis, president and CEO of the National Catholic Risk Retention Group Inc. in Lisle, Ill., said

See **MARKET** page 11

CAPTIVES LEADING DOMICILES

SPOTLIGHT

BI RANKS LARGEST CAPTIVE MANAGERS WORLDWIDE

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EMPLOYER INTEREST GROWING IN CAPTIVES FOR BENEFIT RISKS

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OWNERS LEVERAGING CAPTIVE ASSETS TO OFFSET EXPENSES

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ECONOMIC SQUEEZE TRIMS MANAGERS' STAFF, NOT SERVICE

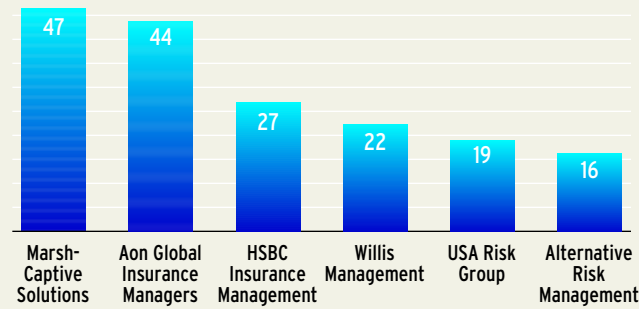
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Q&A WITH DEUTSCHE POST'S HUGH O'NEILL ON PIONEERING MOVES

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LARGEST MANAGERS OF PROTECTED CELL COMPANIES

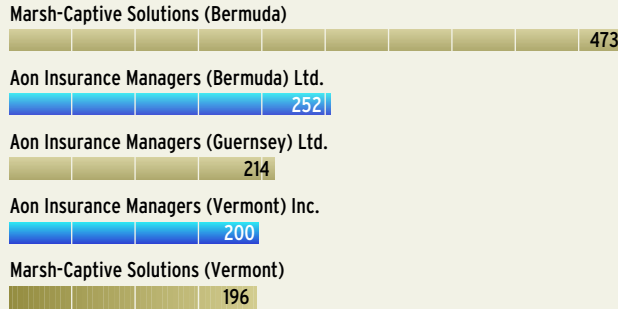
Ranked by cell companies managed



Source: BI survey

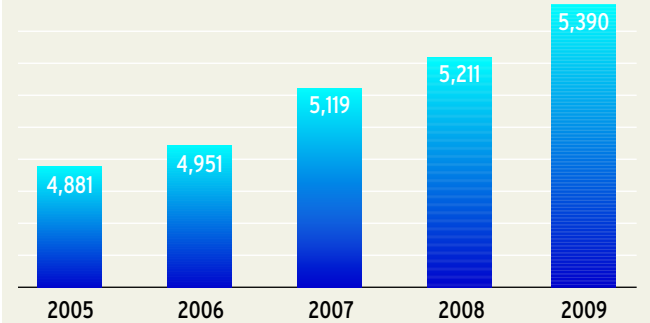
LARGEST MANAGERS BY DOMICILE

Ranked by captives managed in a single domicile at year-end 2008



Source: BI survey

TOTAL CAPTIVES WORLDWIDE



Source: BI survey

Largest captive managers worldwide

Ranked by captives managed worldwide in 2009

Rank	Company/Address	Phone/Web site	Captives 2009	Captives 2008	Domiciles	Captives formed in 2009	Total staff	Principal officer
1	Marsh-Captive Solutions 1166 Ave. of the Americas, 37th Floor, New York, N.Y. 10036	212-345-7769 www.marsh.com	1,272	1,118	33	39	527	Michael Cormier, managing director-Global Captive Solutions practice leader
2	Aon Global Insurance Managers St. George Court, Upper Church St., Third Floor, Douglas, 1M1 1EE Isle of Man	44-1624-692-400 www.aon.com	1,253	1,267	41	N/A	469	Andrew Tunnicliffe, COO
3	Willis Management 1 Lawson Lane, Suite 410, Burlington, Vt. 05601	802-658-9466 www.williscaptives.com	310	298	23	17	130	James Girardin, executive vp
4	USA Risk Group P.O. Box 306, Montpelier, Vt. 05601	800-872-7475 www.usarisk.com	237	254	14	9	64	Gary Osborne, president
5	HSBC Insurance Management 8 Canada Square, London, E14 5HQ England	44-207-991-0273 www.insurancemanagement.hsbc.com	211	194	12	15	98	Roy Fellowes, chief executive
6	Alta Holdings L.L.C. 2010 Main St., Suite 650, Irvine, Calif. 92614-7294	949-269-1400 www.altaholdings.com	139	117	8	19	35	Bruce Molnar, CEO
7	Active Captive Management 16485 Laguna Canyon Road, Suite 250, Irvine, Calif. 92618-3837	800-921-0155 www.activecaptive.com	124	92	4	N/A	34	Fred Turner, president
8	Strategic Risk Solutions Inc. 2352 Main St., Concord, Mass. 01742	781-487-9800 www.strategicrisks.com	116	95	9	13	31	Brady Young, managing director/president
9	Tribeca Strategic Advisors L.L.C. 1635 N. Greenfield Road, Suite 115, Mesa, Ariz. 85205	480-248-6400 www.captiveadvisors.com	110	2	7	32	17	Karl Huish, president
10	AMS Group Sea Meadow House, P.O. Box 116, Road Town, Tortola VG1110 British Virgin Islands	284-494-3399 www.amsbvi.com	106	100	2	14	12	Derek Lloyd, director/insurance manager

N/A: Not available

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.

Market: Parents look to captives for capital

CONTINUED FROM PAGE 9

captive formations are part of the current "slow, steady" growth of the market and "are being formed for all the right reasons." They're taking a long-term view, focusing on broad coverage, proper limits and reasonable rates, and will be there when the traditional market turns, he said.

In general, the economy still is making it difficult for new group formations. In fact, 2009 was the first year with a net loss in the number of risk retention groups since 2000, with 18 RRGs ceasing operations and eight new ones forming.

"Something that you would expect is very few formations of risk retention groups. And in the last 18 months, we've only looked at one," said Jeff Kehler, program manager of alternative risk transfer services in the South Carolina Department of Insurance.

"I think it's difficult for companies to band together at this point in time when a lot of companies are having such difficulty," said Mark Bernfeld, senior consultant with Towers Watson's reinsurance brokerage business in Boston. "Even if they can get letters of credit or whatever, they may be in a situa-

'Unless you're a very big company, the geographic thing is becoming very substantial.'

Gary Osborne, USA Risk Group

tion where they don't want to band together, because they don't know how the next guy's going to do."

Collateral issues remain a concern for existing captives and new formations, and the cost of letters of credit isn't showing any sign of easing.

"We're getting ready in 2011 to renegotiate our LOC facility," said Richard Rabs, vp, claims and risk management at Veolia Transportation Inc. in Chicago, which operates fronted programs through its Guernsey captive, Camelback Insurance (Guernsey) Ltd. "We're getting ready to reduce our LOCs and those we're going to have to cover will be very expensive."

"I've had several people talk to me about, 'Have you considered setting up a collateral trust?' But that's tying up a lot of cash," Mr. Rabs said. "Nobody's looking to tie up the cash we've got there in the first place. Nobody wants to tie up additional cash in the captive."

Despite the economy, a soft traditional insurance market and collateral issues, those in the captive industry still see potential for captive growth in the year ahead.

"I believe the growth in the next few years will be in the middle-market sector," said Aon's Ms. Gray. She also sees growth opportunities in health care industry captive and physician groups, and in areas where companies are looking at customer risk and ideas such as selling extended warranties through captives.

"We're working on a lot of warranty programs right now," said USA Risk's Mr. Osborne. USA Risk has seven or eight such prospects in

the works, he said.

Towers Watson's Mr. Lochner said among the clients he's talking with about captive opportunities are two public entity pools that "want to explore potentially a different operating model, or a complementary risk financing structure."

Another area of anticipated growth is using captives for employee benefit programs. "We are seeing a lot more in employee benefits," said South Carolina's Mr. Kehler. "At the end of last year, 3M (Co.) moved their international employee benefits into their captive that they did here."

"We're seeing other companies that formed their captives last year

now getting Department of Labor approval and doing more employee benefits," he said.

As companies look to form captives, the economy also is increasing the role of geography in choosing a domicile. "If you've got a domicile close to home and it costs less to travel there and you need to do that a number of times...more companies may be interested in taking advantage of that," Mr. Bernfeld said.

"Unless you're a very big company, the geographic thing is becoming very substantial," said USA Risk's Mr. Osborne. His company recently placed some Indiana-based companies' captives in Kentucky,

for example, and he said he believes Hawaii is well-positioned with companies based in western states. "The stability they've had for a long time is appealing right now," he said.

The economy also is causing some to be wary of newer domiciles' commitment to the captive business, some experts say.

"One of the issues of concern given the economy is will these less mature, these newer domiciles, be committed for the long run in terms of providing the necessary regulatory oversight and staffing for their departments," Mr. Lochner said. "If you're a new domicile and you're trying to regulate on a shoestring budget, that could be setting yourself up for failure."

"Last year we did five in Vermont, which is the most we've done in

Vermont in a long time and I think part of that was that little bit of a flight to quality," said Mr. Osborne.

Political uncertainty involving the Obama administration's budget plans and its potential effect on offshore captives also is a potential factor in domicile selection. "I think Vermont did very well last year for that reason," Mr. Osborne said.

Rhetoric about additional taxation of offshore business inevitably "creates an environment of uncertainty, so more companies are potentially looking at forming onshore rather than offshore," Ms. Gray said.

"At the end of the day, maybe nothing will happen, but the uncertainty right now is enough to drive some of those decisions," said South Carolina's Mr. Kehler.

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Smaller firms turning to captives

By **JERRY GEISEL**

Captive insurance companies are performing a new role with a new group of players.

Utilized for decades by larger employers to cover their property/casualty exposures, small and midsize employers are turning to captives to fund a portion of their health care benefit risks.

"This is the newest frontier," said George O'Donnell, a senior vp with Aon Consulting in Somerset, N.J.

"The potential here is huge," said Dick Goff, a managing member

with captive manager Taft Cos. L.L.C. in Towson, Md.

Smaller employers' health care benefits captive funding is taking a variety of directions. In some cases, small employers, with the help of third-party claims administrators or benefit consultants, are joining forces to set up their own captives or using a cell in an established captive to cover risk above a self-insured retention.

In other cases, small- and medium-size employers—typically defined as firms with between 50 and 500 employees—are securing

coverage in captives owned by TPAs or trade associations to which they belong.

"A variety of models are being used," said Karin Landry, a managing principal with Spring Consulting L.L.C. in Boston.

Regardless of the approach, small employers banding together to fund health care benefits risks are so doing with the singular purpose of saving money.

