

**As insurers go, so goes
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\$4

Pension funding levels decline

By ROBERTO CENICEROS

Continuing U.S. stock market declines will pressure many employers to make difficult employee benefit and compensation tradeoffs.

That's because, observers say, a 28-month bear market, one of the longest in U.S. history, is forcing more employers to make sizable contributions to their underfunded defined benefit retirement plans. As a consequence, several of these observers say, employers are more often finding themselves choosing among trimming employee compensation levels, cutting back on health care benefit funding or, possibly, limiting or scrapping defined benefit retirement plan offerings.

One such employer forced to make hard choices is Delphi Automotive Systems. John G. Blahnik, treasurer for the Troy, Mich.-based company that employs about 200,000 workers, said Delphi is now considering benefit and compensation tradeoffs in light of both retirement plan assets that have been shrunk by stock market declines and growing health benefit costs. Delphi's pension plan assets shrunk about 6% during 2001.

Observers note that low interest rates are adding to pension plan liabilities, though stock declines are a greater concern, they say.

Most plans invest about 60% of their assets in equity markets, pension plan advisers say, and as those investments take a beating, employers must con-

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New rules on blackout warnings

Congress passes 401(k) reforms

By JERRY GEISEL
and MARK A. HOFMANN

WASHINGTON—Employers will face new rules designed to protect 401(k) plan participants under Enron-type disasters under corporate governance and accounting reform legislation passed by Congress last week.

Under the legislation, which President Bush will sign, employers would have to give 401(k) and other defined contribution plan participants 30 days' advance notice of plan blackouts—periods in which transactions cannot be conducted.

The 401(k) provisions are part of

a broader corporate governance bill that, among other things, would require corporate attorneys to report wrongdoing to senior managers and, if necessary, to board members. It also would create a new federal fund to reimburse investors who lose money because of corporate misconduct.

Benefit lobbying groups, amid the breakneck speed at which congressional conferees last week hammered out differences between the broader measures earlier passed by the House and Senate, successfully won changes that will make it easier for employers to comply with the

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Corporate governance: From Wall Street to Washington

Risk managers' oversight is vital

But influence has room to grow

By MARK A. HOFMANN

WASHINGTON—The risk manager's role in corporate governance goes considerably beyond merely making sure that the corporate directors and officers liability policies are up to date and adequate to deal with corporate crises, say risk managers themselves.

This is true even though, as middle managers, most risk managers aren't going to be calling into question the decisions of chief executive

officers or corporate directors. But risk managers serve as information conduits and intelligence gatherers for upper management, say risk managers. In some cases, risk managers may actually be involved in policing some corporate activities.

And, no matter what else, risk managers have to serve as symbols of professional integrity.

"From a global standpoint, I really think this is the time risk managers should step up and become

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Late News



PHOTO:KRT

Crashed FedEx jet insured in London

Days before the renewal of FedEx Corp.'s aviation hull and liability coverage, one of the cargo carrier's Boeing 727s crashed on landing in Tallahassee, Fla., injuring the crew and destroying the aircraft. The jet is valued at \$15 million, according to a source. FedEx's hull and liability coverage is led by Lloyd's of London syndicate 839, managed by Trenwick Managing Agents Ltd., a unit of Trenwick International Ltd. FedEx carries \$1.25 billion of liability coverage, according to a source.

Trade bill conferees agree on COBRA subsidy

The federal government would subsidize 65% of COBRA health care premium costs for workers who lost their jobs due to foreign competition under a trade bill that congressional negotiators agreed to last week. The agreement on the COBRA subsidy, hammered out by a congressional conference committee, bridges differences in trade bills earlier passed by the Senate and House. The Senate bill called for a 70% subsidy, while a House bill set a 60% premium subsidy.

Court rejects names' appeal in Jaffray case

The U.K. Court of Appeal dismissed an appeal by Lloyd's of London names in the *Jaffray vs. Lloyd's* fraud case, upholding an earlier High Court ruling. The *Jaffray* case centered on allegations by more than 200 names—individual investors in the Lloyd's market—that 33 senior figures at Lloyd's had, between 1978 and 1988, knowingly concealed the extent of asbestos-related losses about to hit the market.

State official seeks ban on some investments

California's state treasurer has proposed that two California

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International SPACE INSURANCE MARKET REPORT

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Inside

Bill would create pension protectorate

A new federal office to protect the interests of pension plan participants is proposed in the Senate. **Page 6**

Insurance in the arts has loyal following

In Commentary, Mark Hofmann writes there are far more examples of insurance in fiction, film and song than he had realized. **Page 6**

Congress at play before summer recess

In the days leading up to its summer recess, Congress appears more concerned with the appearance of action than with working to achieve real results, this week's editorial says. **Page 8**

Future liabilities create present claims

Two rulings affirm the right of companies to recover insurance for future liabilities that are known today, Robert M. Horkovich and Edward J. Stein of Anderson Kill & Olick P.C. write in Perspectives. **Page 10**

Pool Re expands terrorism coverage

The U.K.-backed terrorism reinsurance pool has expanded its definition of covered terrorist acts beyond fire and explosion. **Page 15**

Space market reviews options to cut losses

While rates are higher for satellite insurance, underwriters proposed tighter terms and conditions to keep losses from outpacing premiums. **Page 15**

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REPORTING WEEKLY ON CORPORATE RISK, EMPLOYEE BENEFIT AND MANAGED HEALTH CARE NEWS

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pension funds, which have about \$250 billion, stop investing in companies, including insurers, that relocate their headquarters to Bermuda, the Cayman Islands and other offshore locations. State Treasurer Phil Angelides released the names of 23 companies—including three that write insurance or reinsurance—that he accuses of relocating to offshore domiciles to avoid U.S. taxes. Everest Reinsurance Co., PXRE Corp. and White Mountains Insurance Group Ltd. are the three insurers included among the 23 companies named.



GE Frankona sets up aviation unit in London

GE Frankona Re has formed a London-based aviation unit that will underwrite small airlines, aviation product manufacturers and airports, as well as aircraft refueler service providers and general aviation risks. The unit will cover up to 60-seat turbo-prop planes and jets flown by regional airlines in the United States and Europe, according to Florian Karner, underwriting manager for AerospaceDirect, a unit of GE Frankona Re's Global Specialty division. Senior Underwriter Greg Dawson will lead the new facility.

Passage nears on pension shield against creditors

Federal bankruptcy reform legislation expected to receive final congressional approval this week would protect from creditors the pension benefits of employees who work for tax-exempt and public employers. The legislation would extend the same protection from creditors enjoyed by plans governed

Late News

by the Employee Retirement Income Security Act to non-ERISA group plans. That includes Section 457 plans and certain 403(b) plans.

Weyerhaeuser covered for boiler explosion

Weyerhaeuser Co. expects to recoup from its insurers most of the losses it suffered from a recent boiler explosion at one of its pulp-and-paper mills. Until the claim is paid, though, Weyerhaeuser is incurring related expenses and had to report the incident—which caused about \$65 million to \$70 million in property and business interruption damages—in its earnings statement for the second quarter. The insurers and reinsurers on the risk are the company's own captive, Factory Mutual Insurance Co., Swiss Reinsurance Co., Munich Reinsurance Co., Partner Re. Ltd. and XL Capital Ltd.

Lilienthal named CEO of CNA

Stephen W. Lilienthal will become chief executive officer of CNA Financial Corp. and chairman and CEO of CNA Insurance Cos. on Aug. 26. Mr. Lilienthal, who joined Chicago-based CNA in July 2001 as president and CEO of CNA's property/casualty operations, will succeed Bernard L. Hengesbaugh, who will become chairman of the

board of CNA. That position is currently held by Edward Noha, who will retire.

Senate names conferees on terrorism bill

Lawmakers took another step toward a final terrorism insurance bill as Senate leaders named seven of their colleagues to a conference committee charged with working out differences between the Senate and House approaches to the issue. The conferees include Senate Banking Committee Chairman Paul Sarbanes, D-Md., and the committee's ranking minority member, Sen. Phil Gramm, R-Texas. The others are Sens. Christopher Dodd, D-Conn.; Jack Reed, D-R.I.; Charles Schumer, D-N.Y.; Mike Enzi, R-Wyo.; and Richard Shelby, R-Ala.



Cancer most common cause of LTD: Insurer

Long-term disability insurer UnumProvident Corp. says that claims for cancer are the most-prevalent types of LTD claim it receives from working-age Americans. Rounding out the top-five list for LTD causes are pregnancy complications, back conditions, cardiovascular conditions

and depression, according to UnumProvident's analysis of its claims database.

Rate hikes fuel profit growth at AIG

Rate increases helped drive up profits at American International Group Inc. to \$3.78 billion for the first six months of 2002, a 19.3% increase over the same period last year. AIG's property/casualty net written premiums increased 34.2%, to \$6.78 billion, in the first half. "Rates are going up after a decade of price declines and policy form inflation," Maurice R. Greenberg, AIG's chairman and chief executive officer, said in a statement.



Mr. Greenberg

Briefly noted

The New Jersey Supreme Court has upheld the \$6.1 million judgment against Aon Corp. won by Phil McConkey. Mr. McConkey, a former professional football player, won a jury verdict that includes \$5 million in punitive damages in 1999, asserting that he joined insurance brokerage Alexander & Alexander Services Inc. only after its chairman promised that the company would not be sold. Shortly after Mr. McConkey joined the company, it was purchased by Aon Corp. and he was dismissed...Massachusetts legislators have overridden acting Gov. Jane Swift's veto of tax legislation that includes provisions to amend state law to conform with a catch-up contribution provision in the Economic Growth and Tax Relief Reconciliation Act. That provision allows employees 50 years of age and older to make catch-up contributions to their 401(k), 403(b) and 457 savings plans.

Cash compensation of insurer execs tracks company fortunes

Poor results dampen pay of CEOs

By NICOLE VOGES

Compensation for top executives of leading publicly held insurers and brokers withstood the devastating blows of 2001 with surprising durability, even though more of these companies posted losses last year than in years past.

The average cash compensation—comprising salary and bonus—of CEOs at 25 of the largest companies in the commercial insurance industry was \$2,713,209 in 2001, according to a *Business Insurance* survey of company reports and U.S. Securities and Exchange Commission filings.

Cash compensation in 2001 was down 6% from the average of \$2,885,027 for a similar group of CEOs in 2000. Some CEOs in this year's report were newly appointed in late 2000 or early 2001, making direct comparison difficult.

The trend toward overall lower cash compensation in 2001 is due, in part, to the reduced amounts of bonuses awarded. Dick Furniss, a New York-based specialist in insurance industry executive compensation for Towers Perrin, said that annual bonuses for senior executives are on the decline because investments are down and insurers are underwriting less business.

Six of BI's 25 highest-paid industry executives went without bonuses in 2001. According to Towers Perrin's own current research on a similar group, the number of CEOs receiving no bonuses doubled. Towers Perrin found a 38% drop in bonuses among those insurance CEOs who have been among the consulting firm's top 25 for two consecutive years.

The trend in reduced bonuses even applied to Sanford I. Weill, the CEO of New York-based Citigroup



PHOTO: ZUMA PRESS



PHOTO: AFP

At opposite ends of the cash compensation spectrum are Warren Buffett (left) of Berkshire Hathaway, lowest paid of the group, and Sanford Weill (right) of Citigroup, highest paid.

Inc. and the highest-paid CEO on the BI list for the second consecutive year. In 2001, Mr. Weill took home \$17,986,748 in cash compensation—\$1,000,000 in salary and \$16,986,748 in bonus—down more than 7% from 2000.

This year's list includes some newcomers, including the top executives of Willis Group Holdings

Ltd. and Aetna Inc.

Willis, a London-based brokerage, held its initial public offering in June 2001. CEO Joseph Plumeri's \$2,756,000 cash compensation in 2001 landed him the No. 7 spot on the list of insurance industry executives, as well as made him the second highest-paid CEO of a broker-

See **CEOs**/page 4

July 29, 2002

Claimants must prove employer intended to discriminate

2 courts raise the bar for job bias claimants

By JUDY GREENWALD

A plaintiff with a protected or minority status must first prove an employer was aware of that status before the plaintiff can pursue a claim of job discrimination, two federal appeals courts have held.

In both cases—one involving a Jewish job applicant who was rejected for a position and one concerning an employee who was fired two days after telling a supervisor she was pregnant—employers successfully argued they were not aware of each individual's protected status when they made their decisions. The appellate rulings in both

cases affirmed lower courts' summary judgments dismissing the cases.

"Ignorance is bliss, sometimes," said employer attorney John-Edward Alley of Ford & Harrison in Tampa, Fla.

The first ruling was a July 12 decision by the 11th U.S. Circuit Court of Appeals in Atlanta in *Steven Lubetsky vs. Applied Card Systems Inc.*

Mr. Lubetsky was offered a position by a recruiter for Applied Card Systems in Boca Raton, Fla., conditioned on a satisfactory credit check. Mr. Lubetsky, an Orthodox Jew, then asked about leave policy for observation of religious holi-

days. In court filings, Mr. Lubetsky said he was reassured such absences would not pose a problem.

But a manager, John Bardakjy, told the recruiter he had met Mr. Lubetsky at a job fair, where he was rude and aggressive, and he ordered the recruiter to rescind the job offer. The recruiter then told Mr. Lubetsky the position had been promised to someone else. The recruiter testified she did not tell Mr. Bardakjy about her conversation with Mr. Lubetsky concerning his religion, and Mr. Bardakjy said he did not know that Mr. Lubetsky was Jewish.