By boosting retentions and pooling risks in captives with other employers—who typically agree to put in wellness, disease manage-

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DRIVE TO FUND EMPLOYEE BENEFIT RISKS THROUGH CAPTIVES

Employers that have received approval to fund benefit risks in their captives under rules the Labor Department liberalized in 1999.

EMPLOYER	BENEFITS FUNDED	CAPTIVE DOMICILE	YEAR OF APPROVAL
Columbia Energy Group ¹	LTD, Life	Vermont branch of Bermuda captive	2000, 2007
Archer Daniels Midland Co.	Life	Vermont	2003
International Paper Co.	Life	Vermont	2003
Alcon Laboratories Inc.	Life, LTD	Vermont	2004
SCA Corp.	AD&D, Life, LTD	Virgin Islands branch of Ireland captive	2004
Alcoa Inc.	Life	Vermont	2005
Sun Microsystems Inc.	Life	Vermont branch of Bermuda captive	2005
AstraZeneca	AD&D, Life, LTD	Vermont	2006
H.J. Heinz Co.	Life, LTD	Vermont	2006, 2008
AGL Resources Inc.	AD&D, Life, LTD	Hawaii branch of British Virgin Islands captive	2006
Wells Fargo & Co.	Life, LTD	Vermont	2006
Cephalon Inc.	Life, AD&D, LTD	Vermont branch of Bermuda captive	2008
YKK Corp. of America	AD&D, Life, LTD	Vermont	2008, 2009
ConAgra Foods Inc.	Life, AD&D	Arizona	2008
United Technologies Corp.	Life, AD&D, LTD	Vermont	2008
DHL Express ²	LTD	Vermont branch of Bermuda captive	2008
Memorial Sloan-Kettering Cancer Center	Life, LTD	Vermont	2008
Dow Corning Corp.	Life, LTD	District of Columbia	2009
Banner Health	Life	U.S. Virgin Islands branch of Cayman Islands captive	2009
Microsoft Corp.	LTD	Vermont branch of Bermuda captive	2009
Coca-Cola Co.	Retiree health ³	South Carolina	2010

¹ Later acquired by NiSource Inc. ² And other U.S. affiliates of Deutsche Post A.G. ³ Tentative authorization.

Source: BI survey

ment and other programs to lower claims costs—small employers hope to keep increases in health insurance costs more in check.

"Captives can be an excellent solution" to slow increases in costs, Ms. Landry said.

In addition, by pooling their risks in a captive program, participating small employers can hold on to profits—if premiums they pay exceed claims and other costs—rather than surrendering profits to a commercial insurer, as would be the case in a fully insured program.

"We can save employers money by eliminating carrier profits," said Gary Becker, president of Becker Benefit Group Inc. an Owings, Md.-based insurance agency and consultant that works with small and midsize employers on group health care captive approaches.

Some of the programs are relatively new. For example, Avizent Alternative Re, a unit of Avizent, a Columbus, Ohio-based TPA and risk management service provider, launched a program last month that provides coverage above a minimum \$25,000 self-insured retention to employers with at

least 50 employees.

Coverage is offered through a cell that is part of a Bermuda captive, Atlantic Gateway International Ltd., which Avizent owns.

By year-end, "we'd like to have 1,000 lives covered through the program," said Rick Stasi, chief operating officer for Avizent Alternative Risk in Lexington, Ky.

Other programs are expanding. For example, Vermont-domiciled SystemsPlus Mutual Insurance Co. was launched last year as an association captive to provide coverage to the small-business membership base of the Cedar Rapids, Iowa-based National Systems Contactors Assn.

Then in January, the captive was redesigned into a sponsored segregated cell captive. In that arrangement, other trade organizations and industry groups can utilize cells to provide coverage to participating members, said Tim Johnson, CEO of Benefit Captive Re in Norwalk, Iowa, which is the captive's program manager. The newest cell participants are members of the Oak Brook, Ill.-based Associated Equipment Distributors Inc.

Captive owners using assets to back LOCs

High collateral costs make it more difficult for captives to form

By **ROBERTO CENICEROS**

The high cost of collateral is pushing more captive owners to leverage their facilities' financial assets to offset the expense, several captive experts say.

Captives more often are using their assets, such as cash premiums paid into the facility or money that's been invested to pay captive losses, to back letters of credit or fund trusts that fronting insurers can tap should a captive owner fail to pay claims and leave the insurer on the hook, experts say.

In addition, high collateral costs are keeping certain captives from forming, said Mark Bernfeld, a senior consultant in Boston at Towers Watson & Co.'s reinsurance brokerage business.

As upper management pressures a company's captive operations to rely less on the parent's line of credit, several sources say the asset-leveraging strategies are being applied more often to satisfy collateral needs.

"That is becoming much more prevalent—shifting the responsibility to post collateral down to the captive rather than it being (provided) at the parent company level," said Jason Palmer, director of Willis Management Hawaii, a Honolulu-based captive manager and unit of Willis Group Holdings P.L.C. "It's a shift in the party that is providing that collateral."

Constricted credit markets have made it more costly for corporations to obtain the credit limits they desire from their banks, prompting the change.

"What we are seeing is the cost of capital is such that, at the parent level, they don't want to tie up that line of credit," said Jason Flaxbeard, senior managing director in Denver for broker Beecher Carlson Holdings Inc.

Collateral cost increases have been substantial in some cases, said Lisa K. Wall, a senior vp at Lockton Cos. L.L.C. in Kansas City, Mo. For "a lot of companies, their letter-of-

credit costs have doubled and if not, tripled (then) quadrupled," she said. "Those increases in cost are material to their business."

Captive owners rely on collateral to meet fronting insurer demands. The insurers traditionally require collateral to offset their credit risk resulting from an obligation to pay claims should their insured fail to do so.

Requiring collateral is most common when workers compensation claims are at stake and insurance regulators would insist that a fronting insurer bear the burden if a captive insurer could not meet its statutory obligations.

But collateral arrangements also are common for other lines of cov-

'What we are seeing is the cost of capital is such that, at the parent level, they don't want to tie up that line of credit.'

Jason Flaxbeard,
Beecher Carlson Holdings Inc.

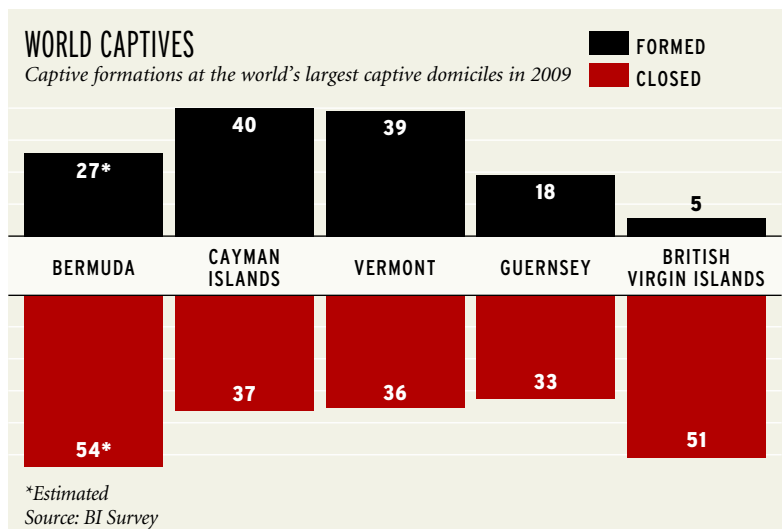
erage, such as general liability and auto liability policies, sources said.

Simultaneously, with credit becoming more challenging to obtain from banks, insurers are demanding that policyholders provide greater financial assurance claims will be paid, sources said.

To mitigate collateral costs, the use of bank instruments referred to as Section 114 trusts has grown in popularity recently although the trust arrangements have been available for years, Mr. Flaxbeard and others said. Under the three-party agreements involving the captive owner, a bank and a fronting insurer, the insurer is named as the trust's beneficiary.

For example, the Alliance of Schools for Cooperative Insurance Programs won't pay ever-increasing basis points for letters of credit for the captive it owns, said Paula Chu Tanguay, CEO. Instead, the Cerr-

See **COLLATERAL** page 15



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Some captive managers trim staff but not services

By **DAVE LENCKUS**

Recessionary pressures and soft insurance pricing have financially challenged captive managers, but managers generally have maintained the quality of their services and even added a few, say captive owners and regulators.

While some new services generate additional revenue for captive managers, limited new captive formations since 2008 have pinched many managers' revenue streams. Many potential captive owners have been reluctant to tie up capital in captives until the recession wanes, and the soft insurance market has made that an easier decision, managers and regulators say.

To remain profitable, many captive managers are cutting expenses—including staff in some cases—but not to captive owners' detriment, observers say.

"We've seen no curtailment in the services our captive manager's provided us," said Sheila Small, assistant treasurer-risk management and insurance for New York-based Verizon Inc. The captive solutions practice at New York-based Marsh Inc. manages Verizon's Vermont-domiciled captive.

The Cayman Islands-domiciled captive owned by Urbana, Ill.-based Carle Foundation Hospital has not only experienced continued strong service from its manager, the manager's staff has grown, said Lawrence J. Fallon, Carle's senior vp-legal affairs. Carle switched in August 2008 to Strategic Risk Solutions Inc. in Concord, Mass., because of the electronic communication services the captive manager provides, Mr. Fallon said.

Regulators report that managers, overall, have not shed employees to the same extent as corporate America.

For example, in South Carolina, where captive formations in 2009 fell more than one-third to 15, captive managers "have been very loyal to their employees," said Ronald Krebs, applications coordinator in the South Carolina Insurance Department's Alternative Risk Transfer Service in Charleston.

Managers' staff count in South Carolina last year fell 3% to 4% from 2008 levels and only because of attrition, Mr. Krebs said.

In Vermont, the nation's largest captive domicile, managers' full-time staff count dropped by one last year to 231, said David Provost, deputy commissioner of captive insurance.

"I don't think service changed at all" and there was no unusual account churning to support that assessment, said Mr. Provost.

Even staff cuts do not necessarily mean a significant reduction in professional resources, managers said.

For example, Marsh last year trimmed its Vermont captive management staff by about 10 and independent manager USA Risk Group Inc. in Montpelier, Vt., shrank its staff 4.9% overall.

For Marsh, consolidations and closures among captive insurer clients—an industry trend—drove much of its staff reduction through layoffs and attrition, said Michael Cormier, a New York-based managing director for Marsh and CEO of its captives practice, and Julie S. Boucher, Marsh's Burlington, Vt.-based

U.S. captives practice leader.

Contributing to staff cuts, Marsh reduced local office administrative personnel and now provides centralized administrative services, the executives said.

At USA Risk Group, two of three net staff cuts occurred in one office where recent hires were terminated when anticipated new business didn't develop, said Jeff Kenneson, Burlington, Vt.-based senior vp-business development.