In its unanimous ruling, a three-judge panel said Mr. Lubetsky

"failed to establish a prima facie case of intentional religious discrimination" because he did not present "any evidence that the decision-maker knew of his religion. Instead, all of the evidence indicated Bardakjy, the individual who made the decision to rescind appellant's conditional job offer, was unaware of appellant's religion."

Mr. Lubetsky's attorney, G. Ware Cornell Jr. of Fort Lauderdale, Fla.-based Cornell & Associates, said he plans to ask the appellate court to reconsider its decision. He contends that Mr. Lubetsky was in Pittsburgh during the time Mr. Bardakjy claims to have met him at the job fair.

Richard Tuschman, an employer attorney with Baker & McKenzie in Miami, said the opinion arguably "raises the bar for a religious discrimination claim" within the 11th Circuit. "It requires the plaintiff to prove that the decision-maker knew of his religion, even in circumstances where the employee's name might very well suggest the religion of the plaintiff," he said.

The other ruling, *Cindy D. Prebilich-Holland vs. Gaylord Entertainment Co.*, was a July 18 decision by the 6th U.S. Circuit Court of Appeals in Cincinnati.

Ms. Prebilich was a new business
See **BIAS**/page 23



PHOTO: AP/WIDE WORLD

Cattle feedlots of Greeley, Colo.-based ConAgra Beef Co., which recalled 19 million pounds of beef due to possible contamination. Insurers say the severity and frequency of recalls is growing.

Buyer demand for recall cover exceeds supply

Market shrinks after hefty losses

By SALLY ROBERTS

Risk managers seeking product recall coverage for food and beverages are finding a market with fewer players, smaller capacity and higher prices.

The combination of the soft market and an increase in frequency and severity of product recall losses over the past few years—particularly in the meat and poultry industry—has sent many reinsurers and insurers running from the market. As a result, few underwriters remain, which leaves many food and beverage manufacturers and retailers in need of coverage but unable to find adequate limits and prices.

The food and beverage product recall market "pretty much collapsed about two years ago, and capacity has fallen ever since," said Ed Wu, senior vp-global broking for Marsh Inc.'s FINPRO unit in New York.

"I think the soft market—

when there was some competition—burned a lot of reinsurance companies," he said. "At that time, they underwrote policies inexpensively to gain market share. So when losses started coming in, it was full-limit losses because a recall, when it occurs, is a very large loss."

The market tends to look at product recall coverage as a low-frequency and high-severity exposure, said Bernhard Steves, a vp with wholesaler Swett & Crawford Group in Chicago.

"The problem that happened a few years ago was there was a spate of recalls and suddenly this became a higher-frequency, high-severity situation, which isn't going to work for this type of coverage," Mr. Steves said.

"We're seeing underwriters being more selective in their risks now, and they seem to be more concerned with retentions than with premiums, although premiums are going up as well,"

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Second-quarter cat losses less than half of 2001 toll: PCS

JERSEY CITY, N.J.—Catastrophes caused about \$1.97 billion in insured property damage in the second quarter of 2002, according to preliminary estimates by the Insurance Services Office Inc.'s Property Claim Services unit.

Most of the damage was caused by wind, hail, tornadoes and flooding, as well as by the recent wildfires in Arizona, according to PCS. The most severe catastrophe occurred between April 27 and May 3, when a severe weather system battered 17 states, causing an estimated \$855 million in insured losses.

Jersey City, N.J.-based PCS declared 10 catastrophes in the second quarter. PCS defines a catastrophe as an event within a particular territory that causes \$25 million or more in insured property losses and affects a significant number of property/casualty policyholders and insurers.

Second-quarter 2002 losses fell far short of those a year earlier, when Tropical Storm Allison and a Midwestern storm system were the main factors in total insured property damage of about \$6.24 billion.

Cat losses for the first half of 2002 now stand at an estimated \$2.585 billion, or less than half the about \$6.95 billion toll in first-half 2001. The 2001 period was the second-costliest first half since 1993, with only the first six months of 1994 registering a higher catastrophe loss total, due mainly to the earthquake that ravaged the Northridge section of Los Angeles.

—Mark A. Hofmann



PHOTO: KRT

A late April storm system that struck 17 states is the costliest insured catastrophe so far this year, generating an estimated \$855 million in claims, according to the Insurance Services Office's Property Claim Services unit.

4th Annual Global Risk Management Summit

Handled well, privacy issues can foster trust, opportunities

By RODD ZOLKOS

CHICAGO—Although customer privacy concerns can present risks for businesses that gather and use customer information, the privacy issue can create opportunities when those risks are addressed properly, according to one corporate privacy officer.

Speaking at Economist Conferences' 4th Annual Global Risk Management Summit earlier this month in Chicago, W. Peter Cullen, corporate privacy officer at RBC Financial Group in Toronto, said that at his company, which relies heavily on customer information, managing that information and the related

privacy issues became a core corporate strategy.

"We see (privacy) very much as a business strategy," Mr. Cullen said, "one that's obviously fraught with risks but brings with it tremendous opportunities and customer value."

Although only about 25% of consumers say they've experienced misuse of their personal information, losing control over that information is a significant concern for consumers, Mr. Cullen said. "It's starting to drive people's behavior."

At the same time, having robust information is necessary for success in a service economy, Mr. Cullen said. "But in order to use information, customer trust is absolutely es-

sential," he said, and the reputational risk faced by a company that violates that trust, or is perceived to be violating it, is very real.

The company found that privacy is a prominent factor in consumer perception of the RBC brand, which the company estimates to have a value of \$11.3 billion Canadian (\$7.34 billion). That figure represents 27.4% of RBC's total economic value, Mr. Cullen said.

Of that brand value, privacy accounts for 14%, according to RBC's analysis, and it represents 7% of the company's overall share value, the privacy officer said. "In the RBC banking platform, privacy con-

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HIGHEST-PAID INSURANCE INDUSTRY CEOs

| Name, Age | Company | 2001 cash compensation | 2000 cash compensation | % change | Value of shares ¹ | 2001 total revenues | % change | 2001 total net income (loss) | % change |
|------------------------------|---|------------------------|------------------------|----------|------------------------------|---------------------|----------|------------------------------|----------|
| Sanford I. Weill, 68 | Citigroup Inc. | \$17,986,748 | \$19,484,414 | -7.7% | \$845,379,107 | \$83,625,000,000 | 7.6% | \$14,569,000,000 | 3.0% |
| Robert H. Benmosche, 57 | Metropolitan Life Insurance Co. | 4,300,000 | 4,400,000 | -2.3 | 2,732,083 | 31,928,000,000 | 0.6 | 473,000,000 | -50.4 |
| Jeffrey W. Greenberg, 50 | Marsh & McLennan Cos. Inc. | 3,700,000 | 2,700,000 | 37.0 | 5,035,702 | 9,943,000,000 | -2.1 | 974,000,000 | -17.5 |
| H. Edward Hanway, 50 | CIGNA Corp. | 3,611,500 | 5,271,200 | -31.5 | 8,193,899 | 19,115,000,000 | -4.4 | 989,000,000 | 0.2 |
| William R. Berkley, 56 | W.R. Berkley Corp. | 3,030,000 | 3,032,550 | -0.1 | 143,478,083 | 1,941,797,000 | 9.0 | (91,546,000) | -352.6 |
| Jon A. Boscia, 49 | Lincoln National Corp. | 2,950,000 | 4,250,000 | -30.6 | 30,183,224 | 6,381,000,000 | -6.9 | 590,211,000 | -5.0 |
| M.S. McGavick, 44 | SAFECO Corp. ² | 2,830,207 | NA | NA | 382,842 | 6,866,900,000 | -1.8 | (989,200,000) | -963.2 |
| Joseph J. Plumeri, 58 | Willis Group Holdings Ltd. ³ | 2,756,000 | 1,000,000 | 175.6 | 80,661,133 ⁴ | 1,424,000,000 | 9.1 | 2,000,000 | -77.8 |
| David F. D'Alessandro, 51 | John Hancock Financial Services | 2,600,000 | 2,876,923 | -9.6 | 25,780,640 | 9,109,000,000 | 1.9 | 618,700,000 | -24.4 |
| Patrick G. Ryan, 64 | Aon Corp. | 2,587,500 | 1,125,000 | 130.0 | 753,710,930 | 7,847,000,000 | 7.4 | 203,000,000 | -57.2 |
| J. Harold Chandler, 52 | UNUMProvident Corp. | 2,450,000 | 2,300,000 | 6.5 | 20,009,221 | 9,394,800,000 | -0.4 | 579,200,000 | 2.7 |
| Brian Duperreault, 54 | ACE Ltd. | 2,225,008 | 2,875,000 | -22.6 | 9,564,403 | 6,644,687,000 | 26.2 | (146,414,000) | -127.0 |
| Ramani Ayer, 54 | Hartford Financial Services Group Inc. | 2,128,917 | 2,747,833 | -22.5 | 28,885,916 | 15,147,000,000 | 3.0 | 507,000,000 | -47.9 |
| Dr. John W. Rowe, 57 | Aetna Inc. ⁵ | 2,000,000 | 648,077 | 208.6 | NA | 25,190,800,000 | -6.1 | (279,600,000) | -320.0 |
| Brian M. O'Hara, 53 | XL Capital Ltd. | 2,000,000 | 1,850,000 | 8.1 | 25,486,375 | 4,056,759,000 | 49.5 | (576,135,000) | -213.8 |
| Bernard L. Hengesbaugh, 55 | CNA Insurance Cos. | 1,900,000 | 1,873,400 | 1.4 | 10,683,133 | 13,203,000,000 | -15.0 | (1,644,000,000) | -235.4 |
| Douglas W. Leatherdale, 65 | St. Paul Cos. Inc. ⁶ | 1,736,929 | 2,756,154 | -37.0 | 13,856,982 | 8,943,000,000 | 12.2 | (1,088,000,000) | -209.6 |
| Carl H. Lindner, 82 | American Financial Group Inc. | 1,365,600 | 950,500 | 43.7 | 174,952,394 | 3,924,000,000 | 2.8 | (15,000,000) | -73.2 |
| Edward M. Liddy, 56 | Allstate Corp. | 1,093,356 | 1,548,250 | -29.4 | 10,184,331 | 28,865,000,000 | -0.9 | 1,158,000,000 | -47.6 |
| A.C. Zucaro, 62 | Old Republic International Corp. | 1,056,164 | 894,846 | 18.0 | 3,339,777 | 2,373,400,000 | 14.6 | 346,900,000 | 16.6 |
| Dean R. O'Hare, 59 | Chubb Corp. | 1,012,501 | 1,804,751 | -43.9 | 8,389,597 | 7,754,000,000 | 6.9 | 111,500,000 | -84.4 |
| Maurice R. Greenberg, 76 | American International Group Inc. | 1,000,000 | 6,000,000 | -83.3 | 2,658,816,048 | 62,402,000,000 | 9.4 | 5,363,000,000 | -19.2 |
| J. Patrick Gallagher Jr., 50 | Arthur J. Gallagher & Co. | 850,000 | 1,150,000 | -26.1 | 12,035,550 | 910,043,000 | 22.9 | 125,256,000 | 42.7 |
| John J. Schiff Jr., 58 | Cincinnati Financial Corp. | 559,792 | 486,776 | 15.0 | 417,569,664 | 2,561,000,000 | 9.9 | 193,000,000 | 63.6 |
| Warren Buffett, 71 | Berkshire Hathaway Inc. | 100,000 | 100,000 | NC | 31,302,368,200 | 37,668,000,000 | 10.8 | 795,000,000 | -76.1 |
| Average | | \$2,713,209 | \$2,885,027 | -6.0% | | | | | |

¹ Based on July 17, 2002, closing price and shares beneficially owned as of Dec. 31, 2001. ² Mr. McGavick succeeded Roger H. Eiqsti at SAFECO in January 2001. ³ Mr. Plumeri succeeded John Reeve at Willis in October 2000. ⁴ Shares held as of March 8, 2002, including exercisable options. ⁵ Dr. Rowe succeeded William H. Donaldson at Aetna in September 2000. ⁶ Mr. Leatherdale retired from St. Paul and was succeeded by Jay S. Fishman in October 2001.

Source: Securities and Exchange Commission filings and company reports

CEOs: Compensation trend follows profits down

Continued from page 2

age. Mr. Plumeri's salary remained at an even \$1 million for his second year as CEO, but he received a bonus of more than \$1.7 million in 2001. Mr. Plumeri, who joined Willis in October 2000, received no bonus that year.

The lowest-paid CEO on the list was Warren Buffett, of one of the industry's largest companies, Omaha, Neb.-based Berkshire Hathaway Inc. As do many of the highest-paid industry CEOs, Mr. Buffett has a substantial holding in beneficially owned common shares in his company. Once again in 2001, Mr. Buffett earned a salary of \$100,000 with no bonus. At year-end 2001, his nearly 475,000 beneficially owned Berkshire shares were valued at more than \$31.30 billion, based on a July 17 closing price.

Other CEOs with significant stakes in their companies at the end of last year include American International Group Inc.'s Maurice R. Greenberg. His nearly 44 million beneficially owned AIG shares were valued at \$2.66 billion. Citigroup's Mr. Weill held more than 22 million shares of Citigroup Inc. stock at the end of last year, worth more than \$845 million.

While cash compensation de-

clined for most of the 25 CEOs, pay did increase for a few.

The highest increase in cash compensation went to Dr. John W. Rowe, who succeeded William H. Donaldson at Hartford, Conn.-based Aetna in September 2000. Dr. Rowe received a 208% hike in cash compensation for 2001, comprising \$1,000,000 in salary and an equal amount as a bonus. His increase in pay did not reflect any improvement in Aetna's profits, however. Aetna in 2001 had a net loss of \$279.6 million, compared with net income of \$127.1 million the year before.

Although some of these heavy hitters did quite well in 2001, declining statistics, such as the drop in industry bonuses, are in line with the overall consensus among compensation consultants. They agree that 2001 was a bad year for corporate America and that the insurance industry is feeling the repercussions of losses taken. Heavy losses that are still occurring post-Sept. 11 and ongoing corporate accounting scandals are also shaking up the industry.

Although insurance companies as a whole suffered in 2001, some lines of business did exceptionally well. "Most people are predicting

that property/casualty is going to be great this year," Mr. Furniss said. Other consultants agree that the insurance industry's tendency toward conservative practices has resulted in fewer upsets for most insurance companies.

More good news for the industry's CEOs is a shift toward greater performance sensitivity in relation to bonuses and other compensation, said Mike Garelik, Philadelphia-based practice leader for Watson Wyatt Worldwide.

Paying more attention to corporate financial performance is one way compensation committees are determining fair payment packages for CEOs and other executives, compensation consultants say. The consultants say that though they have seen this trend increase in the past few years, the Enron scandal forced the actions of compensation committees into the spotlight, making more-radical revisions necessary.

Alan Johnson, managing director of New York-based Johnson Associates, agreed that, "for a long time, we were too forgiving of bad performance."

David Hofrichter, the Chicago-based national practice director for compensation for Buck Consul-

tants, noted that, in the past, poor company performance did not always had a significant impact on CEO paychecks. But now, Mr. Hofrichter said, there is "no backing away from the sort of 'pay for performance' ways companies have."

This pay for performance theory applied to many CEOs in 2001.

Mr. Greenberg of AIG fell to the No. 22 spot this year, from No. 3 in 2000. AIG's net income took a 19% dive in 2001, and Mr. Greenberg's overall cash compensation fell 83%, to \$1,000,000.

Dean R. O'Hare, No. 21 on the list, also felt the pain when Chubb Corp.'s net income dropped 84%—his total compensation decreased 44%, to \$1,012,501. Among other factors, Chubb's results reflected claims from the World Trade Center attack and surety losses related to Enron Corp.'s collapse.

Other changes are being made behind boardroom walls that will affect the wallets of insurance industry executives. "The role of the compensation committee has become more active," Mr. Hofrichter said.

Consultants also report that members of compensation committees are increasingly being asked to sign conflict-of-interest statements.

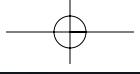
The committees are also moving toward standardized formulas for reaching salary agreements.

These agreements take more than company performance into consideration; they're also looking at other measures of company health, such as policyholder satisfaction and customer service. "It's the quantitative and the qualitative," Mr. Hofrichter said, "and that's a shift."

Although bonuses went down in 2001, long-term compensation was up 19%, according to Towers Perrin research. The median change in total compensation is also up by 15%. Mr. Furniss said that one possible reason executives are being granted long-term stock options, for example, is to "turn the company around."

Errors & omissions

- A July 8 article on directors and officers liability insurance rates misidentified Jack Kuhn. Mr. Kuhn is the president of Kemper Financial Insurance Solutions, a unit of Kemper Insurance Cos. in Berkeley Heights, N.J.

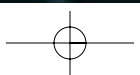


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What can we do to help you?



Bill would create federal office to protect pension participants

By JERRY GEISEL

WASHINGTON—Legislation headed to the Senate floor would create a new office in the Department of Labor devoted entirely to protecting the rights of plan participants.

The proposal, backed by Sen. Tom Harkin, D-Iowa, and tucked by a Senate panel into legislation appropriating funds for the Labor Department and several other federal agencies, would establish a new Office of Pension Participant Advocacy. The office, which would have a \$3 million budget, would report directly to the secretary of Labor rather than to the department's Pension and Welfare Benefits Administration, its pension regulatory and enforcement unit.

Several federal agencies share jurisdiction over pension law, but none works exclusively in the interests of plan participants, according to a committee explanation of the amendment.

When pension problems arise, participants often need prompt help, said Sen. Harkin. But currently, he said, that help isn't available.

"People who have a genuine legal claim to their pension but have been unfairly denied it can end up spending countless hours calling phone number after phone number and getting the runaround. This office will put the needs of pension participants first," said Sen. Harkin.

The proposal is drawing fire from some employer groups concerned that the new office would complicate pension regulation.

Aside from helping plan participants, the new pension office would have policymaking responsibilities. Among other things, the office would identify needed changes in pension policies, and this role could lead to conflicting plan regulation, the Washington-based American Benefits Council has argued.

While the PWBA is intended to

incorporate the views of participants, employers, unions and administrators in issuing guidance and enforcing law, the proposed Office of Participant Advocacy would rely on participant lobbying groups and report directly to the secretary of labor, the council said.

"In effect, two separate and distinct offices would be responsible for regulating and enforcing the private retirement system. Such a structure would lead to conflicting and uneven administration of the nation's pension laws," the group said in a letter to Appropriations Committee Chairman Robert Byrd, D-W.Va., and Sen. Ted Stevens, R-Alaska, the panel's ranking member.

The Senate is unlikely to take up the appropriations bill until it returns from the August recess after Labor Day. Appropriations legislation currently before the House of Representatives lacks a comparable provision.

Commentary

Finding new gems of insurance genre

Sometimes, readers really make it easy for commentators to do their jobs.

Back in May, I wrote a commentary noting the relative dearth of insurance professionals in fiction. I'd initially planned to examine how novels, movies and television shows—as well as rock music—deal with insurance, but I soon realized that I didn't have enough space. That should have raised the flag that insurance-themed entertainment was more prevalent than I'd thought.

Within hours of the appearance of the piece, the e-mails began arriving pointing out movies and TV shows that deserve mention, as well as a few books and pieces of music

spin on the insurance noir genre.

Among other flicks, careful readers also cited "The Apartment," "Memento" and what may be the most obscure reference of all, a 1938 movie called "Accidents Will Happen." The movie deals with insurance fraud and has apparently been shown at some insurance gatherings. As one faithful correspondent put it, the movie "is notable because it has a twist and the lead claims investigator is played by a young Ronald Reagan."

Insurance as portrayed on the small screen drew fewer comments. Readers cited George Peppard's "Banacek" as one of the best television treatments of the business. I'll have to take their word

I'd overlooked.

Here is what I've learned should have been added to my original commentary, courtesy of alert—and better-informed—readers.

There are at least seven—eight, if you count two versions of the same tune—rock or pop songs other than Warren Zevon's "Mr. Bad Example" that deal with insurance.

My favorite among this eclectic collection is the Ramones' "High Risk Insurance."

Insurance fiction, though a relatively narrow field, has a lot more to offer than I initially thought. Among the titles cited that I'd overlooked are "Jurassic Park," "Darwin's Blade," "Coyote Blue" and some of the works of Sara Paretsky. Paretsky, as one correspondent pointed out, had actually worked for an insurance company—CNA.

But this is only scratching the surface. The University of Connecticut Law Library has a collection of about 50 books—one dating back to 1905—that qualify as insurance fiction. This includes many, but not all, of the titles I'd mentioned. The full catalog is at www.insurancelawcenter.com/library/ilc/fiction. It's worth a visit.

Readers pointed out that insurance has been the theme of numerous movies and TV shows, though none mentioned the 1936 classic film "Lloyd's of London."

Several readers reminded me of the central role of insurance in "The Thomas Crown Affair"—both the Steve McQueen/Faye Dunaway and Pierce Brosnan/Rene Russo versions. Both definitely merit a mention—and a viewing—which I would have been mentioned had I the space last time around. The same goes for the fantastically weird, twisted and sexy Linda Fiorentino flick "The Last Seduction," which put a whole new



Mark A. Hofmann

on that because I've never seen any of the episodes—it was on when I was in college and didn't have ready access to TV.

In addition, one reader reminded me that television's paragon of paternal virtue—Jim Anderson of "Father Knows Best"—was an insurance agent for General Insurance Co.

Given the breadth of arcane knowledge demonstrated by my readers, I was a bit surprised that no one mentioned an insurance-themed TV show from my childhood: "The Man From Blackhawk."

The show, which didn't survive its inaugural season, dealt with the adventures of Sam Logan, who was kind of a frontier claims adjuster for a Chicago-based insurer. As I recall, every week he got dispatched to some place in the Wild West, becoming sort of the organization man's version of Paladin.

The catch was, Sam wielded a pen, not a six-gun. And while the pen might be mightier than the sword, in the eyes of the target audience for Westerns—basically 7-year-old boys of all ages—the six-gun would win every time, and any Western that failed to acknowledge that fact was doomed to a short run.

But even though this program failed to generate a wider audience and a longer run, it's clear from the responses to my original commentary that insurance-themed entertainment has, in general, a fiercely loyal following. Maybe writers and Hollywood producers will sit up and take greater notice?

Senior Editor Mark Hofmann's commentary appears periodically in *Business Insurance* and on www.businessinsurance.com. He can be reached by e-mail, at mhofmann@crain.com.

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Editorial

Congress driven to distraction

DECADES AGO, in the era before central air conditioning, Congress took the summer off, or a good deal of it off, to escape the stifling summer heat in Washington.

Today, thanks in part to central air, congressional sessions run much longer and have shorter summer breaks, but we wonder if that is necessarily a good thing. In an election year, with lawmakers determined to have something to show for themselves and their parties before the August recess, there is a flurry of legislative proposals—some at cross-purposes—now occupying the congressional agenda.

Unfortunately, much of this legislation was proposed more for show than for the advancement of needed reform, and it often makes little sense or is downright silly. For a few worthwhile and important proposals, the timing of their introduction can mean they get overlooked. Not only does the upcoming summer break limit the time available for consideration but the multitude of proposals also dilutes the attention that can be given to any one bill.

Take, for instance, the debate in Congress on proposals to add a prescription drug benefit to the federal Medicare program. The idea of a Medicare prescription drug benefit is a good one. With prescription drugs now such a vital part of medical therapy, a health plan that lacks coverage for drugs really isn't much of a health plan.

There has been a cacophony of legislative proposals on how to address this benefit gap in Medicare.

There is a Republican plan, which recently passed the House. There is also a plan from the Senate Democrats that was rejected last week, as was a so-called "tripartisan" plan, so-named because its backers are three Republicans, one Democrat and the Senate's sole independent, Sen. James Jefford, I-Vt.

What all these proposals lack is broad bipartisan support, without which chances of final enactment are poor. That's because the introduction of the measures and congressional votes on them are done more for political posturing rather than with any expectation of them becoming law.

The political parties want to show the public that they care about a hot issue, rather than compromise and work to pass legislation that would help the public. These measures also are the result of political fears that if they don't have some sort of proposal, the other party will bash them during election campaigns.

It is a shame that the leaders of both parties couldn't have reached an agreement, at the beginning of the session, to work together to develop and pass a bipartisan Medicare prescription drug plan. Surely, bipartisanship is an absolute must on legislative changes to a program of this size and importance. To endlessly debate the issue this late in the session strikes us as silly.

Silly, or perhaps nonsensical, could also characterize a proposal by Rep. Bernard Sanders, I-Vt., that was adopted by the House last week.

Rep. Sanders' proposal would bar

the Internal Revenue Service from using any of its funds to develop cash balance valuation rules that conflict with a proposed method the IRS outlined in a notice six years ago but never adopted. The notice suggested a methodology employers could follow in valuing cash balance pension plan accounts when employees terminate employment before retirement.

The fact that the IRS never formally proposed, much less finalized, that methodology clearly is an indication, though, that IRS officials had reservations about it. That isn't surprising, given that one of the effects of following the methodology would be that terminating employees could, in certain situations, receive more than their actual account balances.

The practical effect of the Sanders amendment would be to prevent the IRS from issuing any guidance in this area unless it were to fit with the 1996 notice, which the IRS, given how much time has elapsed, almost certainly isn't going to do. The result would be a lack of official guidance for employers, which is hardly in anyone's interest.

This isn't to say that the closing months of this year's session have all been in vain. Last week, lawmakers agreed on a much-needed corporate accountability bill and included in that measure reasonable and workable provisions requiring employers to give 401(k) participants advance notice of plan blackout periods when transactions can't be conducted.

And we would hope that when legislators return in September,

they can come to an agreement on such priority items as federal terrorism insurance legislation and other pension reforms needed in the wake of the Enron Corp. debacle.

There will be only a limited time to make progress on these proposals before Congress adjourns for elections. We hope lawmakers use that time more wisely than they have used that which preceded their summer recess.

Letters to the Editor

Stock market plunge to blame for hard market

To the editor: I concur with your assessment of the current property/casualty marketplace and how it got to where it is. However, you didn't play up one important consideration, and that is the falling out of the stock market.

Soon we will be reading that insurance companies are making an underwriting profit. In my 35-plus years in the business, that's unheard of. Until recently, most companies, except AIG and Hartford Steam Boiler, were very happy with underwriting loss ratios of 100% to 108% or higher. Their bottom lines were kept in the black and stockholders were delivered a profit from their investment income.

Now that we're seated in a deep bear market, things will not get better in the property/casualty industry until the stock market shows a strong, continuous rebound.

If the public thinks Enron and WorldCom took advantage of the public, wait until Congress gets to insurers. Antitrust, collusion, rate fixing—all the things we learned about in school that were forbidden in corporate America—are prevalent in today's insurance market. Already we've seen two of the industry's most-visible company heads announce their departure next year; more will follow as they jump off the ship before it goes under. Questionable accounting practices have always existed in the corporate business world.