Even Beecher Carlson Insurance Services L.L.C.'s reported 11.1% staff reduction is misleading, said Jason Flaxbeard, a Denver-based senior managing partner. The reduction reflects Beecher's decision to exclude marketing personnel, who remain with Beecher, from its captive management staff count, he explained.

Like Marsh's administrative services retooling, many managers said they found other ways to control costs without eliminating personnel.

"So it's not so much a cost-cutting process we're going through, but better cost management of resources we have," said Nancy Gray, the Burlington, Vt.-based regional managing director-Americas at Aon Global Insurance Managers, a unit of Aon Risk Services Inc.

Some managers even have grown.

For example, Strategic Risk Solutions last year boosted its staff by 15%, said Brady Young, president and CEO. That was driven in part by an increase in new and established captives under

management during the past two years, he said.

But, he said, expanding staff also was necessary to handle established clients' additional service demands.

That's a trend many captive managers have seen.

For example, captive owners are looking for help to protect and maximize capital, said Tom Coughlin, the New York-based head of the global captive practice at Willis Group Holdings P.L.C. and a national partner with Willis North America, and Malcolm Cutts-Watson, the London-based chairman of the international captive practice.

Captive owners, the Willis executives said, want to consolidate or close multiple captives obtained through mergers and acquisitions; place their only captive in dormancy; develop revenue-producing coverages, such as warranty insurance for products they sell; and evaluate the strength of and service agreements with fronting insurers and reinsurers.

Other capital-related advice that captive owners want includes how to return capital to parent companies through loans or dividends and, for European-based captives, meet the risk-based capital requirements under Solvency II, captive managers said.

Captives also are asking for help in preparing financial reports, conducting audits, performing administrative duties and covering more parent-company risk, managers and captive owners said.

Not all managers, however, provide top-notch service at all times, observers said. But, they noted, disappointing service occurs occasionally even during heady economic times.

Questions & Answers



Deutsche Post A.G. didn't set out to break new ground when it established its Bermuda-based captive, Marias Falls Insurance Co. Ltd., in 1984. The captive insurer was set up in response to the hard market for U.S. workers compensation insurance at the time, said Hugh O'Neill, the Bonn, Germany, delivery giant's senior vp, insurance and risk management. It eventually became clear, however, that the captive would be well-suited to fund Deutsche Post's employee benefit coverages. The company, which now operates after numerous acquisitions under the brand Deutsche Post DHL, began a pioneering effort in 2002 to fund those coverages in a captive for its far-flung global network of delivery operations. Mr. O'Neill spoke with Business Insurance Senior Editor Michael Bradford about the evolution of Marias Falls and how its success saves his company millions of euros each year.

Captive pioneer finds success

Q: When did you become involved with Marias Falls?

I came along in 1988. I took over the risk function at DHL in the early 1990s and began to grow the captive to become the central risk financing vehicle for the group.

Q: Why did you take that approach?

We had a huge range of frequency exposures and very few catastrophe exposures—a perfect fit for a captive. A captive could operate effectively at lower costs compared to the traditional insurance market.

Q: How did Marias Falls expand over the years?

In 2002, DHL was acquired along with other companies by Deutsche Post. Marias Falls was operating global insurance programs and had a range of insurance products that happened to fit the nature of exposures and logistics activities of the growing company. So we were invited to roll the risk exposure of other companies Deutsche Post had acquired into the captive strategy. One of the bold decisions that was made at the time was to finance employee benefits in the same way property/casualty was financed. We decided that life, medical, disability and other benefits would be funded in the captive.

Q: Were you going out on a limb at the time by financing benefits in a captive?

We weren't really going out on a limb. The thought process at the time was that we have a captive writing noncatastrophe, property/casualty frequency exposures. At the time the benefits insurance process was (handled) through human resources, the procurement (was made) through the normal insurance market for life and medical coverages. It had the same profile—high-frequency spread over many jurisdictions. But if you called it employee benefits, it was in the local market. If it was property/casualty insurance, most of the big companies used captive insurance to finance it. We said, "Why is that the case? It's still noncatastrophe business." The insurance market

at the time said no one had done it before and what we really wanted was a pool. We didn't want a multinational pool; we wanted to assume the risk and set the front-end price.

Q: Were you the first to fund benefits through a captive?

There certainly was not a global program like ours doing it. We had benefits in more than 100 countries. No one had tried it with a global program.

Q: Were there regulatory hurdles, as you were a pioneer in this area?

No, the regulatory regime was relatively flexible. It's slightly different in the U.S. because the Department of Labor is one of the regulatory bodies, but other than that, the regulatory constraints were fairly few. The problem was not of a regulatory nature: It was of a skills nature and experience. The problems we encountered were more a lack of experience in the life and benefits business. The benefits insurance networks had not done this before and were not familiar with captives. They were familiar with pooling agreements. It took about a year, but once their hearts and minds were in it, it was just a question of rolling it out.

Q: How much does Marias Falls save Deutsche Post in insurance costs?

It saves around €100 million (\$136.2 million) per year to insure through the captive rather than buy insurance in the traditional market. Employee benefits in the captive save something like €13 million (\$17.7 million) per year.

Q: Do you operate other captives?

We have six. They have been acquired mainly through acquisitions of other companies. We are consolidating those.

Q: What are the biggest challenges faced by captive owners?

There obviously is a lot of focus on the regulatory environment. Solvency II is a current issue and planning for that will require a lot of effort. There will be a lot of work to plan for the changes.

Collateral: Owners using assets

CONTINUED FROM PAGE 13

tos, Calif.-based school insurance program continues earning interest from investment funds it places in an escrow trust for its captive's fronting insurer.

In this case, however, ASCIP provides the investment assets placed in the trust account, not its captive, Ms. Tanguay said. ASCIP's Hawaii-domiciled facility, Captive Insurance for Public Agencies, insures an owner-controlled insurance program for school construction.

Not all insurers allow replacing letters of credit with trust accounts, Ms. Tanguay said.

Regardless, negotiating with the insurer to reduce the collateral amount is the most important step for a captive owner, she said. "That is all negotiable," Ms. Tanguay said.

To remain competitive and retain clients, more insurers have begun

'Carriers respect the fact that if they don't do something, someone else is going to.'

Jason Palmer,
Willis Management Hawaii

accepting the trust arrangements, rather than only letters of credit, sources said.

"It's becoming more of an issue at the carrier level because companies are coming to them and saying, 'We would like to use our captive assets to provide collateral. What can you do to help us?'" Mr. Palmer said. "And carriers respect the fact that if they don't do something, someone else is going to."

Using captive assets to back letters of credit also is a growing strategy that reduces a bank's risk.

In return for using captive assets to secure LOCs, rather than relying on unsecured LOCs, captive owners should see their banks reduce the basis points charged for the collateral instruments, Ms. Wall said.

But in other cases, entities that otherwise might form an association or group captive are not doing so in part because banks normally view them less favorably than they do larger companies that already have an established captive, Towers Watson's Mr. Bernfeld said.

Association captives typically are set up by smaller entities that would face high costs for LOCs if they could obtain them, Mr. Bernfeld said. That additional cost, along with competitive pricing for insurance, is a likely factor in a recent slowing of captive formations, he said.

"It's just one more factor (slowing the formation of facilities), but I do think it's an important factor," Mr. Bernfeld said.

LARGEST U.S. CAPTIVE DOMICILES

Ranked by number of captives in 2009

DOMICILE	2009	2008
Vermont	560	557
Hawaii	162	165
South Carolina	161	156
Utah	148	122
Nevada	126	123
District of Columbia	116	90
Kentucky	105	67
Arizona	99	106
Delaware	49	41
Montana	47	35

Source: BI Survey

LARGEST EUROPEAN CAPTIVE DOMICILES

Ranked by number of captive in 2009

DOMICILE	2009	2008
Guernsey	355	370
Luxembourg	251	262
Isle of Man	145	156
Dublin	114	131
Switzerland	42	42
Gibraltar	17	19
Malta	9	7
Jersey	3	5

Source: BI Survey

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SOUTHERN DISTRICT OF NEW YORK

IN RE PETITION OF DAN YORAM SCHWARZMANN AND MARK CHARLES BATTEN, AS PROVISIONAL LIQUIDATORS OF INDEPENDENT INSURANCE COMPANY LIMITED,
DEBTOR IN A FOREIGN PROCEEDING
CASE NO. 01-13899 (SMB)

NOTICE IS HEREBY GIVEN THAT ON FEBRUARY 25, 2010, THE BANKRUPTCY COURT ENTERED AN ORDER (THE "ORDER") CONTINUING THE PRELIMINARY INJUNCTION ORDER PURSUANT TO 11 U.S.C. §304 ORIGINALLY ENTERED IN THIS CASE ON JULY 31, 2001. THE ORDER SHALL REMAIN IN EFFECT PENDING A HEARING SCHEDULED TO BE HELD ON FEBRUARY 24, 2011 AT 10:00 A.M. (THE "RETURN DATE") BEFORE THE HONORABLE STUART M. BERNSTEIN, UNITED STATES BANKRUPTCY JUDGE, IN THE UNITED STATES BANKRUPTCY COURT LOCATED AT ONE BOWLING GREEN, NEW YORK, NEW YORK. ALL PAPERS SUBMITTED FOR THE PURPOSE OF OPPOSING THE CONTINUATION OF THE ORDER AFTER THE RETURN DATE SHALL BE FILED WITH THE COURT, WITH A COPY TO THE CHAMBERS OF THE HONORABLE STUART M. BERNSTEIN AND SERVED ON COUNSEL FOR THE PETITIONERS LISTED BELOW, SO AS TO BE RECEIVED AT LEAST FOURTEEN (14) DAYS PRIOR TO THE RETURN DATE. ANY PERSON WISHING TO OBTAIN A COPY OF THE ORDER SHOULD CONTACT COUNSEL TO THE PETITIONERS.

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UP Comings & Goings CLOSE



FIONA GILVEY

NEW JOB TITLE: London-based director of client development, Willis U.K. & Ireland.

PREVIOUS ROLE: London-based managing director for Aon Global Risk Consulting.

GOALS FOR NEW POSITION: To combine the tremendous strengths of the Willis team to create and deliver world-class solutions to more clients, thereby growing Willis' profile as the risk partner of choice.

INDUSTRY CHALLENGES: In these times of unprecedented volatility and uncertainty, the pressure is on to reduce cost and justify value to a greater extent than ever before. Risk managers have two real challenges: to support their businesses to take more of the right risks and to find a method to demonstrate the value from their function.

INDUSTRY OUTLOOK: As a knowledge-based industry, it is imperative that investment continues in retaining and developing talent. As the old economies tackle some of the fundamental changes required and

as the new economies evolve, we need to be agile and adaptable to exploit the opportunities that arise.