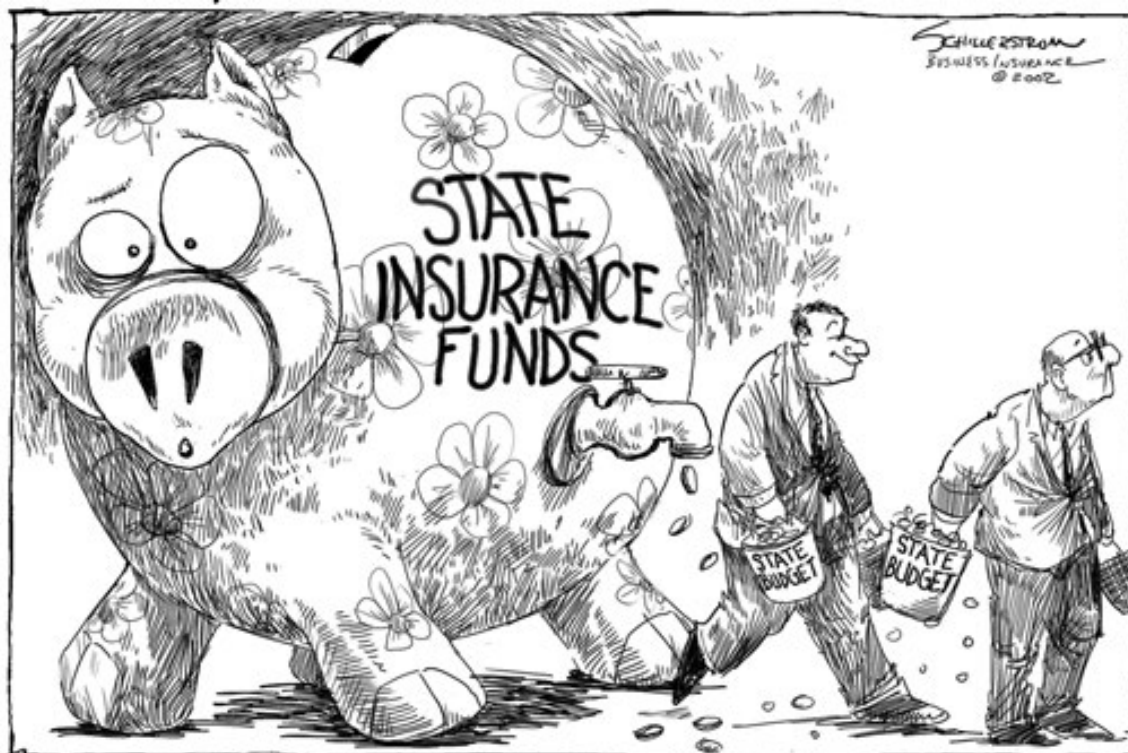
Wait until Washington gets into the insurance industry—we ain't seen nothing yet!

David J. Skolsky
Insurance Analysts & Consultants
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Courts affirm recovery of future claims now

By Robert M. Horkovich and Edward J. Stein

Many corporate policyholders are concerned not only about the steady flow of long-tail claims that may threaten their future but also about the collection risk on the insurance they expect to cover those claims. Recent judicial



Mr. Horkovich



Mr. Stein

decisions recognize a simple solution: the policyholders' right to collect the insurance now for liabilities that include future costs and claims.

For most of the past century, the insurance industry heavily marketed liability insurance for unknown risks. Now, the unknown risks insured under older occurrence-based policies have emerged in force. Asbestos, diethylstilbestrol—or DES—and environmental liabilities are the best known, but the list also includes other pharmaceuticals, tobacco, toxic mold and even claims for sexual molestation.

Unfortunately, the current insurance market presents additional uncertainties,

particularly concerning the solvency and long-term viability of many insurers, including the London insurance market. Sept. 11 and the collapse of Enron Corp. hit an insurance industry already weakened by a previous economic downturn, and, recently, some insurers have become insolvent. Others—notably Lloyd's of London and the Insurance Co. of North America—try to limit the past promises through complex “firewall” reorganizations, restricting claimants under historic insurance to fixed-asset pools.

Three court rulings illustrate the current recovery principle. While two involve asbestos bankruptcies, a third, involving the environmental liabilities of a solvent company, shows that the recovery solution applies to cases involving neither asbestos nor bankruptcy.

In *Fuller-Austin vs. Fireman's Fund*, a California trial court decided on Feb. 26 that a policyholder facing present liabilities for current and future claims could prove and recover all liabilities now. The policyholder faced numerous asbestos bodily injury claims and expected additional claims for years to come. Its liability for those claims, and the damages to the claimants, were established through a “pre-packaged” bankruptcy plan. The insurers had sought to delay payment for decades, until individual asbestos claims were submitted and paid in future years.

The court rejected this attempted delay, though, and held that the policyholder could prove its aggregate liability—the current liability for both pending and future claims.

Although hotly disputed, *Fuller-Austin* simply applied fundamental law, recognized in California and elsewhere, that there is a right to recover future damages in a contract or tort action as part of a present liability.

The policyholder in the case offered expert witnesses using recognized methods to calculate the present liability, and the trial court observed that such expert testimony is typical in contract or tort disputes.

Similarly, in 1991, the 7th U.S. Circuit Court of Appeals held in *UNR Industries Inc. vs. Continental Casualty Co.* that a liability insurer owed the policyholders' present liability for the full value of pending and future asbestos claims, based on the present liability established in a bankruptcy proceeding.

The appeals court rejected the insurers' argument that their coverage would not respond because the policyholder was not paying all claims immediately, and the court remanded the case to determine the number of claims that would fall within the insurers' policy periods.

Insurers cannot limit this recovery principle to asbestos bankruptcies. Although both *UNR* and *Fuller-Austin* involved asbestos claims and *Fuller-Austin* concerned a particular section of the U.S. Bankruptcy Code dealing with asbestos bankruptcies, *UNR* was decided prior to the enactment of that section, on principles applicable to any type of long-tail liability.

Outside the asbestos bankruptcy context, the current recovery principle was upheld in *INA vs. Kayser-Roth Corp.* This 2001 decision of the Rhode Island Supreme Court involved a typical scenario: A corporation with federal Superfund liability was responsible for environmental cleanup, and under Environmental Protection Agency orders, the property and groundwater cleanup was expected to take more than 30 years to complete.

In *Kayser-Roth*, the court affirmed a judgment against the insurer for EPA oversight costs. The court found that the

policyholder was entitled to \$5.4 million, despite the insurer's arguments that the judgment was premature, that it was based on speculation and conjecture and that there was no evidence that the policyholder had paid or had been found legally obligated to pay that amount. The state Supreme Court noted the policyholder had provided a damages expert at trial and that payment would be required under an administrative order.

Courts regularly award damages for present liabilities, including future costs, in cases unrelated to insurance, such as tort awards based on future medical costs and lost earnings, and “front pay” in employment cases. Insurers regularly defend and indemnify defendants in these cases. In commercial cases, lost profits and cash flow regularly are factored into damages.

Applying these concepts in the insurance context should not be controversial. Insurance actuaries use IBNR—incurred-but-not-reported claims—every day for accounting, reserve establishment, regulatory reports and the settlement of reinsurance claims.

Where present liability is fixed, and there is a reasonably reliable basis for projecting the future claims or costs, policyholders should not hesitate to ask for a present-dollar judgment from their liability insurers.

Typically, insurers benefit from the time value of money. But under appropriate circumstances, using the current recovery solution, the tables may now be turned.

Robert M. Horkovich and Edward J. Stein are partners in the New York office of Anderson Kill & Olick P.C., a law firm that represents corporate policyholders in insurance coverage disputes.

Use psychology to identify harassment risks

The Manager's Guide to Preventing a Hostile Work Environment

By Wanda Dobrich, Steven Dranoff and Gerald Maatman Jr.

Published by McGraw-Hill, \$21.95
800-722-4726; www.books.mcgraw-hill.com

By Michael Prince

When it comes to dealing with sexual harassment in the workplace, prevention is key.

But it's not up to lawyers or human resource executives to dispense this ounce of prevention; instead, the task falls to managers, who can spot a volatile situation and prevent it from escalating into a sexual harassment disaster, say the authors of a new



book, “The Manager's Guide to Preventing a Hostile Work Environment.”

The book takes a different approach to addressing the problem of sexual harassment in the workplace than do many other guides. Rather than addressing sexual harassment as chiefly a legal problem, the authors—two of whom are psychologists with long records of

working on the human side of corporations—see the problem as rooted in the interaction between the two individuals involved in a sexual harassment scenario, the accuser and the accused. According to the book's authors, it is through understanding and monitoring the relationships between these people that the potential for sexual harassment can be defused. And, they say, an organization's managers—those who observe employee relationships on a daily basis—are the people who are positioned to step in and prevent harassment.

“The bottom line for employers is clear,” the authors write. “Litigation over personnel decisions and workplace harassment is time-consuming and inconsistent with keeping a clear focus on running a business. It is also the most expensive type of litigation a company will ever battle. The manager's challenge, then, is to prevent workplace harassment from every happening in the first place.”

Though the book includes a review of employment discrimination laws and a detailed discussion of the various types of sexual harassment suits, much of it is devoted to providing a framework that will help companies prevent sexual harassment litigation. Although the legal section drags in spots, it serves mainly to detail the problem before the authors delve into the solution they propose on how to prevent harassment and avoid the nightmare of litigation.

Indeed, the core of the book is an in-depth

look at the approach advocated by the authors—one based in psychology—on how to prevent hostile work environment litigation. According to the authors, although the laws covering sexual harassment are evolving at a rapid pace, people's habits merely inch along. This book, then, is designed to accelerate the rate at which employees, managers and top executives change their behavior, the authors say.

One key point the authors raise again and again is that sexual harassment is a symptom of a deeper problem within an organization—unhealthy interpersonal relationships among employees. And the key to unearthing these problems lies with managers who know the people they supervise in a way that senior management and the human resources staff cannot. Such awareness of employees' behavior is the key to preventing harassment, the authors assert, because it provides an understanding of a worker's “private voice,” or what a person really thinks and feels, as opposed to what he or she is told is the proper way to think. The book examines how those voices can play out in a sexual harassment situation—on the part of the accused, the accuser and the manager—and discusses ways a manager can intervene.

The authors set forth two basic situations in which a hostile work environment can develop. In one, the harasser privately disagrees with the public rules of behavior. In the other, the individual simply doesn't

understand how others perceive his or her behavior, such as telling jokes that others find offensive. In either case, a manager is the representative of the organization who is in the best position to step into a situation, correct it and prevent it from escalating.

“The manager's definition of hostile work environment sexual harassment is therefore different from that of human resources. HR has a procedural definition, based on compliance to the corporation's policy. The manager has an interpersonal definition. It is based on how employees treat one another. When the two are not in alignment, the risk of an employee incident increases,” the authors write.

This book differs from others in that it attempts to examine the thought processes of harassers, victims and managers; it deals with feelings and emotions, rather than just with laws and cases. As such, it provides valuable and needed insights.

This also results in one of the book's few weaknesses, because the use of psychological jargon and concepts may put off some readers. But the authors, to their credit, use such terms sparingly and don't allow them to obscure the book's principal message: You can't “just say no” to sexual harassment and hope it goes away. Preventing workplace harassment takes work and attention, and this book provides a useful plan of attack.

Michael Prince is an associate editor in Business Insurance's New York bureau.

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Fourth Annual Global Risk Management Summit

Controlling market, credit risks aids operations

By **RODD ZOLKOS**

CHICAGO—Because of the “subtle interplay” between the various exposures that place a company’s capital at risk, any failure to manage one of those risks can negatively affect the entire organization, according to one chief risk officer.

Given that relationship, the potential effects of market and credit risks cannot be isolated from the other factors affecting an organization’s capital, said Erwin Martens, chief risk officer at Putnam Investments in Boston.

Speaking at the Economist Conferences’ Fourth Annual Global Risk Summit earlier this month in Chicago, Mr. Martens noted that financial instruments and risk exposures have been increasing both in number and complexity, with the escalation in the number of financial products largely reflecting the desire to trade risks.

In terms of market risk, Mr. Martens said he thinks there is less disruption in the financial markets now, despite “very adverse conditions,” than had occurred during previous financial crises or major investment fund failures. He attributes that difference between then and now to the lessons

learned from the prior situations.

Managing and reducing market risks can put a company in a better position to capitalize on business opportunities, Mr. Martens said. “If you can diminish uncertainty in a primarily market-driven or price-

‘Everybody loves to win, but we’re also interested in the days when we don’t do so well and comparing the days when we don’t do well to the days we do well.’

*Erwin Martens
Putnam Investments*

driven area of your organization, suddenly you can increase opportunity on the operational end,” he said. “You only need to cut off a couple of basis points of market impact.”

Reducing those risks begins with an analysis of the exposures and an understanding of their “risk signatures,” or the circumstances under which the risks have an impact, Mr. Martens said.

“Everybody loves to win, but we’re also interested in the days

when we don’t do so well and comparing the days when we don’t do well to the days we do well,” the Putnam CRO said. “Do we truly win more than we lose? And when we win, how do we win? Do we win by hitting home runs or do we win by hitting singles and doubles?”

“At the same time, one takes a look at setting boundaries on what the expectations are” of assuming risk, Mr. Martens said. Various aspects of the operation will be expected to have some market risk exposure, but looking at return vs. cost of risk in those cases provides metrics a company can use to com-

pare those operational areas equally and determine how much market risk each can afford to assume, he said.

Various policies and procedures can help a company control its credit risk exposures, Mr. Martens said.

Among them are strict counterparty approval processes based on defined criteria and credit analysis, enforceable legal documentation of transactions and sound communication within the organization about risk thresholds and exposure information.

In general, communication is an

important element of the market and credit risk management process, Mr. Martens said. As risk managers, “one of the biggest challenges that we have is simultaneously communicating with different layers of the institution,” he said. And one of the biggest problems for an organization arises when senior management is disconnected from the operational side of the business, he said.

The risk manager, Mr. Martens said, needs to be aware of “what each layer of the institution actually consumes from the risk management group.”

Deadline for international reinsurer directory nears

Business Insurance will publish its online Directory of International Reinsurers in conjunction with the Sept. 2 issue. That issue will include a Spotlight report on the international reinsurance market and a ranking of the world’s largest reinsurers.


The online directory will be available to subscribers on www.businessinsurance.com and will be included in *BI’s* 2002/2003 Market

Source Book, a special printed compilation of all of *BI’s* directories and rankings to be published Dec. 22.

This directory is published as an editorial service; there is no charge to be included. To be listed, a company must have at written at least \$100 million in reinsurance premiums—including both property/casualty and life/health business—in 2001. Companies must provide premiums written and capital-and-sur-

plus figures for 2000 and 2001 to be included. If your company meets the requirements but has not received a questionnaire, please request one immediately by calling Directory Editor Kevin Edison at 312-649-5279.

Copies of the questionnaire also can be printed from www.businessinsurance.com. Completed questionnaires must be submitted by the extended deadline of Aug. 15.



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Pool Re to expand its coverage

By SARAH VEYSEY

LONDON—U.K. risk managers and insurers are welcoming the government's decision to broaden the coverage provided by Pool Reinsurance Co. Ltd., the government-backed reinsurance pool for terrorism risks.

Ruth Kelly, financial secretary to the Treasury, announced last week that the property and business interruption reinsurance coverage provided by Pool Re would be expanded to "all risks" and would now include exposures such as contamination, impact by aircraft and flood damage. Previously, Pool Re provided reinsurance only for prop-

erty and business interruption losses caused by fire and explosion.

The changes to Pool Re are the result of months of discussions between the Treasury and a group comprising representatives from the Assn. of Insurance & Risk Managers, the Assn. of British Insurers, and the British Insurers Brokers' Assn. Insurers and risk managers have expressed fears that Pool Re, which was created to pay losses from attacks by Irish Republican terrorists, does not provide adequate protection for events similar to the Sept. 11 attacks (*BI*, Jan. 14).

Under the Pool Re arrangement, standard commercial property poli-

cies in the United Kingdom provide up to £100,000 (\$145,600) in limits for terrorism property and business interruption risks. Policyholders can buy coverage above that limit from their insurers, which are reinsured by Pool Re.

The expanded coverage should be available within the next few weeks, the Treasury said in a statement. If an insurer opts for the all-risks reinsurance, the premiums would be roughly double the cost of the fire-and-explosion coverage, and there will be an option to backdate coverage to Jan. 1, 2002.

Pool Re's coverage will exclude certain risks, the Treasury noted.

The existing war-risks exclusion will remain, and an exclusion for computer hacking and virus-related damage to electronic components has been added because of a potential difficulty in establishing that such activity involved terrorism.

But one previously excluded exposure that had been a significant concern—nuclear risks—will soon be covered by Pool Re. "It is intended that the present exclusion which exists under the scheme for damage caused by nuclear devices will be deleted as soon as practicable, and by Jan. 1, 2003, at the latest," the Treasury statement said.

See **POOL RE**/next page

World Updates

Moody's reviewing Munich Re ratings

Moody's Investors Service in London has placed its Aaa financial strength rating of Munich Reinsurance Co. and the debt and financial strength ratings of Munich Re's U.S. subsidiary, American Re-Insurance Co., under review for possible downgrade. Moody's said the move was prompted by Munich Re's July 10 announcement that it had increased reserves for American Re by \$2 billion and had raised its Sept. 11 loss estimate by \$500 million. Moody's review follows a similar move by Standard & Poor's Corp., which earlier put its long-term ratings on Munich Re under review, with negative implications.

JLT, Prudential enter pension services deal

Jardine Lloyd Thompson Group P.L.C. has entered a strategic alliance with London-based Prudential P.L.C. to provide administration, accounting and payroll services to some of Prudential U.K.'s defined benefit pension plan clients. In addition, JLT will provide services to the Prudential staff pension plan. Fifty Prudential staff will transfer to JLT as part of the deal. Financial terms were not disclosed.

Wellington plans share offering

Wellington Underwriting P.L.C., the parent company of Lloyd's of London managing agency Wellington Underwriting Agencies Ltd. and of London-based Wellington Reinsurance Ltd., has announced plans to raise £74.4 million (\$116.8 million) of new capital through a share offering. Wellington said the proceeds would be used to finance its investment in Exali Reinsurance Holdings, the holding company for Wellington Re, as well to support underwriting on composite Lloyd's syndicate 2020.

New definition of 'terrorism' offered

Insurance industry experts have called for a single global definition of "terrorism" during the Asia Pacific Risk & Insurance Assn. conference in Shanghai, China. Tom Player, chairman of the insurance practice at the Atlanta-based law firm of Morris, Manning & Martin L.L.P.; Harold Skipper, chairman of the risk management department of Georgia State University; and Janet Lambert of the London-based law firm of Barlow Lyde & Gilbert, recommended that governments and insurers adopt a global

See **WORLD NEWS**/next page

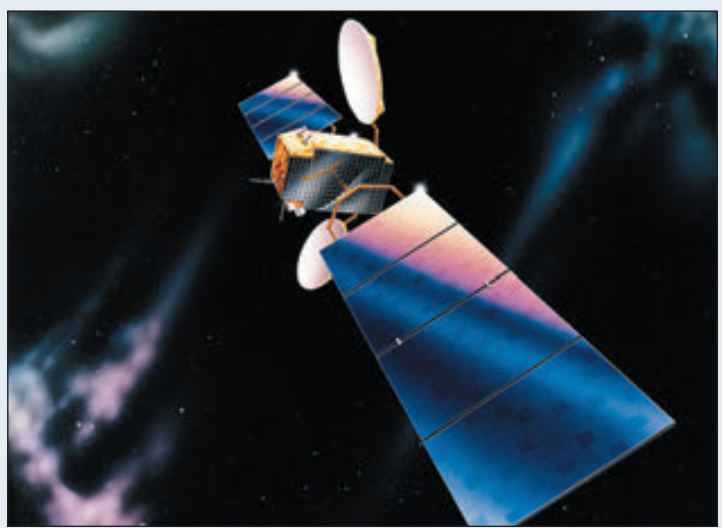


PHOTO: COURTESY OF LOCKHEED

Artist's rendering of Lockheed Martin's A2100 satellite in space.

10th International Space Insurance Conference

Space insurers see course change on coverage terms

By STACY SHAPIRO

LONDON—Space insurance underwriters are contemplating additional changes in coverage terms and conditions on top of the already steep rate hikes for satellite insurance buyers.

Some underwriters, for example, are thinking about offering lower in-orbit coverage rates to satellite operators that decline to sign hold-harmless agreements of satellite manufacturers. Until now, satellite operators have routinely signed such hold-harmless agreements, which has limited the liability of manufacturers for satellite anomalies in orbit.

But it remains uncertain whether this and other changes in coverage terms will truly be able to take hold before current market hardening eases. Already, some satellite operators are opting to self-insure their in-orbit risks rather than pay the big rate hikes demanded by the market. In addition, if current market

hardening produces better underwriting results, that could attract additional capacity, which would likely force rates down.

These are among the market developments reviewed during the 10th International Space Insurance Conference, presented by IBC UK Conferences in London this month.

Currently, the space insurance market is the hardest it has been in years, with launch insurance rates averaging about 16% of the insured value of the satellite, compared with only 10% a year ago. In addition to sharply higher pricing, space insurance underwriters are imposing exclusions and deductibles on coverage (see story, page 19).

The space insurance market can expect some "significant changes" in the future, said Pierre-Eric Lys, the head of space risk at AGF IART in Paris, a unit of Allianz A.G. Holding. "To be honest, I'm not sure whether

See **SPACE**/page 18

Market withdrawal of 26 Aussie insurers won't hurt buyers

By SIMONE ZENONI

SYDNEY, Australia—The Australian insurance market will not suffer a significant decrease in capacity despite the loss of 26 property/casualty insurers, which exited the market after the introduction of more stringent capital requirements earlier this month.

Most of the insurers were minor participants in the market, said Geoff Atkins, head of nonlife insurance at Sydney, Australia-based Trowbridge Consulting, a unit of Deloitte Touche Tohmatsu.

Nevertheless, insurers and buyers have welcomed the new capital requirements, saying that the more stringent rules will make insurance companies stronger.

The General Insurance Reform Act 2001 took effect July 1.

Among other things, the law: increased minimum capital requirements to \$5 million Australian from \$2 million Australian (to \$2.7 million from \$1.1 million), with higher-risk investments requiring additional capital; requires insurers to introduce a reinsurance management strategy and a risk management strategy; and requires insurers to appoint an approved actuary.

The Sydney-based Australian Prudential Regulation Authority said that, after the introduction of the law, 10 companies entered runoff and 16 exited the market after their licenses were revoked.

ADFA Insurance Pty. Ltd., AMP General Insurance Ltd., American International Assurance Co. (Aust.) Ltd., Australian Family Assurance Ltd., Boral Insurance Pty. Ltd., Dentists' Sickness & Accident Insurance Ltd., HSB Engineering Insurance Ltd., Lionheart Insurance Pty. Ltd.,

PMI Indemnity Ltd. and Zurich Insurance Co. have entered runoff.

Alea Europe AG., Allianz Australia (Run off) Pty. Ltd., Commercial Alliance Lenders Mortgage Insurance Ltd., GE Capital Insurance (Australia) Pty. Ltd., Key Insurance Co Pty. Ltd., Mercantile Mutual Insurance (Workers' Compensation) Ltd., NAC Reinsurance International Ltd., NTI Ltd., RACI Pty. Ltd., Riverstone (Stockholm) Insurance Corp., Rural & General Insurance Ltd., St. Paul Fire & Marine Insurance Co., Sumitomo Marine & Fire Insurance Co Ltd.,

The Koa Fire & Marine Insurance Co Ltd., Transport Industries Insurance Co. Ltd. and Western QBE Insurance Ltd. have had their licenses revoked.

Rural & General has indicated it plans to appeal to the Administrative Appeals Tribunal, but cannot write new business before its appeal is decided.

Mr. Atkins said the 26 companies were minor. "More than half of them were subsidiaries of other groups already writing insurance in another part of their group."

APRA would not disclose how much insurance capacity the 26 companies had provided.

Other companies entering runoff wrote coverage for niche markets, such as personal accident and engineering insurance, he said.

The loss of the 26 insurers will have little effect on corporate insurance buyers, and will not limit their choices, Mr. Atkins said.

Bruce Ferguson, president of the Assn. of Risk & Insurance Managers of Australasia Ltd. and risk manager for Sydney Water Corp., agreed that the departure of the 26 insurers would not have a significant impact on the market because they operated predominately in niche markets.

See **EXIT**/next page

Pool Re: Expanding coverage

Continued from previous page

The Assn. of Insurance & Risk Managers said in a statement that it hoped this issue would be quickly addressed. "This area of uncertainty needs to be dealt with as soon as possible, and AIRMIC will continue to work with the insurance industry and the Treasury for an early solution," AIRMIC said.

David Gamble, executive director of AIRMIC in London, hailed the decision to broaden coverage. "The government-industry working group has managed to produce that most difficult of results, a win-win situation for insurers, government and insureds," he said.

Mr. Gamble said that, at the beginning of discussions with the government, AIRMIC's representatives had asked AIRMIC council members to outline what they hoped the talks would yield. "They said (they wanted) all-risks cover....And to come back with all risks, which includes contamination and, eventually, nuclear, shows great flexibility on the part of the Treasury," Mr. Gamble said.

"This all-risks cover for property and business interruption now specifically includes contamination, which is a very important addition when faced with the new terrorist threats," AIRMIC said in its statement. "Companies whose balance sheets were exposed to the wider terrorism risks for their property and business interruption now have the option to purchase cover if they need it."

Mr. Gamble said that many risk managers would also like to see the pool extended to offer coverage for employers' liability and public liability. But he noted that such an expansion not been discussed during

the recent talks, because it would require an act of Parliament.

A spokeswoman for the London-based BIBA, which also participated in the discussions, said the group welcomes the Treasury's move, saying it "is good for the clients and offers broad coverage."

The Treasury also announced new limits to insurers' retentions for risks covered by Pool Re. An insurer's retention now is based on the number of sections of insurance policies it has underwritten that are affected by a terrorist event. But from Jan. 1, 2002, the maximum aggregate retention borne by the insurance industry will be set at £30 million (\$43.7 million) per event, with individual insurers' retentions based on their market share.

The Treasury said this change would mean that participating insurers would have losses capped for any one event and would know in advance how much they could expect to pay out in any one year. Also, the per event retention will rise gradually to £100 million (\$158.0 million) in 2006, to let commercial reinsurers offer coverage or insurers to retain more of the risk themselves, the Treasury said.

Mr. Gamble praised the efforts of insurers in the recent talks and the support they offered risk managers in agreeing to take larger retentions.

Mary Francis, director general of the ABI in London, said the changes will let insurers "expand the cover they currently offer against acts of terrorism in the U.K. The reforms are good for insurers and good for our customers."

She added that the change should allay the coverage fears of insurance buyers in the wake of the Sept. 11 terrorist attacks and subse-

quent withdrawal of insurance capacity. The expansion of Pool Re, she said, "removes much of the uncertainty faced by our customers. They can now purchase wider cover to meet their needs."