FIRST MARKET EXPERIENCE: I was a trainee underwriter at Guardian Royal Exchange in Melbourne, Australia.

CAREER HIGHLIGHT: Seeing the people I have worked with thriving and succeeding in life.

HOW YOU GOT WHERE YOU ARE: A combination of good luck, hard work and taking chances. I have been extremely fortunate, working with some truly fantastic people and having the privilege and opportunity to learn from them. This, combined with a strong drive and a willingness to take risk and look for opportunities, has meant I am never bored.


ADVICE: Be ambitious, seek good counsel and allow yourself to be surprised at what you can achieve.

OUTSIDE THE INDUSTRY, A DREAM JOB: International restaurant critic or travel reviewer.

E-MAIL OR PHONE, AND WHY? E-mail. If I called everyone, I would run out of hours in the day.

Business Resources

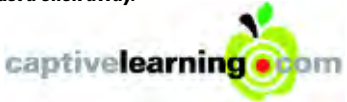
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Contact Monique Murray at 212-210-0129 For Details

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Products & Services

Hartford simplifies private equity firm cover

HARTFORD, Conn.—Hartford Financial Services Group Inc. says it has simplified coverage for private equity firms and those with similar risks.

Hartford Private Equity Choice is a management liability insurance policy designed for the risks facing private equity firms and fund managers, the insurer said in a statement.

"Managing a private equity fund offers a significant opportunity for financial reward, but the risk of costly litigation can also be substantial," Amit Davé, assistant vp of financial products underwriting for Hartford, said in the statement. "Lawsuits can arise from many sources, including limited partners, portfolio companies and their shareholders, and even a firm's own employees."

Hartford said the program combines basic liability coverage, such as fund management and fiduciary liability, into a single, comprehensive policy.

For more information, contact Mr. Davé at 212-277-0726 or amit.dave@thehartford.com.

Catastrophic losses decline: Marsh report

DUBAI, United Arab Emirates—A report by Marsh Ltd. examines the most significant property losses in the hydrocarbon industries since 1972.

The report, "The 100 Largest Losses," shows that as companies have enhanced risk management practices, catastrophic losses have declined at petrochemical plants, gas processing plants, distribution facilities and other operations, the London-based unit of Marsh & McLennan Cos. Inc. said.

"Energy-sector risk management has evolved into an applied science that is making a real difference to mitigating the catastrophic losses that were more common in previous years," Jim Pierce, chairman of Marsh's global energy practice, said in a statement.

The report, which said national oil companies could see a "lower overall cost of risk over the next few years," was released at Marsh's National Oil Companies Conference in Dubai, United Arab Emirates, and is available at www.marsh.co.uk.

Vitality Group develops program modeling tool

CHICAGO—The Vitality Group, a unit of Johannesburg-based Discovery Holdings Ltd., has developed a wellness program modeling tool for employers.

The Vitality Employer Optimization Tool aims to estimate worker participation in the wellness program offered by Vitality Group.

In a statement, Vitality Group said its incentive-based health program helps workers achieve "a per-

sonalized verifiable and clinically sound set of activities and goals to assist them in improving their health."

The Chicago-based company said the forecasting tool allows employers to estimate the program's effect on costs, savings, productivity and return on investment to best effect health behavior change.

"Each employer's population, health risks and claim patterns are different, so it's important to design a wellness program specific to their culture," Arthur C. Carlos, president and CEO of Vitality Group, said in the statement.

For more information, contact Stuart Slutsky, Vitality Group's chief marketing officer, at 312-224-7100 or info@thevitalitygroup.com.

Student-run site serves insurance tech field

COLUMBIA, S.C.—The University of South Carolina's Moore School of Business has launched a student-run Web site that serves the insurance technology industry.

The Innovation in Insurance, or i3, Web site aims to provide the latest news and resources regarding technology innovation in the insurance industry, the school said in a statement. Also, the site is designed to engage students at the Moore School of Business in Columbia, S.C., who are interested in insurance and technology.

Students will manage and operate i3 as a small-business enterprise.

"By doing so, students will gain

the experience of running a full-time business, interact with leaders in the insurance technology sector, tap into their creative potential and, most importantly, prepare themselves for full-time employment after graduation," Frank Heaps, i3 managing director and adjunct professor at the Moore School of Business, said in an e-mail. "Our goal is to mentor the students to develop the next generation of insurance IT professionals."

The Web site is supported by private donations from individuals and corporations.

Access and use of the Web site, along with a subscription to its newsletter, is free.

For more information, contact Mr. Heaps at 803-476-1463 or

i3uscadmin@gmail.com or go to i3 at www.innovationininsurance.com.

TO SUBMIT ITEMS

PRODUCTS & SERVICES

BI's Products & Services column reports on new product offerings.

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BI's Market Moves column reports on activities by insurance industry companies and related entities.

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Strict building codes credited for lack of loss

By MARK A. HOFMANN

Chile suffered extensive destruction from last month's magnitude 8.8 earthquake, but it could have been far worse had the country not adopted and enforced stringent building codes decades ago, observers say.

Chile repeatedly has drafted and improved its building codes in the past 80 years. A 1960 earthquake said to be the strongest worldwide in the past two centuries spurred the process. According to the U.S. Geological Survey, the 1960 quake killed approximately 1,655 people—including 61 in Hawaii who died as result of a quake-generated tsunami—and caused \$550 million in damage to southern Chile.

Chile's building code is one of the world's most stringent, several observers say.

"They started revising their building codes back in 1931," said Lou Gritzo, Norwood, Mass.-based vp and manager of research for Johnston, R.I.-based Factory Mutual Insurance Co., which does business as FM Global. "Since then, they've been revised five times. They're currently on par with the Western United States."

In an e-mail, Insurance Information Institute President Robert Hartwig noted that Chile's code adopted in 1996 is being used.

The stark contrast between the experiences of Chile and Haiti, where an earthquake a few weeks earlier destroyed the capital city of Port-au-Prince and killed more than 200,000 people, reflects the effectiveness of building codes, said Kate Stillwell, earthquake product manager at Oakland, Calif.-based catas-

trophe modeler EQECAT Inc.

"The difference between Chile and Haiti is...all attributable to the building codes," she said. "The lesson is building codes are effective both in terms reducing loss of life and loss of money."

The rule that establishes the seismic design of structures—Chilean Regulation 433—"establishes the highest security standards in terms of seismicity ratios and is intended

THE BIG ONES

Largest earthquakes in Chile since 1960

Year	Location	Magnitude
1960	Valdivia	9.5
2010	Concepcion	8.8
2005	Tarapaca	7.8
1985	Santiago/Valparaiso/ San Antonio	7.6
1965	Valparaiso	7.4
1997	Pueblo Nuevo/Illapel	7.1
1998	Antofagasta	6.5

Source: Insurance Information Institute

to protect human lives, allowing for certain construction fractures but preventing buildings from collapsing," Javier Carvallo, president of Atlanta-based adjuster Crawford & Co.'s Chilean operations in Santiago, said in an e-mail.

"In simple terms, if the (regulation) is complied with, no construction will suffer any structural damages that require its demolition, and repairs after a quake will usually involve partition layout, doors, windows and interior plaster coats," Mr. Carvallo said. "In general terms, we can say that this norm helped save

many lives. Only one newer building has been reported to have collapsed at this time in the area of Concepción."

"Building codes generally take into account the probability of experiencing certain levels of ground motion at each locality," said Guillermo Franco, senior research engineer at catastrophe modeler AIR Worldwide Inc. in Boston.

Chile's code requires lateral stiffening of buildings.

"They have built vertical walls all along the whole height of the building, using between 2% and 4% of the floor area devoted to these walls to give the buildings enough resistance to lateral shaking," Mr. Franco said.

Chile has adopted various provisions from U.S. and Japanese building codes as well, said EQECAT's Ms. Stillwell.

According to an AIR Worldwide analysis, masonry construction—whether reinforced, confined or unreinforced—accounts for roughly 60% of residential buildings and more than 40% of commercial buildings in Chile. Wood-frame construction accounts for about 20% of the residential building stock. Concrete, which typically is used for mid- to high-rise apartment buildings, accounts for approximately 15% of residential structures. About one-third of commercial buildings use reinforced concrete, while steel construction accounts for about 15%. Industrial buildings typically are erected using steel or light metal.

"Steel reinforcement is key," said FM Global's Mr. Gritzo. "That is the single biggest factor in improving performance in earthquakes."

In addition, Chile's "industrial design code specifies a compulsory design review and construction inspection by independent parties," such as structural engineers, he said.

"It looks like the newer buildings have tended to fare pretty well. There's always the issue with enforcement, and we would expect that to be pretty good for big new buildings in Santiago, but when you get outside the main urban areas, there may be less stringent enforcement," said Don Windeler, director-model management, for Newark, Calif.-based catastrophe modeler Risk Management Solutions Inc. He said an RMS team sent to Chile will examine retrofitting. "Many times the issue with industrial facilities is the risk of business interruption, and the awareness that retrofitting can help keep the facility online after an event," he said.

Enforcing building codes is critical, said Julie Rochman, president of the insurance industry-supported Institute for Business and Home Safety in Tampa, Fla. "This was the big one, and the fact that those cities are not entirely in ruins with hundreds of thousands of people dead is amazing, particularly coming so closely on the heels of the Haitian tragedy," she said.

"Within the last six weeks, we've really had two wake-up calls for risk managers," said FM Global's Mr. Gritzo. "Now is the time to reflect on the seismic hazard facing their own facilities, and probably more important is for them to examine their supply chain for not only damage to property but damage to infrastructure that can affect their supply chain."

Quake: Chile losses to hit global market

CONTINUED FROM PAGE 1

to \$30 billion, according to Oakland, Calif.-based catastrophe modeling company EQECAT Inc.

Chile's property insurance market of domestic and foreign insurers has a history of sending much of the earthquake coverage they write to the global reinsurance market, sources say.

"Domestic and international companies will be affected," said Imelda Powers, a Philadelphia-based manager of Towers Watson & Co.'s catastrophe modeling group and a senior consultant in its reinsurance brokerage. More than half of the companies operating in the Chilean property market are foreign companies, she said.

As much as 75% of earthquake cover written in Chile likely was ceded to reinsurers, according to Axco Insurance Information Services Ltd. in London.

Chile's local market largely is driven by foreign insurers and reinsurers, Axco said in a recent report. In 2007, the latest year figures are available, insurers ceded 74.6% of the earthquake risk to the reinsurance market, according to the report. That includes intragroup

reinsurance, whereby insurers cede coverage to related companies.

With loss estimates not yet complete, uncertainty remains as to the size of claims that will hit reinsurers.