The change is good news for buyers, who previously had to buy extra coverage to fill in gaps, said Steve Bessant, executive director of the property facultative team at HLF Group P.L.C. in London.

He said that while the costs of the extension were not yet fully known, the Treasury had indicated that insurers' premiums would double, and this would be reflected in direct insurance premiums for buyers. But he said that the new extended cover will be cheaper than buying extra coverages on top of fire and explosion terrorism cover.

Ian Fletcher, the director of commercial and residential property at the British Property Federation, similarly welcomed the Treasury announcement. "We are pleased that strides have been made towards meeting the property industry's needs for cover, whilst encouraging competition in the provision of insurance where that is possible," he said.

World Updates

Continued from previous

wording that defines "terrorism" as: "An act, including, but not limited to, the use of force or violence committed by any person or persons acting on behalf of or in connection with any organization creating serious violence against a person or serious damage to property or serious risk to the health or safety of the public, undertaken to influence a government for the purpose of advancing a political, religious or ideological cause."

China extends air cover aid

The Chinese government has agreed to extend state insurance aid for airlines until Aug. 24. The government will provide terrorism and war-risks coverage above a limit of \$50 million to local airlines. The coverage has been in place since Sept. 25, 2001, and has been extended monthly since then.

Briefly noted

Paul Roberts has been appointed

marine excess-of-loss underwriter at **Goshawk Reinsurance Ltd.**, the Bermuda-based division of Lloyd's of London company Goshawk Insurance Holdings P.L.C. Mr. Roberts was formerly underwriter of marine excess-of-loss and retrocession coverage at Allianz Cornhill Insurance, the U.K. arm of Allianz A.G. Holding....Sarah McCooley has been appointed managing director of London-based warranty and indemnity and intellectual property insurer **Special Risk Services Underwriting Agency**. Ms. McCooley previously worked on the Coterrell & Maguire syndicate at Lloyd's of London....**Folsam International Insurance Co. (U.K.) Ltd.**, which has been in runoff since 1996, has been placed into liquidation. Dan Schwarzmann, a partner in the Insurance Restructuring Group at accounting firm PricewaterhouseCoopers in London, has been appointed administrator of Folsam International, which wrote reinsurance and insurance business, including casualty, marine, property and aviation.

Exit: Capacity loss deemed tiny

Continued from previous page

Their exit will not significantly reduce capacity, and many risk managers already have placed their business overseas, he said.

Kevin Knight, president of the Australian Institute of Risk Management and risk management coordinator for Education Queensland, the Brisbane-based government-run education department, noted that some insurers also withdrew from the market during the last market hardening.

"People had to look at how to manage risk and total risk financing and found they could live without insurance. They either set up a captive or took bigger deductibles. While insurance is cheap, there is a mind-set it will solve the problem. It is used as a commodity. Once the price goes up or they can't get cover, people have to sit back and take a harder look at how they finance risk. As part of doing that, they start to find other ways of financing risk," Mr. Knight said.

But the new laws will discourage policyholders from establishing onshore captives in Australia because the reforms also apply to captive insurers, Mr. Atkins said. Six captives currently are domiciled in Australia. "It makes offshore captives more attractive because the requirements for onshore captives are more onerous," he said.

He said that, "broadly speaking, the reforms have delivered what they promised. They have made the capital requirements more demanding." Nonlife insurers had been "forced through" a process of better planning and risk management, and it had been a steep learning curve for the industry.

Graeme Thompson, APRA CEO,

said the new law would increase the safety, soundness and sustainability of Australian insurers. "The bar is now set much higher for insurers, and safety for policyholders is stronger than it has ever been."

Mr. Thompson said most nonlife insurers met the new requirements. All of Australia's 150 nonlife insurers had to undergo a reauthorization process involving assessment of capital adequacy, and business practices and plans.

The increased capital provided "a buffer" to absorb unusual or extreme shocks which would other-

'Once the price (of insurance coverage) goes up or they can't get cover, people have to sit back and take a harder look at how they finance risk.'

Kevin Knight
Australian Institute
of Risk Management

wise affect policyholders. "Insurers writing liability and reinsurance lines need more capital to meet the greater uncertainty they face, due to the potential time lag between premium and claim, than insurers writing property business."

Mr. Thompson said overall industry capital levels were adequate, but "at a company level, some marginal insurers have been forced to raise new capital, find someone stronger to merge with, or go into runoff."

Boards of nonlife insurers must now develop reinsurance management strategies to be submitted to

APRA for approval and regularly updated. The strategies must establish that reinsurers are creditworthy, ensure reinsurance is diversified, control the use of financial reinsurance and set out clear processes for reinsurance decision-making.

Alan Mason, executive director of Sydney-based Insurance Council of Australia, said the ICA welcomed the new standards. The law will benefit insurers and buyers and improve public perceptions of the industry. Ray Jones, ICA president and Sydney-based QBE Insurance Australia Ltd. managing director, said insurers now had the chance to assure policyholders of their financial strength.

Duncan West, Royal & Sun Alliance nonlife insurance chief executive, said the company welcomed the increased capital requirements. The changes would bring long-term benefits to consumers and the industry, he said.

"Insurers will operate in a more financially robust environment where consumers can be more confident in the products and services offered by the industry," Mr. West said.

Australia already had "fairly stringent" guidelines for the insurance industry, Mr. Ferguson said. "From a risk management perspective, the government can change the legislation as long as the regulator uses the power it has and keeps an eye on companies to stop them going broke," he said.

It is APRA's responsibility to ensure it uses its authority and not "sit on its hands," Mr. Ferguson said. APRA was widely criticized for inaction after the collapse of HIH Insurance Ltd., one of Australia's largest insurers.

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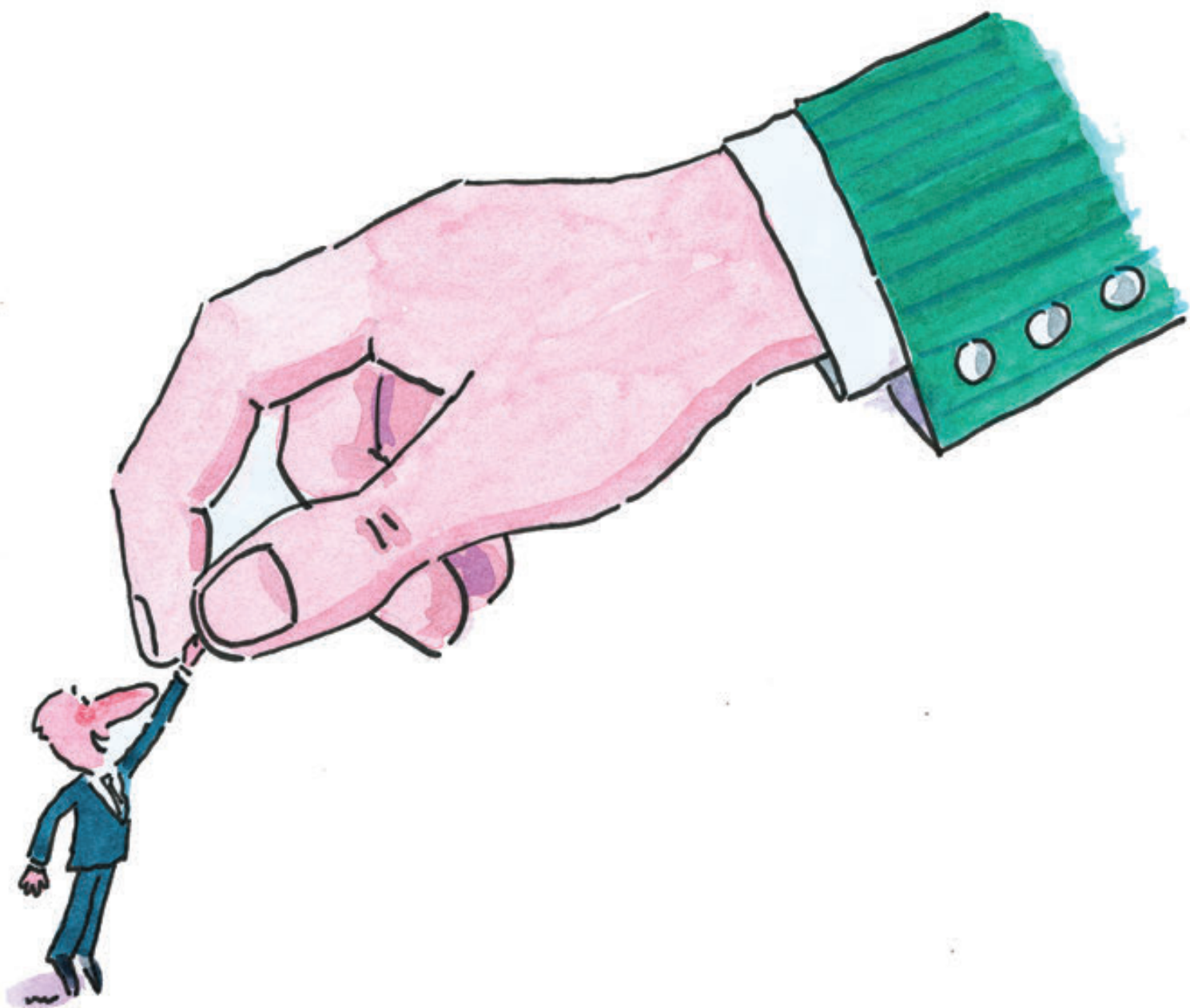
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Space: Changing terms, conditions considered

Continued from page 15

these will be evolutionary changes or revolutionary changes. But there will certainly be some changes."

Whatever course they take, Mr. Lys said, space underwriters must be "proactive" rather than "reactive" to avoid further losses.

Space underwriters need to better differentiate among the risks of satellite operators, satellite manufacturers and launch vehicle manufacturers when writing policies, said Simon Clapham, underwriter for Lloyd's of London's Marham Space Consortium and for the Brit2987 syndicate, managed by BRIT Holdings P.L.C.

Everyone in the insurance market in all

classes also is looking for a good rate of return on capital post-Sept. 11, said Mr. Clapham. "Satellite insurance isn't leading that particular race," he said. "We are finding it difficult to convince our suppliers of capital to continue to write the business...We are trying to convince them that we are increasing rates and reducing coverage, but what we really need to do is to try and differentiate between satellite operators and satellite manufacturers and launch vehicle clients," Mr. Clapham said.

It is difficult, though, for space underwriters to be too selective about the risks they will write, because the market for the coverage is so small and such an approach would result in an insufficient spread of risk, said Ernst Steilen, the head of space underwriting at Munich Reinsurance Co. in Munich, Germany. Only 20 to 25 commercial satellite launches per year are insured, and only between 80 and 100 satellites in orbit are insured, said Mr. Steilen. Many more satellites are in orbit, but the majority are not insured.

"If you start to be too selective, the book of business gets so small that it's more like gambling. A few (insurance) companies tried to do that in the past, and they are not playing a role (in the space insurance market) any longer," he said.

"The book of business is so small that we haven't got the many to pay for the few," Mr. Clapham agreed. "Technically, you cannot be overly selective in whether you accept or decline a risk. But...some operators and manufacturers deserve better rates than others."

The reliability of satellites should improve in the next two or three years, as manufacturers carry out more research and development and testing at the behest of satellite operators, according to Bruno Ritchie, the division head of

aerospace, technology, media and telecom division of underwriter Hiscox P.L.C. in London.

Mr. Ritchie noted that there has been a spate of in-orbit satellite losses caused by manufacturing anomalies (see story, page 19).

Mr. Ritchie observed that, in the near term, the space insurance market is likely to follow fairly normal pricing cycles. The improved reliability of insured spacecraft—paired with the currently higher rates and narrower coverage terms—will mean increased underwriting profits for space insurers, he said. He added, though, that, in time, those profits will attract more capital to the market, and the added capacity will drive the prices down again.

But Mr. Ritchie said that the market might undergo significant structural changes in the long term.

There is a move afoot, for example, to become a catastrophe insurance market and cover only the launch phase of satellites, he said. This is because some satellite operators now are self-insuring the testing and in-orbit phase of satellite launches, he explained.

EchoStar Communications Corp. of Littleton, Colo., decided not to purchase insurance for its EchoStar VIII satellite either during the post-separation phase of its June launch or while in orbit, though it was insured against failure during the actual launch.

Seven other satellites operated by EchoStar, which provides satellite television services via the DISH Network, also are not insured for in-orbit risks, according to documents filed with the U.S. Securities and Exchange Commission.

EchoStar, which is still arbitrating its claim for the constructive total loss of its EchoStar IV satellite against insurers, blames the hard space insurance market for its decision to retain the risk. The EchoStar IV has experienced a series of anomalies and failures since its 1998 launch.

SES-Global S.A. in Luxembourg, one of the largest satellite operators in the world, with more than 40 satellites, also has the ability to self-insure some of its risk, said Anders John-

son, senior vp-risk management.

SES-Global still uses the insurance market for much of its exposure, Mr. Johnson noted, and the company is currently placing an insurance program for seven satellites. But before it considers buying more coverage, the company would like to see more "differentiation" of good risks such as SES-Global by underwriters, Mr. Johnson said.

Indeed, the space insurance market has earned millions of dollars from the two companies that merged in 2001 to form SES-Global while paying out a pittance in claims, he said. Between 1991 and 2002, these companies paid a total of more than \$1 billion in premium and filed claims worth only \$33 million, he said.

Some of the big satellite operators are leaning toward self-insurance for launch and in-orbit, said Jan Skolmli, vp-European operations for launch vehicle operator Sea Launch Co. L.L.C., which is based in Long Beach, Calif. "We think that trend will continue...if rates are not lowered," he said.