"There will be an impact on global reinsurers, but it is far too soon to tell how large that impact might be," said Robert P. Hartwig, president of the Insurance Information Institute in New York. "Given that the cat modeling firms have put the loss at somewhere between \$2 billion and \$8 billion—an enormous range—the potential impact on global reinsurers is highly uncertain at this point," he said in an e-mail.

"There has not been enough time to conduct thorough inspections at this point," Mr. Hartwig said of damage, such as structural problems, that is discovered later.

As of Friday, only London-based RSA Insurance Group P.L.C. had estimated its potential exposure to the quake. Those losses could reach £30 million (\$45.7 million) net of reinsurance for RSA, which writes general insurance through subsidiary Royal & Sun Alliance Seguros Chile.

"It's still too early. In an event like this, people are sorting out their lives and they will have to ascertain damages later," said a spokesman

for Allianz Global Corporate & Specialty A.G. in Munich.

Neither Munich Reinsurance Co. nor Swiss Reinsurance Co. had loss figures available as of late last week.

The area most severely affected by the quake contains residential and commercial properties with an insurable value of about \$275 billion, according to Boston-based modeling company AIR Worldwide Corp. Of this, about 70% is in the Santiago area and about 5% is in Concepción.

However, only about 10% of residential policyholders and about 60% of commercial policyholders buy earthquake insurance, according to AIR.

Chile's pulp and wine industries were among those hit hard by the quake.

Celulosa Arauco temporarily shut its operation and was assessing damages. The large Santiago pulp producer said it has insurance for damage and business interruption losses.

Chile's wineries lost 125 million liters (33 million gallons) of wine, including bulk, bottled and aging wine, said winemakers' association Vinos de Chile A.G. The loss amounts to around \$250 million.

"The damage to infrastructure

varies among the different wineries and has not, as yet, been fully measured," René Merino, the association's president said in a statement last week. The group did not immediately respond to questions about its insurance coverage.

While earthquake coverage already is pricey in Chile because of its high frequency, it is unlikely to become significantly more expensive even after major earthquakes that hit Haiti and Taiwan this year, Mr. Hartwig said.

"The Chile quake is not a market-changing event," he said in the e-mail. "The Haiti quake produced very little in the way of insurance and reinsurance losses...and therefore had no impact on global reinsurance capacity or pricing." Insured losses in Taiwan had not been estimated as of late last week, he noted.

EQECAT said Friday that it expects total economic damages from the Taiwan quake to be less than \$1 billion, including losses from secondary fires and landslides, with insured losses a "small fraction" of that amount.

Ms. Powers said this is the second major earthquake Chile has experienced since a magnitude 9.5 quake—the strongest recorded worldwide—hit in 1960. "That's a very high frequency. So you would expect that it is extremely expensive to buy earthquake insurance," he said.

Max: M&As may pick up

CONTINUED FROM PAGE 3

billion at year-end.

"Max's reinsurance business is solid and complementary to that of Harbor Point," Mr. Berger said during the conference call. "Max's focus has typically been on the smaller, more targeted specialty cedents, which will fit well with Harbor Point's larger-account client base."

Gaining access to Max's primary business and Lloyd's platform is a "unique opportunity," said Mr. Berger, who added that the firms have "similar underwriting cultures."

After the combination, Alterra is expected to write approximately 50% long-tail and 50% short-tail business, the firms said.

"We don't expect them to do anything too aggressively at first, given the soft market conditions. However, when things start to improve, they will be able to use their added financial strength to retain and reinsure more business," said Gretchen Roetzer, director of Fitch Ratings Inc. in Chicago.

The stronger balance sheet will offer buyers "improved security," said Paddy Jago, New York-based CEO of U.S. operations of Willis Re Inc., a reinsurance unit of Willis Group Holdings P.L.C.

Neither Standard & Poor's Corp. nor Fitch Ratings issued downgrades because of the deal, but both said "integration risk" is a concern. A.M. Best Co. Inc. put Max Capital's A- rating under review with positive implications.

New York-based S&P said the combination will significantly boost "the merged group's market presence in the reinsurance sector, strengthening its competitive position."

Several observers said the deal could spur more consolidation as Bermuda firms look to gain scale through mergers. "The capital markets and the equity markets are opening up a bit and I think consolidation (in Bermuda) is inevitable," Ms. Roetzer said.

Storm: \$4B losses likely

CONTINUED FROM PAGE 3

strengthen levees that gave way during the storm and caused extensive flooding. Flood damage from breached levees was particularly heavy in L'Aiguillon sur Mer, about 300 miles southwest of Paris.

France was hit hard because some of the construction there could not withstand Xynthia's hurricane-force gusts, Peter Dailey, director of atmospheric science at AIR, said in a statement. "Unreinforced masonry construction is common throughout France," he said.

While the size of individual claims is expected to be relatively small, the overall volume is expected to be significant because of the large area affected, AIR said.

LETTERS

CONTINUED FROM PAGE 8

of business over time, often paid sometime after the end of a calendar year.

That sets up the conflict. In placing risk and servicing policies in a retail insurance brokerage, you can't have two masters. But that's what happens with these brokers beholden to insurance companies for big bonuses dependent on growth and profitability (read: higher premiums and lower claims costs). That lure of easy money and lax disclosure is what led to steering, book rolling and, yes, bid rigging.

When New York regulators reached agreement recently with Marsh, Aon and our firm, Willis, the deal rolled back burdensome and costly compliance obligations from the Spitzer era. But the flip side of leveling the industry playing field is losing the strongest safeguard against conflicts of interest: the ban on contingent commissions in place at these firms since 2005.

You'd hope lessons were learned, but taking contingents is a hard habit to break, especially when thousands of other brokers and agents are similarly addicted. In the weeks since the deal was inked, we've read from some a spinmaster's lexicon of parsed positions proffering transparency while dodging true intentions about what they'll do when the Wild West of broker compensation returns next January.

Let's be clear: True transparency and contingent commissions are mutually exclusive. At the time of placement, a broker's contingent compensation—dependent on a carrier's increased volumes, renewal volumes, profit or a mixture of factors—cannot be known. And yet, the buyer still gets the tab in the form of higher premiums. Buyers of insurance, beware: Unless a broker tells you, upfront, who is paying them, how much they are being paid and in what form they are receiving payment, you're not getting the whole story.

In 2005, we looked forward to a day when no insurance carrier paid contingents, no broker took them and insurance the buyers of insurance boycotted the outliers. It is now 2010, the Wild West is set to return and the buyers, individually and as a posse, are more important than ever to hold the brokers accountable.

We're pleased that organizations like the Risk & Insurance Management Society have taken a strong stand that contingent commissions are a conflict of interest. Beyond RIMS, in the corner offices of small, medium and large-sized businesses, each company should make their own assessment. CEOs, CFOs and general counsels should sit with their risk managers and ask hard questions of each other. Is our broker squarely on our side? Will they fight to get us the best terms and conditions, fairest premium and fastest claim service, or are they conflicted?

When insurance matters most, clients and carriers often find themselves on opposing sides of a claim. Our own data show that

about 50% percent of nonstatutory claims bring push-back from the carrier. If the claim is large, the percentage spikes as high as 90. Our trends show push-back—disputes, denials and reservations of rights—on the rise, with about 25% percent of claims litigated. We advocate over 50,000 claims per year, and are currently advocating over \$1.5 billion in claims that exceed \$10 million.

How can that aggressive advocacy square with taking an incentive pegged to carrier profitability? In retail insurance brokerage, it can't. Claims happen.

A broker shouldn't straddle the

fence. You wouldn't retain a law firm if they had such a conflict. Why should an insurance brokerage firm be any different? In an era when trust in business has eroded to new low levels, a broker should remain a client's trusted advocate.

To ensure that trust, they should be paid fairly for services rendered, but only by one party.

Here is where agents and brokers differ. An agent is legally bound to represent the carrier.

Willis has some businesses in which it acts as an agent, relationships that are fully disclosed and separate from our core retail bro-

kerage business.

In addition, when Willis bought Hilb Rogal & Hobbs for \$2.1 billion in 2008, we inherited that firm's contingent program and went right about the work of shutting it down.

In the first full year of that process, over 90% of what were HRH's contingents were converted to upfront commissions, fast-tracking the effort to make another big broker conflict-free.

Buyers deserve true transparency. Contingent commissions and similar programs—along with high-dollar trips and entertainment—blur transparency between

brokers and their clients. A shortcut, some say, is for clients to "opt out" of these programs, but the accounting for this is opaque at best and doesn't unchain the broker from having two masters. What's not opaque is that insurance companies have one primary revenue source: premiums. The only way they can pay contingents is by charging higher premiums. It's time to kick the habit. Buyers, demand that your brokers give up contingents cold turkey.

Joseph J. Plumeri

Chairman and CEO

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AIG faces tough market in drive to sell assets

By JUDY GREENWALD

American International Group Inc.'s planned sale of AIA Group Ltd. would move it closer to becoming a pared-down company consisting largely of its core property/casualty business, Chartis Inc., and its domestic life and retirement services businesses, SunAmerica Financial Group, observers say.

Observers point to American Life Insurance Co., International Lease Finance Corp. and American General Finance as likely divestiture candidates.

An improving economy may help AIG sell its remaining noncore assets, but observers say the economy remains far from ideal.

The general merger and acquisition and the housing and related financial markets are improving, said Bill Bergman, an analyst with Morningstar Inc. in Chicago. That "external tail wind" will help but may not last, he said.

The environment has improved, but "it's nowhere near what it was before the meltdown and we still have a long way to go," said John L. Ward, CEO of Cincinnati-based Cincinnatus Partners L.L.C.

Cathy Seifert, an equity analyst with New York-based Standard & Poor's Corp., said despite the improvement, "it's still not what anybody would call robust, and I also think there's a notion there's blood in the water. The sellers don't want to overpay," she said.

There also is a "tremendous amount of uncertainty" as to which AIG deals will be consummated, at what terms and whether this will involve writing down assets, Ms. Seifert said.

"The real question is: Are there buyers out there for them and how aggressive do they have to be?" said independent consultant Myron Picoult.

"We might not see sales of entire busi-

nesses, but rather various funding and unwinding mechanisms to shrink those noncore businesses and eventually dispose of them," said Bruce Ballentine, an analyst with Moody's Investors Service in New York.

John Wicher, principal of John Wicher & Associates in San Francisco, said AIG "will continue to be prudent and recognize market realities and allow those market realities to dictate decisions."

"To the extent they're able to execute these few transactions, that goes a long way towards making strong progress on the debt repayment," said Kevin Ahern, a credit analyst with New York-based S&P. "It's not as if the noncore assets had to be sold by any particular date," he said in noting that the Federal Reserve Bank credit facility that provided the government bailout extends until 2013.

Late last week, AIG was reportedly close to agreeing on ALICO's sale to MetLife Inc. for \$15 billion. An ALICO deal "would be a very nice transaction if it comes in at the \$15 billion" mentioned as the possible sale price, Mr. Ward said.

ILFC, AIG's airplane leasing unit, "is a great franchise and has a top-quality fleet of planes, so I think either selling off the planes individually or selling the company as a whole are still viable transactions," said Cliff Gallant, an analyst with Keefe, Bruyette & Woods Inc. in New York.

While ILFC "is a very attractive asset," there is a limit as to how much buyers will pay and there "may not be a whole lot of strategic buyers out there," Ms. Seifert said.

"It's still a tough market, I would say, for finance companies" said Mark Rouck, Chicago-based senior director for Fitch Ratings Inc. That means "it might be less likely that you'd see a transaction" involving ILFC.

DEBT REDUCTION PROGRAM

American International Group Inc.'s \$35.5 billion deal to sell AIA Group Ltd. to Prudential P.L.C. is its largest asset sale since its September 2008 bailout. Gross proceeds of previous asset sales total more than \$10 billion in deals where financial data was disclosed. This excludes two deals totaling \$25 billion with the Federal Reserve Bank of New York that reduced AIG's outstanding balance owed. Major transactions include:

NOVEMBER 2008: AIG closed the sale of its 50% stake in Brazilian joint venture Unibanco AIG Seguros S.A. to joint venture partner Unibanco-Uniao de Bancos Brasileiros S.A. for \$820 million. As part of the deal, AIG acquired the shares held by AIG Brasil Companhia de Seguros S.A. for \$15 million.

DECEMBER 2008: AIG closed the sale of its Taiwan finance business assets to Taiwan Acceptance Corp. for an undisclosed amount.

JANUARY 2009: AIG sold its interest in Omaha, Neb.-based Tenaska Inc. back to Tenaska for an undisclosed amount.

MARCH 2009: AIG closed the sale of AIG PhilAm Savings Bank, PhilAm Auto Financing and Leasing Inc. and PFL Holdings Inc. in the Philippines to EastWest Banking Corp. for an undisclosed amount. It also closed its sale of HSB Group Inc., parent company of Hartford Steam Boiler Inspection & Insurance Co., to Munich Re Group for \$739 million and the assumption of \$75 million of outstanding HSB capital securities.

APRIL 2009: AIG closed the sale of AIG Life Insurance Co. of Canada to BMO Financial Group for \$308 million in cash. AIG closed the sale of AIG Retail Bank Public Co. Ltd. and AIG Card (Thailand) Co. Ltd. to Bangkok-based Bank of Ayudhya Public Co. Ltd. for \$45 million. AIG closed the sale of Switzerland-based AIG Private Bank Ltd. to Aabar Investments P.J.S.C. for \$253 million and the sale of Berlin-based Deutsche Versicherungs und Rückversicherungs Aktiengesellschaft to Augur Capital A.G. for an undisclosed amount.

MAY 2009: AIG completed the sale of its Tokyo headquarters for about \$1.2 billion in cash to Nippon Life Insurance Co. AIG Financial Products Corp. also

completed the sale of its commodity index business to Swiss bank UBS A.G. for up to \$150 million.

JUNE 2009: AIG closed its secondary public offering of 29.9 million common shares of Transatlantic Holdings Inc. common stock for \$1.1 billion. Last week, AIG said it plans to sell its remaining 9.19 million shares of Transatlantic by March 9, 2010. In addition, the Federal Reserve Board of New York entered into an agreement under which it purchased preferred equity interests in a special-purpose vehicle containing AIA in exchange for a reduction of about \$16 billion in the New York Fed facility's outstanding balance. In addition, an American Life Insurance Co. purchase agreement led to about a \$9 billion reduction in the balance.

JULY 2009: AIG generated \$1.9 billion in closing the sale of its U.S. auto insurance business, 21st Century Insurance Group, to Farmers Group Inc. It also completed the sale of a majority of AIG Credit Corp.'s and A.I. Credit Consumer Discount Co.'s U.S. life insurance premium finance business for \$680 million, including \$230 million held in escrow and an additional \$61.2 million if certain future conditions are met. It also agreed to combine its consumer finance business in Poland into Santander Consumer Finance S.A.'s consumer finance business.

AUGUST 2009: AIG Financial Products Corp. completed the sale of its energy and infrastructure investment assets for net proceeds of more than \$619 million.

SEPTEMBER 2009: AIG agreed to sell its investment advisory and third-party institutional asset management business for cash to be determined at closing.

OCTOBER 2009: AIG agreed to sell its 97.6% share of Nan Shan Life Insurance Co. Ltd. in Taiwan to a consortium for about \$2.15 billion, with AIG recognizing a \$1.5 billion tax loss on the transaction.

DECEMBER 2009: AIG's mortgage guaranty business entered into two stock purchase agreements for sale of its Canadian and Israeli operations.

Source: American International Group Inc., Business Insurance

AIG: Unit sale puts dent in insurer's debt

CONTINUED FROM PAGE 1

outstanding to be repaid by AIG of \$94.76 billion as of Dec. 31.

The federal government took a nearly 80% ownership stake in AIG in September 2008 after the company came close to collapse because of deals made by its financial products unit. Since then, AIG has been selling off operations to repay the government's financial assistance, with plans to retain its core property/casualty operation, Chartis, and domestic life and retirement services operations, SunAmerica Financial Group (see related story and box).

AIG and Prudential announced a definitive sale agreement last week. Under the terms of the deal Prudential will pay \$35.5 billion in cash and stock for Hong Kong-based AIA, which is one of AIG's most-prized assets. Prudential, which is a major U.K. life insurer and is not affiliated with the U.S. firm Prudential Financial Inc., said it would finance the cash component of the deal through a \$20 billion rights issue and a \$5 billion debt issue.

AIG said \$16 billion of the cash

from the sale, which is the largest so far in AIG's ongoing restructuring efforts, will be used to redeem the Federal Reserve Bank of New York's preferred interest in AIA, and it will use the remaining \$9 billion in cash to pare down its outstanding debt under the New York Fed's credit facility. AIG plans to monetize the remaining \$10.5 billion in face value of Prudential securities over time, and those net proceeds also will be used to repay its outstanding debt under the credit facility.

Observers praised the deal. John L. Ward, CEO of Cincinnati-based Cincinnatus Partners L.L.C., said, "It's a fabulous deal for AIG, and adds tremendous momentum to their divestiture program." AIG received double the price it would have gotten a year ago, he said.

Cathy Seifert, an equity analyst with New York-based Standard & Poor's Corp., said, "The terms were reasonably attractive," considering the marketplace, the poor economic environment, "and the fact that everyone knew AIG pretty much has to sell assets."

AIG's situation has "improved from the dire situation a year ago,"

she added. "I don't think the coast is totally clear, and I think there's a lot more work that has to be done, but I think this sale has given the company some breathing room and some credibility," said Ms. Seifert.

The amount of proceeds, if the deal is completed, is "clearly a very good step in the right direction to restore them to financial health and pay back the loan to the government," said Kevin Ahern, a credit analyst with S&P.

John Wicher, of John Wicher & Associates Inc. in San Francisco, said, "The fact that they showed patience and held onto their assets and didn't yield to pressure and sell" last year has "served the taxpayers well."

The deal is a validation of Mr. Benmosche's decision to go slowly on asset sales, say observers. Ms. Seifert said, "The fact that Mr. Benmosche was able to execute a deal of this size and on these terms gives him a lot of credibility."

But, with the sale, AIG no longer will benefit from AIA's income stream, observers point out. Cliff Gallant, an analyst with Keefe, Bruyette & Woods Inc. in New York,

said, "It's a major contributor to the company's earnings, particularly because it did hold up relatively well, so no question, something is being lost here." AIG has not separately reported the operating results of AIA, which has more than \$60 billion in assets.

As the funds are being used to pare down AIG's federal debt, it won't be able to invest the money in the business, said Myron Picoult, an independent consultant.

Meanwhile, noted Ms. Seifert, AIG had to boost Chartis' reserves by \$2.3 billion, while it posted a net premium decline for 2009. The company reported a 13.9% drop in premiums from 2008, to \$30.66 billion.

Business is being hurt by a weak economic environment and a soft insurance market, said Ms. Seifert. While AIG was once the beneficiary of the flight-to-quality characteristic of soft markets, it is now negatively affected by it, particularly in long-tail lines.

Mr. Ahern said, however, "Our sense is they've been doing a pretty good job with business and management retention, and now it's just a matter of them starting to return to some level of profitability" in terms of combined ratios.

The question remains, however,

whether AIG eventually will be able to repay its federal debt. Ms. Seifert said, "There's a lot of uncertainty regarding" this, although the AIA sale is "a step in the right direction."

It also remains unclear whether AIG ultimately will have to sell or spin off its Chartis unit. Mr. Ahern said, "The expectation is, they're viewing this as a core operation, so to the extent they continue to have success with their asset dispositions, we expect that Chartis will remain part of the AIG family."

"I can't say with certainty that (AIG) will survive, but I think it will," with its property/casualty operations intact, said Bill Bergman, an analyst with Morningstar Inc. in Chicago.

Mr. Gallant said, "You need some kind of ongoing business because I don't think asset sales alone are going to be enough to pay back the government."

Mark Rouck, Chicago-based senior director at Fitch Ratings Inc., said, "I think the plan is to kind of streamline the operation" and focus on AIG's core operations. However, "our concern is that there still is a significant amount of debt outstanding...and they also have the ongoing runoff of the financial products group."

Climate: Ruling to be reconsidered

CONTINUED FROM PAGE 4

Victor Schwartz, general counsel to the American Tort Reform Assn. in Washington, which filed an amicus brief seeking the en banc hearing, said the court may be rethinking its previous decision because "every federal trial court that has heard similar global warming suits has dismissed those suits."

Moreover, he said the court may be coming to the realization that the judicial branch should not regulate greenhouse gases. "Tort law is there to compensate people who have been injured by a defendant's action. It's not there to make global determinations," Mr. Schwartz said.

"I believe the 5th Circuit's deci-

'Tort law is there to compensate people who have been injured by a defendant's action. It's not there to make global determinations.'

Victor Schwartz,
American Tort Reform Assn.

sion" to conduct an en banc review signals the "court's recognition that the elected branches of government are far better equipped than the judiciary to set policy on how energy should be produced, priced and consumed," said William Stewart, a partner at Cozen O'Connor P.C. in Philadelphia, who has represented insurers in coverage cases involving some of the defendants.

Richard O. Faulk, chairman of the litigation department and environmental practice at Gardere Wynne Sewell L.L.P. in Houston, said the rehearing bodes well for the defendants because the 5th Circuit's makeup is largely conservative. Of the three justices who allowed the suit to stand, two were appointed by Democratic presidents. While those two will serve on the panel rehearing the case, so will seven Republican appointees.