High insurance rates can have a significant effect on the growth of the space industry, warned Steven Larsen, senior manager-insurance procurement and policy management for The Boeing Co. in Chicago.

The inability of satellite operators to reliably calculate their insurance costs for launches on new vehicles means that the satellites may not be built and launched on these new vehicles, he said. This, in turn, could strangle the market, meaning there would be fewer satellites to insure, less premium to be collected, and insurers leaving the market because of declining growth prospects.

Insurance on a satellite can account for between 20% and 40% of the total cost of a project, said Mr. Larsen.

If the insurance is too expensive, it can drive away customers of new launch vehicles, such as Boeing's Delta 4 rocket, he said. "Then it becomes difficult to grow the market at all. ...When rates get too heavy, no one wants to take the risk."



PHOTO: AFP

Two satellites were launched July 6 on an Ariane 5 rocket from the European Space Agency's Kourou, France, facility.

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Munich Re stays as space market firms

By STACY SHAPIRO

Last October, Munich Reinsurance Co. threatened to pull out of the space insurance market unless pricing improved.

The world's largest reinsurer sent a letter to the world's major space brokers, demanding that launch rates increase, on average, by 50% and in-orbit rates rise, on average, by 75%. Munich Re also called for tighter terms and said that if the space market didn't harden, the company would take its leave.

Nine months later, Munich Re is still writing up to \$50 million per launch through an insurance subsidiary.

"We managed to increase rates substantially, especially on the launch side," Ernst Steilen, the

'I think we need further improvement on the in-orbit side, but the overall (space) premium volume now has reached such a level that I think we have a chance to survive.'

Ernst Steilen
Munich Reinsurance Co.

head of space underwriting at the Munich, Germany-based reinsurer, told *Business Insurance*. "I think we need further improvement on the in-orbit side, but the overall (space) premium volume now has reached such a level that I think we have a chance to survive."

In 2001, space insurance losses certainly outweighed premiums, though many were caused by in-orbit anomalies. According to Airclaims Ltd.'s SpaceTrak, space insurance losses in 2001 totaled between \$1 billion and \$1.3 billion, while premiums totaled between \$500 million and \$550 million.

But the space insurance market has definitely hardened since last October.

Launch insurance rates now average between 15% and 16% of the value of the satellite, compared with 10% early last year, Mr. Steilen said.

Policy periods also have been cut dramatically. Satellite underwriters used to offer launch policies that were valid for up to five years before the launch took place and included in-orbit insurance for five years after launch. Now, satellite underwriters offer policies for up to three years before the launch and include in-orbit insurance for only one year after the launch.

In-orbit rates also are now between 2% and 2.5% of the in-

sured value, though Mr. Steilen would like to see them closer to 3%. Before last October, they used to be between 1% and 1.25% on separate in-orbit insurance policies, and as little as 0.05% or 0.075% when the in-orbit coverage was included in the launch insurance program. These low rates have contributed greatly to the problems in the market, because the vast majority of losses lately have been caused by in-orbit failures.

There also have been changes in the policy conditions for satellite risks since last October. For example, a terrorism exclusion was imposed shortly after Sept. 11.

Some underwriters also have excluded in-orbit coverage for those types of satellites that have caused serious losses for the market. Sources at the 10th International Space Insurance Conference in London recently said that this list includes Boeing Space Systems' BS601 satellites where one of the 601's two spacecraft control processors have failed, though the satellites are still functioning normally.

Underwriters also are imposing deductibles of 10% for launch and in-orbit if the technical margins on the 12-month fuel supply for a satellite are insufficient, said Mr. Steilen.

The space insurance market also has tightened up its definition of a "constructive total loss," a satellite that still functions but that has a substantially shortened life, leading underwriters to pay the total cost for a replacement satellite. When satellites were small and their service lives were typically seven to eight years, space underwriters decided that a constructive total loss would occur when the satellite lost half of its life, Mr. Steilen said.

"But now we have big spacecraft with long lifetimes, so the 50% is totally wrong," he said. Now a constructive total loss can be declared when 70% or 75% of its life is lost, "but still there are policies with the 50% total loss. They do get accepted, especially when the sums are not so high," he said.

Today, the space insurance market has a maximum worldwide capacity of about \$350 million per launch, said Mr. Steilen, though others at the conference placed the figure between \$400 million and \$500 million. A few years ago, \$800 million used to be declared as the worldwide maximum capacity, but that amount was never completely needed on one launch.

Conference speakers warned, though, that the current capacity may be insufficient to cover two big satellites on a new Ariane 5 rocket.

Space market hit by claims for orbiter malfunctions

Losses from in-orbit 'anomalies' outstrip premiums

By STACY SHAPIRO

LONDON—The current spate of losses from in-orbit satellite "anomalies" is of growing concern to companies in the space insurance market.

But it is by no means the only threat facing the industry. If a massive solar corona were to send a huge wave of magnetic particles toward Earth, about 10% of the insured commercial satellite population now orbiting the planet could be damaged, causing \$800 million in damage, according to Lloyd's of London's Marham Space Consortium.

But even such a catastrophic loss would be small when compared with the cumulative toll to insurers from a string of in-orbit satellite claims blamed on manufacturing problems.

Last year alone, total claims for satellite losses came to \$1.57 billion, and most of those were in-orbit losses, according to London-based space analyst Airclaims SpaceTrak.

"The fact is that commercial satellite reliability appears to be getting worse," David Todd, space analyst with Airclaims, said at the 10th International Space Insurance Conference in London earlier this month. "More worrying for insurers is that the average loss value per claim is increasing rapidly."

There have been great strides in the development of larger and more sophisticated satellites, said David Green, director of business development for Lockheed Martin Commercial Space Systems in Newtown, Pa. But, he said, "over the last six years, there has been a dramatic increase in in-orbit failures, or anomalies, as we call them."

Indeed, between 1980 and 2002, insured satellite losses totaled \$4.7 billion, but \$3.7 billion of that was

from 1996 to 2002, as a result of the steep rise in in-orbit failures, he said.

These losses have driven space insurance rates up 129% over the last four years, according to data from technology management consultant Futron Corp. in Bethesda, Md. Mr. Green presented the data at the conference.

From 1996 to April 2002, according to Futron, the annual number of in-orbit problems, which the satellite industry calls "anomalies," increased in BS601 and BS702 satellites manufactured by Boeing Space Systems or its predecessor Hughes; Alcatel Spacebus; and Loral LS1300 satellites.

A2100 satellites manufactured by Lockheed Martin also have caused 16% of the in-orbit insurance losses, said Mr. Green. This parallels Lockheed's share of the satellite manufacturing market, which is about 20%, he added. His company has improved its satellites' reliability, however, by investing in several quality-control programs, including an independent watchdog that reports to the company's president, he said.

Satellite underwriters said in interviews that they have excluded BS601 satellites from in-orbit insurance programs if the satellite has lost one of its two spacecraft control processors, which help power the satellite. Underwriters have paid about \$500 million for the loss of three BS601s.

The largest potential losses may come from BS702 satellites, which have had problems with their solar array reflecting devices.

So far, there has been only one official loss—the Thuraya 1A satellite launched in October 2000, which the United Arab Emirates-based Thuraya Satellite Telecommunications Co. insured for \$371 million—according to Airclaims. But

underwriters are reserving for five other potential losses.

"We still have the untold problem with the 702s where we have all reserved, but we don't know whether we've reserved on a sufficient level," said Ernst Steilen, head of space underwriting at Munich, Germany-based Munich Reinsurance Co. "This could be very significant, when the total amount of insurance (for 702s) is \$1.6 billion," he said.

Steven Larsen, senior manager-insurance procurement and policy management for Chicago-based Boeing, would not comment on these losses except to say that any claims would be between the satellite operator and the operator's insurers.

Satellite underwriters say that they are seeking legal advice on whether satellite manufacturers could be made to contribute to these losses. Satellite operators, however, typically sign hold-harmless agreements in the procurement contracts, and such agreements mean that the manufacturers cannot be held liable for in-orbit satellite performance.

During the conference, one satellite underwriter asked Mr. Green of Lockheed Martin whether his company would consider retaining more risk for satellites in orbit.

"I think there is a movement on behalf of the operators, and perhaps the insurers as well, to enforce more of that responsibility back onto the manufacturer," said Mr. Green.

"We represent (high) quality equipment, so we should stand behind it," he said. But, for satellite manufacturers, "our (profit) margins are, at best, 5%, and satellite operators' margins are in excess of 50%. So there will have to be a shift in the profit pool," Mr. Green said, noting that there efforts afoot to make that happen.

MAJOR SATELLITE CLAIMS FOR 2001

The five largest in-orbit claims for 2001 total an estimated \$1.16 billion in losses, compared with only \$550 million in estimated gross premiums written that same year.

| Satellite | Estimated losses | Stage | Cause |
|------------|------------------|----------|-----------------------|
| Thuraya 1A | \$371 million | In orbit | Solar array reflector |
| Panamsat 7 | \$215 million | In orbit | Solar array anomaly |
| XM-Rock | \$200 million* | In orbit | Solar array reflector |
| XM-Roll | \$200 million* | In orbit | Solar array reflector |
| Arabsat 3A | \$173 million* | In orbit | Solar array reflector |

* Estimated
Source: Airclaims SpaceTrak

Pension: Plan funding levels decline

Continued from page 1

tribute to their pension funds to make up for the underfunding that results.

Until the bull market bubble burst in March 2000, employers enjoyed several years of "holidays" from contributing to their pension plans. Healthy equity returns during the 1990s ensured their plans were overfunded without employer contributions.

Pension plan assets for some employers grew so large during the bull market that they still have "overfunded" plans even as stock markets enter three years of declines, said Ethan Kra, chief retirement actuary for Mercer Human Resource Consulting in New York.

But a growing number of employers now report that they will have to contribute to their plans. General Motors Corp., for example, announced recently that it contributed \$2.2 billion to a pension plan because the fund's assets do not cover its projected liabilities.

"It's no surprise," said a spokesman for Detroit-based GM. "The equities markets did not do very well last year, and they haven't done very well this year."

GM also said that in June it contributed \$1 billion to a voluntary employees' beneficiary association for retiree health benefits. GM made that contribution because falling stock prices had shrunk the association's assets. GM cannot cut

back on other benefits to make such contributions because of union constraints.

Overall, unfunded pension liabilities reported by employers with at least \$50 million in unfunded liabilities jumped to \$111 billion last year, up from \$26 billion in 2000, according to the federal Pension Benefit Guaranty Corp. That increase is due not only to investment losses incurred by the plans, but also to a decline in recent years in the interest rate assumption the PBGC uses to value plan liabilities. The PBGC uses the 30-year Treasury bond rate to value liabilities, while employers tend to use higher interest rate assumptions. The lower the interest rate assumption, the greater the liabilities will be for reporting purposes.

For now, many companies are not in a panic, because they view pension fund asset performance as a long-term goal. They expect it to be up in some years and down in others, several observers say.

"For a lot of companies, the near-term pension contributions are cash flow numbers that they can see themselves handling," said Michael Johnston, practice leader for retirement and financial management at Hewitt Associates Inc. in Lincolnshire, Ill.

Mr. Johnston said he has not heard of any companies cutting other benefits to make increased pension plan contributions.

That is the case at American Airlines, said Nancy Eckl, the Dallas-based company's vp of trust investments. American pension fund contributions have not affected other benefit offerings, Ms. Eckl said.

American's pension plan was 92% funded as of Dec. 31, 2001. The company, like other employers, prefers that its pension plan be

Unfunded pension liabilities reported by employers with at least \$50 million in unfunded liabilities jumped to \$111 billion last year, up from \$26 billion in 2000.

Pension Benefit Guaranty Corp.

100% funded. But it can tolerate a slide down to a 90%-funded level, Ms. Eckl said.

But pension contributions must come from somewhere, Mercer's Mr. Kra said. To make their contributions, companies might cut into areas such as profits, shareholder dividends, wages or future investments. "We have one client who says they may have to lay people off to come up with the money," he said.

Contributing more to pension plans could become a significant problem for some employers, agreed Ken Steiner, resource actuary

for Watson Wyatt in Washington. Mr. Steiner said that while employers cannot reduce the pension liabilities they have accrued to date, they may consider freezing or terminating future defined benefit plan offerings, and he noted that some employers already have stopped providing matching contributions to employee 401(k) plans.

"I think those employers that are really in a pinch here are going to possibly freeze their defined benefit plans," Mr. Steiner said. "We are talking fairly significant increases in contribution requirements over what these employers have seen, and it comes at relatively poor time. Profits are down, and other costs are increasing."

The other increasing costs include employer payments for health benefits. "They are all benefits competing for the employer dollar," Mr. Steiner said.

Watson Wyatt surveys of 500 pension plans found that, for 2000, about 82% had enough assets to terminate their plans and pay out all benefits, Mr. Steiner said. As of Jan. 1, 2002, the number of plans that could do so had dropped to



PHOTO: AFP

Detroit-based General Motors Corp.'s \$2.2 billion pension addition illustrates the impact of investment returns on funding.

about 37%.

"If the market stays where it is until January of 2003, we are probably looking at about one in every five plans having enough money to terminate the plan and pay out all benefits," Mr. Steiner said.

Conversely, about one in seven employers made plan contributions for 2000. By 2001, the number grew to one in four. It is likely that for 2002 one in three will have to make contributions, Mr. Steiner said.

Recall: Demand exceeds insurer appetite for risk

Continued from page 3

Mr. Steves said.

"If the pricing continues to go up to a certain level where we maintain some consistency over the next few years and it becomes profitable again, then you might see some reinsurance companies come back into the marketplace," Mr. Wu added. "But, for the foreseeable future, I don't see it changing much."