Dubai's near-default contains interesting ERM lessons

By John J. Hampton
and Bashar Kilani

Dubai's near-default on \$36 billion in debt in December 2009 shook the capital markets. The situation grew from an ambitious capital development program that got caught in the global financial crisis. It is a story of exposure and opportunity, the contrasting sides of risk management. Let us examine the original strategy and its outcome.

Position of Dubai

Dubai, United Arab Emirates, is not Abu Dhabi, an emirate with large oil and gas reserves that essentially insulate it from dramatic negative changes in global economics. Three million barrels a day of crude oil allow Abu Dhabi to finance a diversification of the economy that will reduce future reliance on the energy sector. It has the world's largest sovereign wealth fund, estimated at more than \$800 billion, and invests money outside the U.A.E. Although Abu Dhabi experienced a decline in real estate values and some adjustments to projects since 2008, the emirate continues substantial spending to build its economy and infrastructure.

Dubai is a different story. It started to diversify earlier. A milestone occurred in Dubai in 1833 with the arrival of the Al Maktoum tribe. It welcomed foreigners and encouraged trade. A big help was the Dubai Creek, a saltwater channel that was one of the few resting places for fishing vessels and dhow sailing ships carrying goods in the region. In the 20th century, Dubai faced the reality that it should diversify. In the 1960s, the government dredged Dubai Creek and built wharfs to handle cargo ships. In the 1970s, it built Port Rashid, capable of handling the largest container ships in the world. In the 1980s, it built dry docks to maintain or construct large oceangoing vessels. Even today, it is the only such facility in the Arabian Gulf.

The modern vision for Dubai starts in 2002. An aggressive plan was developed based on risky debt financing to change its economy. Leveraged to the hilt, the government adopted a grand vision built upon five pillars—port operations, real estate, tourism, transportation and financial services.

Emerging Risk STRATEGIES



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Dubai, United Arab Emirates, for the past 10 years.

Port operations

Dubai has taken advantage of its location to expand port services to vessels in the region. Jebel Ali is the world's largest man-made port. Established as a free zone, the port houses 5,000 companies from 120 countries, contains 70 berths and is one of the world's 10 largest transshipment ports. Companies and vessels operate free of bureaucratic red tape tying up goods, labor and money. The free zone offers business centers, ready-to-occupy offices, warehouses, factories and a modern infrastructure. One-stop shopping simplifies operations licensing and work permit approval.

Dubai set up Dubai Port World in 2005 to oversee port operations and it quickly became more than a local port operator. It acquired large port operators CSX World Terminals and the Peninsular and Oriental Steam Navigation Co. Today, Dubai Port

World operates more than 50 terminals employing 30,000 workers in more than 30 countries and is developing new projects elsewhere.

Real estate

In the real estate sector, the government and private developers financed massive projects, including the world's tallest building, the Burj Khalifa, which opened in January and was renamed from the Burj Dubai to honor the emir of Abu Dhabi who has been supportive amid Dubai's liquidity problems.

Dubai has the tallest hotel, biggest shopping mall, luxury resorts and residences, and entire areas called "cities." Some projects were over the top. They include offshore islands in the shape of palm trees, 50 islands with luxury villas in an artificial lake and plans for an underwater five-star hotel.

Tourism

The tourism plan was equally bold. It started with shopping and the Dubai Mall, a \$20 billion project with 1,200 stores. It includes a three-story aquarium, an ice skating rink that can accommodate 2,000, an indoor amusement park and even an indoor ski slope.

On the future tourism horizon is Dubailand, a project that will create the largest collection of theme parks in the world. When it opens sometime after 2012 and reaches full size, it will be twice as big as Disney World.

The most famous visitor event is the Dubai Shopping Festival, a monthlong event that attracts 3 million shoppers annually. Jazz, film and other festivals are found throughout the year. Sporting highlights include Barclays Dubai Tennis Championship, Dubai Desert Golf Classic and the Dubai 24 Hour Sports Car race. A \$4 billion Dubai Sporting City is being built with a 60,000 seat multipurpose outdoor stadium to host world-class sporting venues.

Transportation

You cannot attract tourists without transportation. Dubai solved that problem on two fronts. The first occurred when Gulf Air reduced service to Dubai in the 1980s. Dubai responded by creating Emirates Airlines, which now operates 2,000 flights every week to 90 destinations in 55 countries. The second

occurred with the construction of a new airline terminal at Dubai International Airport. It is a modern marvel, handling more than 41 million passengers a year. For passenger traffic, Dubai has the 17th busiest airport in the world. For cargo traffic, it ranks even higher.

Finance

The Dubai International Financial Center completes the vision. As with all of Dubai's free zones, benefits include no taxation on income and profits, 100% foreign ownership of operations, and no restrictions on exchanging currency and repatriating profits. The excellent infrastructure allows Dubai to compete with New York, London and Hong Kong in banking services, placement of equity and debt, trading derivatives, managing financial assets, and even reinsurance and Islamic risk transfer.

Conclusion

The failure to take a risk is a risk itself. For Dubai, the exposure was running out of oil and having no other natural resources. The opportunity was to grasp a near-term window of plentiful, low-cost financing that would develop projects to allow it to become a world-class player in the region. Dubai seized the opportunity and, as often happens when risk is accepted, got caught in a liquidity trap that hurt many organizations and investors.

It is fortunate that the emirs of Abu Dhabi and Dubai are cousins. Abu Dhabi has helped Dubai in the past and stepped up with some \$25 billion to rescue its sister state in the current crisis.

We will never know what would have happened without the intervention. The emirate clearly went too far and too fast. Being forced to stop most construction since 2008, accompanied by other serious financial consequences, was costly and unfortunate. But ERM is a two-edged sword. To pursue great opportunity is also to accept significant risk. The emirate borrowed to create assets that would eventually repay the debt, even with a default. Dubai took risks and has a valuable industrial, real estate, tourism, transportation and financial infrastructure. Aside from the pain and lessons learned, this may be the real enterprise risk management story.

Reform: Bill passage looks more likely

CONTINUED FROM PAGE 3

would pass the reform measure the Senate cleared in December. Then, changes to that bill would become part of a budget measure that would have to garner only a majority in the House and Senate to win passage.

While the use of reconciliation would reduce the number of votes needed to win passage, final approval of health care reform still is not certain, observers say.

"At this point, it is hard to count votes," said Helen Darling, president of the National Business Group on Health in Washington.

What is certain is that the debate

will intensify. "Proponents and opponents are taking off the gloves," said Frank McArdle, a consultant with Hewitt Associates Inc. in Washington.

In a briefing last week, Sen. Orrin Hatch, R-Utah, said Republicans will "employ every strategy possible because we know this will be a disaster for the country."

The biggest challenge the administration faces is attracting the votes of moderate and conservative Democrats, observers say. And last week, the administration reached out to that group.

For example, President Obama strongly endorsed health savings

accounts, noting that the legislation has to be clear that employers can continue offering the arrangements and that the plans will be available to individuals buying coverage through state exchanges the legislation would authorize.

President Obama "is reaching out to moderate Democrats," Ms. Darling said.

"The administration is trying to get wavering Democrats back into the fold," said Gretchen Young, vp-health policy with the ERISA Industry Committee in Washington.

The president took other steps to defuse opposition. He endorsed delaying and softening a proposed

excise tax on costly health insurance plans, a provision in the current Senate bill that has triggered opposition from employers, organized labor and many House Democrats.

More than a year after the reform drive began, some say the end may be in sight. White House Press Secretary Robert Gibbs said last week that "March 18 would be a realistic date for the House to complete action."

"Reform is now surging towards a resolution," Mr. McArdle said.

Some say presidential involvement in fashioning legislation will continue.

"This is a signature issue for the Democratic party. The Democrats fear they would be far worse off politically" if the reform effort failed, Mr. McArdle said.

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News In Brief

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last week by Mr. Greenberg, he now wants to testify about the transactions in a suit brought against him by former New York Attorney General Eliot Spitzer. Mr. Greenberg, who was identified by prosecutors as an unindicted co-conspirator in the trial of former General Re Corp. and AIG executives in the 2000-2005 reinsurance deals, said the statute of limitations on any potential charges expired Feb. 21, and that he now requests the right to testify on those matters, according to court documents. In 2008, Mr. Greenberg asserted his Fifth Amendment right against self-incrimination during pretrial testimony in a civil suit filed by New York state. A hearing in Manhattan Supreme Court on Mr. Greenberg's request is scheduled for this week.

NFIP extended through March 28

President Obama has signed into law a measure that extends the National Flood Insurance Program through March 28. The NFIP extension is part of a measure that temporarily extends a variety of federal programs. The NFIP has undergone several short-term extensions because the House and Senate cannot agree whether the program should be expanded to include windstorm coverage, an expansion that insurers oppose.

Former AIG general counsel joins DLA Piper

Former American International Group Inc. General Counsel Anastasia Kelly has joined the Washington office of law firm DLA Piper as counsel. Ms. Kelly resigned from AIG in December to protest federal salary caps imposed on executives of companies that took government bailout funds.

PBGC taking over auto pension plan

The Pension Benefit Guaranty Corp. is taking over the underfunded pension plan New United Motor Manufacturing Inc., an assembly operation jointly owned by Toyota Motor Corp. and Motors Liquidation Corp., the liquidating entity that remained after General Motors Co. emerged from bankruptcy. The plan, which covers United Auto Workers union members and has about 5,800 participants, is 55% funded with \$161 million in assets and \$292 million in liabilities. The PBGC expects to cover \$126 million of the \$131 million funding shortfall.

N.M. bill would set health care spending

Health insurers and health maintenance organizations selling group coverage in New Mexico would be required to spend at least 85% of every premium dollar on health care services under legislation Gov. Bill Richardson is expected to sign. H.B. 12, which would take effect in 2011, would require insurers that fail to comply with the 85% reimbursement requirement to issue a dividend or credit against future premiums to all policyholders in an amount sufficient to make up for any shortfall.

CMS: Medicare changes may be costly

CONTINUED FROM PAGE 1

To comply with the announcement, insurers with deductible policies must notify CMS when workers compensation, liability or no-fault claims with a medical component involve Medicare-eligible beneficiaries.

As a result, insurers and policyholders may have to renegotiate some claims management practices and how claims data will be transferred between them, sources said.

"It's going to take a while for insurance industry (participants) to sort out exactly what their new responsibilities are," said Roy Franco, director of risk management strategies for supermarket chain Safeway Inc. in Pleasanton, Calif.

Because insurers will be on the hook for a potential penalty of \$1,000 per day per claim not properly reported, they could seek greater control over data provided to them by insureds, sources said.

For instance, an insurer may demand that policyholders implement certain data-gathering practices previously not required by the insurer, Mr. Hames said. That would lengthen claims durations and increase case loads, leading to an increase in policyholder costs.

"(Insurers) haven't said anything to us yet, but we foresee that is a possibility," Mr. Hames said.

"The employer may lose control over the management of their claim because the insurer, being concerned about the penalty, perhaps will want to put in their protocols for managing the Medicare component, which may differ from how the employer thinks it should be

managed," Mr. Franco said.

The impact on insurers will depend on the amount of large-deductible business they write, said Peter Foley, vp of claims administration for the American Insurance Assn. in Washington.

But the impact on insureds may be mitigated because many were prepared to report under the old guidelines and many insureds wanted

'It's going to take a while for insurance industry (participants) to sort out exactly what their new responsibilities are.'

Roy Franco, Safeway Inc.

their insurers to take reporting responsibility, Mr. Foley said.

The insurance industry told CMS more than a year ago that it would be more efficient to designate insurers as RREs rather than policyholders, several sources said.

CMS declined that advice and insurers, third-party administrators and employers spent heavily on establishing data-transfer processes so claims information would flow from insureds to CMS.

"This is a big issue" and amounts to a financial penalty for parties that configured their systems to report under CMS' previous directions, said Ken Paradis, CEO of North Reading, Mass.-based Crowe Paradis Services Corp., a Medicare secondary payer

compliance company.

"It's an unfortunate situation that has been created," because substantial sums were spent configuring systems that must be redirected, said Mr. Franco, who also is co-chairman of the steering committee for the Medicare Advocacy Recovery Coalition, an insurer and employer group formed in 2008 to advocate improvements in the Medicare Secondary Payer program.

Previously, CMS said insureds were RREs when they directly paid Medicare beneficiary claims within a deductible, while insurers paying claims more than the deductible also had to report to CMS.

Insurers that paid entire claims and then reimbursed their insureds for claim amounts falling below the deductible also were RREs.

Now, regardless of who pays the deductible, the insurer is the RRE, except with fronting policies or when insureds resolve claims without informing their insurers, Mr. Franco said.

While CMS clarified who is an RRE under deductible programs, its wording raised new questions about what constitutes informing the insurer, particularly under large-deductibles, sources said.

"I don't think (CMS' new directive) is as clear as the agency would have hoped it was going to be, said Katie A. Fox, compliance and resolution unit manager in Parker, Colo., for MedInsights Inc., a managed care services unit of GAB Robins Group of Cos.

"If anything, it somewhat created more confusion," said Ms. Fox, who also is a MARC steering committee co-chairman.

Benefits: Washington gay marriage legalization prompts benefits cut

CONTINUED FROM PAGE 3

ment Income Security Act, church welfare plans are not exempt from state and local mandates.

Private employers governed by ERISA can "choose to define 'spouse' any way they want," said Antoinette Pilzner, a partner at McDonald Hopkins P.L.C. in Bloomfield Hills, Mich. "Church plans generally are not subject to ERISA. As a result, they are subject to state mandates, regardless of whether they are self-insured."

Catholic Charities of Maine Inc. opted into ERISA in July 2003 in response to a 2002 city of Portland ordinance requiring all employers that accept housing and communi-

ty development funds from the county to provide domestic partner benefits. Catholic Charities of Maine is one such organization.

Catholic Charities of Washington, whose plan is self-insured and administered by Care First Blue Cross Blue Shield, declined to say why it didn't opt into ERISA instead of discontinuing all future spousal coverage, regardless of gender.

The move by Catholic Charities of Washington runs counter to a trend among employers to add coverage for same-sex domestic partners and spouses, employee benefits experts say.

"A growing number of employers offer benefits to domestic partners. Virtually all of them provide bene-

fits to employees, and all eligible dependents, who include legal spouses. Presumably, in any jurisdiction that recognizes same-sex marriages, the employer's plan would cover the spouse," Helen Darling, president of the National Business Group on Health in Washington, wrote in an e-mail.

"While faith groups may have their own views and values, most employers, especially those engaged in business, would not be likely to take these kinds of positions," Ms. Darling wrote.

"I would consider this an aberration," Ms. Pilzner said. "The trend has been to add coverage for domestic partners. It's a valuable recruiting and retention tool."

According to the Human Rights Campaign, a national lesbian, gay, bisexual and transgender civil rights organization based in Washington, 83% of Fortune 100 and 59% of the Fortune 500 offer health care coverage to domestic partners. In addition, more than 250 nonprofit employers provide domestic partner coverage, HRC reports.

Joanne L. Husted, senior health compliance specialist at the Segal Co. in Washington, said making it harder for same-sex spouses to obtain health care coverage contradicts the efforts by Congress to reduce the ranks of the uninsured.

Although a growing number of employers are opening up their health plans to same-sex domestic

partners and spouses, some employers have been discouraging employees from enrolling their spouses when they are eligible for other coverage, such as through their own employers, benefit experts note.

Some employers impose "spousal surcharges" on employees who enroll such spouses, noted Craig Hasday, president of Frenkel Benefits L.L.C., a New York-based employee benefits broker and consultant.

But, unlike in the case of Catholic Charities of Washington, which made the change to reflect its religious stance, these other "employers are looking at ways to curtail coverage as part of a larger cost-containment effort," Mr. Hasday noted.

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PlayStation glitch bugs some gamers

The gaming world has encountered its own version of the Y2K bug.

That was the computer glitch many feared would shut down the world as Dec. 31, 1999, became Jan. 1, 2000, because computers were programmed with only the last two digits of a year and were able to read 2000 correctly.

Fortunately, the world did not come to a grinding halt and Y2K problems were minimal compared with what had been feared.

Something similar, albeit on a much smaller scale, happened last week when Sony Corp. uncovered what might be called a leap year bug with its PlayStation Network.

It seems the internal clocks in older PlayStation3 units treated 2010 as a leap year, which turned March 1 into Feb. 29. That kept some PlayStation 3 users from playing games.

In a March 1 posting on its PlayStation Blog at www.blog.us.playstation.com, Sony said the glitch was fixed.

But a posting earlier the same day noted some of the error messages and problems users had encountered. One of the more intriguing ones was, "The date of the PS3 system may be reset to Jan 1, 2000."

Talk about back to the future. But just like Y2K, the leap year bug's manifestation appears to be far less damaging than some may have feared.



Business Insurance END PAGE

Contributing: Jeff Casale, Judy Greewald, Mark A. Hofmann



Characters played by Eli Roth and Brad Pitt look to collect Nazi scalps in the Oscar-nominated film "Inglourious Basterds."

Risky films can be 'basterds' to insure

The end-of-the-world flick "2012" may have been shut out when it comes to Oscar nominations, but it was No. 1 in 2009 as far as Fireman's Fund Insurance Co. is concerned.

In its annual ranking of the riskiest Hollywood movies, the Novato, Calif.-based insurer put "2012" at the top followed by "Crazy Heart," "Inglourious Basterds" and "Nine" as the most difficult films to insure last year.

"2012," a natural disaster-filled blockbuster, could be seen as an underwriting catastrophe waiting to happen. Fireman's Fund said provided coverage and loss control services for several stunt sequences, including explosions, aircraft crashes, earthquakes and underwater scenes.

"Crazy Heart," with Oscar-nominated performances by Jeff Bridges and Maggie Gyllenhaal, featured risks such as a hot air balloon crash, a car crash and a boat sequence on a lake. These scenes, the insurer said, required precision and

safety to pull them off successfully.

Best Picture nominee "Inglourious Basterds," set during World War II and filmed in Germany and the United Kingdom, included fight scenes, stunts, pyrotechnics and international locations, which provided several challenges and risks, Fireman's Fund said.

The somewhat surprising pick, perhaps, is "Nine." The cast had to be underwritten with dance injuries in mind, which could have resulted in delaying or halting the filming. The insurer said it also had a hand in risk mitigation for a high-wire act in the film.

"Most (viewers) weren't aware of the risk challenges involved when filming complex sequences that included air and watercraft stunts, strenuous dance sequences, air balloon explosions and simulated natural disasters," Wendy Diaz, the insurer's entertainment underwriting director, said in a statement. Such "scenes contribute appreciably to a film's overall risk."



Burned customer lands McDonald's in hot seat once again

How hot is too hot?

A federal judge in Alexandria, Va., will confront that question yet again in the case of Frank Sutton, who alleges he was burned in 2005 when he bit into a grease-filled chicken sandwich at a McDonald's in Duffield, Va.

This isn't the first time McDonald's Corp. has felt the heat over the temperature of its food; in 1994 a woman sued for injuries suffered when too-hot coffee spilled in her lap.

According to the decision by a divided panel of the 4th U.S. Circuit Court of Appeals earlier this year, after Mr. Sutton was burned, he approached two women in McDonald's uniforms outside the restaurant, "told them what had happened and showed them the blisters on his lips and chin. One of the women responded, 'This is what happens to the sandwiches when they aren't drained completely.'"

Mr. Sutton sued McDonald's and its local franchisee for \$2 million for a variety of damages, including pain and suffering. But when the case went to trial in 2008, Judge Claude Hilton dismissed the case and held that the statement about the improperly drained chicken was inadmissible hearsay.

"There's just no evidence here of any kind of negligence. He ordered a hot piece of chicken and he got a hot piece of chicken," Judge Hilton reportedly said. "It was hotter than he anticipated, and that was unfortunate."

The appeals court disagreed, saying "it is not contributory negligence as a matter of law to merely bite into food served hot by a restaurant."

The appeals court remanded the case to Judge Hilton, and hearings are set later this month. It may seem a case of déjà vu as the court considers whether overheated chicken can land McDonald's in a legal hot seat.

Woman strikes out with age bias claims

Can an 83-year-old ballpark beer vendor whose post was changed to a less lucrative site successfully sue for age discrimination?

Not if she was replaced by a 75-year-old, a New York judge has ruled.

Mildred Block, who worked as a beer vendor at the Mets' Shea Stadium, was reassigned in 2008 to a concession stand, where she received no tips compared with the \$40 per shift she had earned at her previous post.

Her employer, Philadelphia-based Aramark Inc., said she was reassigned because of excessive lines at her position. Ms. Block, who had sold beer near Shea's right field line for 18 years, contended she was reassigned because of age discrimination, among other reasons.

However, a New York state judge disagreed. In upholding an earlier decision by the New York City Commission on Human Rights, Supreme Court Justice Joan B. Lobis pointed out late last month that Ms. Block had been replaced by 75-year-old Gloria Smith.

The facts "adequately support (the commission's) finding that there was no probable cause to find that Aramark had engaged in age discrimination," Justice Lobis said in the ruling.

Ms. Block told the New York Daily News that she could serve the brew no faster than her partner, who was 40 years younger, and that she "never made a mistake with the change" at the ballpark.



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