The number of product recalls occurring today cannot be helping the situation.

Greeley, Colo.-based ConAgra Beef Co.'s recent voluntary recall of 19 million pounds of beef that may be contaminated with the dangerous E. coli bacteria is just the latest example of more than 50 active meat and poultry product recall cases that are currently being monitored and coordinated by the U.S. Department of Agriculture.

Various other federal and state agencies monitor and coordinate recalls of beverages and privately owned food and beverage retail outlets.

ConAgra's beef recall, which is linked to illnesses in more than 20 people in several states, is the second-largest recall in U.S. history. In 1997, Rogers, Ark.-based Hudson Foods Inc. recalled 25 million pounds of ground beef after 15 people in Colorado fell ill from E. coli. Hudson Foods, which soon after shut down its Nebraska beef processing plant and sold it to a competitor, did not carry product recall

coverage.

Calls to ConAgra were not returned.

Despite the challenging environment, there are still markets that can provide product recall insurance for the food and beverage industry, Mr. Steves said. He noted, however, that the underwriting criteria today are "pretty tough."

"They're looking quite closely at quality control as well as the type of product," he said. Underwriters over the years have gathered enough data to be more selective about which risks they underwrite.

At the same time, underwriters also are increasing retention levels, Mr. Steves said. Standard minimum attachment points run anywhere from \$10 million to \$50 million and up, depending on the risk involved, he said.

Premiums for product recall coverage also have risen due, in part, to changes in pricing and rising reinsurance costs, said Diane Borden, vp and head of the crisis management division of American International Underwriters, a unit of American International Group Inc. in New York. AIG started offering accidental contamination coverage in 1993, she said. "We now have 10 years of loss statistics and can price the product where we need to for us to stay in business," she said.

AIG offers \$10 million in accidental product contamination limits, with varying deductibles. The policy provides coverage for recall

costs, lost profits and rehabilitation costs following an accidental contamination. It also provides crisis management planning and loss prevention services through specialty consultants.

'No insurer to my knowledge has come forward and said, "By the way, retail industry, here's the best thing since sliced bread for your product recall program." If they did, we would definitely look at it.'

*Joe Hardy
Hudson's Bay Co.*

Jane McCarthy, product line manager-contaminated product insurance for AIU in New York, noted that "there are desperate buyers out there trying to scramble to get the capacity they feel they need for the size of their company."

"We do see a few companies walking away and taking (the exposure) net where they have not before. And there are small companies that feel they need coverage, but they have to buy much higher attachment points to get the price they can afford," she said.

"We have no coverage for product recall, and that really opens a window for us," said Joe Hardy, di-

rector of risk management and insurance for Hudson's Bay Co., a Toronto-based retailer that sells general merchandise and food.

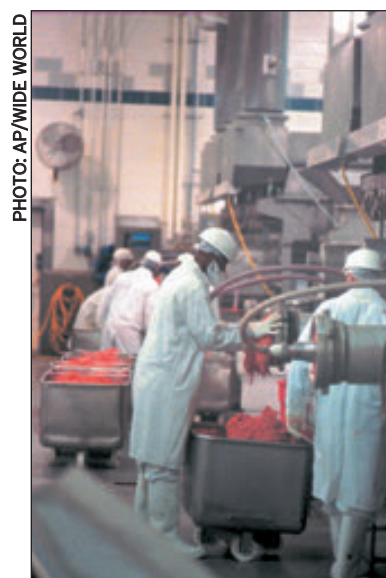
"No insurer to my knowledge has come forward and said, 'By the way, retail industry, here's the best thing since sliced bread for your product recall program,'" he said. "If they did, we would definitely look at it."

"I think you always have to be cognizant of the exposure," said Paul W. Pressley, director of risk management and insurance for Gold Kist Inc. in Atlanta. The poultry processor does not carry product recall coverage. "If the insurance was available and if we thought it was cost-effective, we would buy it," he said.

Brokers and underwriters say that, given the current market conditions, it's only a matter of time before risk managers turn to alternative risk financing options.

"As for alternatives, I can't say necessarily that any clients have purchased finite risk as a way to manage the impact of the cost of the recall over several accounting periods, but a lot of clients have looked at that," said Joe Peiser, managing director and head of global broking excess casualty for Marsh Inc. in New York. In addition, "a lot of clients have talked about forming industry groups and risk retention groups, which might make some sense, but frankly it's all preliminary," he said.

"We haven't seen it or tried to



Hudson Foods Inc. was uninsured for the largest meat recall in U.S. history in 1997.

convert it, but I think (alternative risk financing) is the next frontier for us to try and push that side of it," said AIU's Ms. Borden.

Swett & Crawford's Mr. Steves noted, however, that because product recall losses are more of a severity type of risk rather than a frequency type of risk, it's difficult to get the historical loss data from a company because the losses don't happen every year.

"You need that kind of information to do any ART program or finite program," he said.

July 29, 2002

Comings & Goings

Insurers:

ACE Bermuda Insurance Ltd. named **John C. Lenzen** as senior vp-claims and claims counsel. Previously, Mr. Lenzen practiced insurance law at Roseland, N.J.-based Connell Foley L.L.P.

CIGNA Corp.'s Group Insurance division named **Gary Kirkner** senior vp of sales and account management. He previously was chief executive officer and president of Colonial Life & Accident Insurance Co., a unit of UnumProvident Corp.

Colonial Life & Accident Insurance Co. in Chattanooga, Tenn., tapped **Jean Duke** as president and chief financial officer. Ms. Duke previously was vp of finance at Colonial before serving as a consultant to insurance and financial services companies.

Paul LaPerriere has joined OneBeacon Insurance Group in Boston as senior vp of marketing.

Mr. LaPerriere previously was chief marketing officer at Novato, Calif.-based Fireman's Fund Insurance Co.

Kenneth J. Juneau has been named executive vp of American International Assurance Co. Ltd., the flagship life insurance company in Southeast Asia and China for American International Group Inc. He also will serve as senior life insurance executive for China. Mr. Juneau has been vp and general manager of AIA Korea since 1998.

Also at AIG's Asian operations, **Joel L. Epstein**, chairman and chief executive officer of AIG Consumer Finance Group Inc., has been named to the new position of country manager in the People's Republic of China.

Matthew Hoefert was named senior vp of Zurich Corporate Solutions, a unit of Schaumburg, Ill.-based Zurich North America. Mr. Hoefert, based in St. Louis, had served as North Central region cus-

tomers solutions manager for Zurich Target Markets.

Warren, N.J.-based Chubb & Son Inc., a division of Chubb Corp., made several appointments:

• **Henry G. Gulick**, senior vp and corporate secretary of the Chubb Corp., was named managing director.

• **Mark Korsgaard**, senior vp and worldwide casualty claim manager, was named managing director. He also oversees Chubb Services Corp., a third-party administrator.

• **Donald B. Lawson**, senior vp and worldwide compensation and benefits practice leader, was named managing director.

Reinsurance:

Mike Emerson has succeeded **Theresa A. Wurst** as president of ING Re Group Life, Accident & Health Reinsurance in Minneapolis. Mr. Emerson had been the head of the Minneapolis Actuarial CFO unit within ING's U.S. financial services business. In his new position, Mr. Emerson is responsible for ING Re's group reinsurance activities. Ms. Wurst, who has been with ING Re

since 1983, is retiring after more than 25 years in the industry.

Several new executives were announced by New York-based Folksamerica Reinsurance Co.:

• **Molly Sanders** joined as senior vp and casualty facultative manager. She previously was a senior vp of Trenwick America Reinsurance Corp.

• **Bob Robertson** joined as senior vp and chief information officer. He most recently was vp-information technology at Sorema N.A. Reinsurance.

Other suppliers:

Frank J. Coyne, president and chief executive officer of Insurance Services Office Inc., has been named chairman of the ISO board of directors. He succeeds **Fred R. Marcon**, who will continue to serve on the



Mr. Coyne

board of Jersey City, N.J.-based ISO.

Michael M. Halbreich has been named senior vp at Mullin Consulting, a Los Angeles-based firm specializing in designing and administering executive benefits. Mr. Halbreich, who is based in Atlanta, had served as an independent counsel and consultant in corporate real estate, financing, acquisitions and strategic planning projects.

T. James Bethea has been named senior vp of Mystic Capital Advisors Group L.L.C. in Columbus, Ohio. Prior to joining Mystic Capital, which provides financial consulting services to the retail insurance and financial services industries, Mr. Bethea was a member of several operational project teams at Bridgestone/Firestone Inc.

R. Nicholas Gimbel, formerly with the law firm of Klett, Rooney, Lieber & Schorling, joined the Philadelphia office of McCarter & English as special counsel in its insurance coverage practice group. Also at McCarter & English, **Gregory H. Horowitz**, formerly an associate in the Newark office, has been named partner.

Reforms: 401(k) changes in corporate reform bill

Continued from page 1

advance notice requirement for blackout periods. The provisions were spurred by the collapse of Enron Corp. and the losses incurred by participants in its 401(k) plan.

Initially, the legislation called for 30 days' advance notice for even brief blackouts, such as when 401(k) transactions are stopped and systems taken down for routine maintenance or software upgrades. In many cases, benefit groups and consultants said, it would not be possible to give 30 days' advance notice of such shutdowns, which rarely last more than a day.

Congressional staffers, responding to that concern, revamped the legislation to exempt from the advance notice requirement blackouts that do not exceed three business days.

In addition, the legislation was fine-tuned to make clear that the advance notice must be provided only to plan participants affected by the blackouts and not to other participants, such as employees covered in other 401(k) plans that are not shut down. Some benefit experts interpreted the original legislation as requiring that all of a company's 401(k) plan participants be notified of a blackout involving any of the company's plans.

Unchanged from the original legislation is a provision barring top corporate executives from selling company shares they hold outside the plans during periods in which participants cannot conduct transactions.

Benefit experts hailed the last-minute changes, which they say will make compliance easier.

"Real protection is provided for the participant, while the notice requirements will be workable for plan administrators," said Kyle Brown, an attorney with Watson Wyatt Worldwide in Washington.

Clearly, legislators listened to em-

ployers and administrators' concerns, noted Marilyn Scalia, a vp with Mellon HR Solutions in Fort Lee, N.J.

The legislation also details the content of the blackout notices that employers must provide. Among other information, the notice would have to give the reasons for a blackout period, the identification of investments and other rights—such as the ability to take out a loan—that would be affected, and the expected beginning and ending dates of the blackout period.

Amid the passage of the accounting and corporate governance reform legislation, House Republicans last week called on the Senate to pass legislation, which the House already has done, with even more far-reaching 401(k) reforms. Two Senate panels have passed reform measures, but a date for full Senate consideration of the legislation has not yet been set.

"The Senate still has work to do," said Rep. Sam Johnson, R-Texas, at a press briefing on the measure.

A stand-alone 401(k) reform bill passed by the House several months ago, aside from mandating advance notice of plan blackouts and a ban on insiders selling company shares during a blackout, also would require employers to allow employees to sell company stock contributed as a match after three years of service.

"That would be a huge change," said Rep. Rob Portman, R-Ohio, at the press briefing. Rep. Portman co-sponsored pension reform legislation passed by Congress last year.

The 401(k) reform drive was triggered by the losses incurred by Enron's 401(k) plan participants, who collectively lost about \$1 billion when the value of company shares they held in the plan evaporated.

Losses were so dramatic at least in part because of the design of Enron's 401(k) plan, which is not an

uncommon one. For example, Enron made its matching contributions only in company stock, and it required participants to hold on to those shares until age 50, leaving employees unable to sell shares as the value declined.

Enron employees were "handcuffed," said Rep. Portman, adding that the three-year limit on mandatory holdings of company stock in the House bill would be a huge change for participants.

In addition, Enron employees received only 25 days' notice of the plan's blackout, which occurred as

the company was changing plan administrators and as the share price was sinking. During the blackout, Enron executives were free to sell company stock they held outside the plan.

Aside from the 401(k) provisions, much of the legislation passed by Congress last week focuses on accounting practices, with some provisions addressing the broader issues of corporate governance.

For example, the measure would create an independent review board to monitor accounting practices, add a number of criminal sanc-

tions—including prison terms—for certain corporate crimes, and restrict the ability of accounting firms to provide both audit and consulting services to the same client at the same time.

Although conferees drew much of the bill from the measure passed by the Senate, they agreed to a House-passed provision that would create a so-called "FAIR fund" to reimburse investors who lost money because of securities laws violations. The SEC would provide money for the fund from civil penalties levied against violators.

Amendment would revive 'whipsaw' valuation for cash balance plans Timely guidance threatened

By JERRY GEISEL

WASHINGTON—Employers would face more uncertainty in how to calculate the value of cash balance pension accounts for terminating employees under an amendment passed by the House of Representatives last week.

The amendment, proposed by cash balance critic Rep. Bernard Sanders, I-Vt., and incorporated on a 308-121 vote into a broader appropriations bill that the House later passed, would bar the Internal Revenue Service from spending funds in the next year to take action that would contravene informal guidance the IRS outlined in a 1996 notice but never formally proposed.

That guidance, Notice 96-8, suggested a methodology, known as the "whipsaw" theory, that

could be used in calculating the value of an account balance. Under this theory, the account balance, expressed as a lump sum, is projected to the plan's normal retirement age using the interest rate that the plan uses to credit employees' account balances. That amount then is discounted using the 30-year Treasury-bond rate—an index set under a 1994 law—to a present value, reflecting the employee's current age.

In certain situations, such as when the 30-year Treasury bond rate is much lower than the interest rate that employers use in crediting account balances, an employee terminating employment would be entitled to a sum greater than his or her account balance.

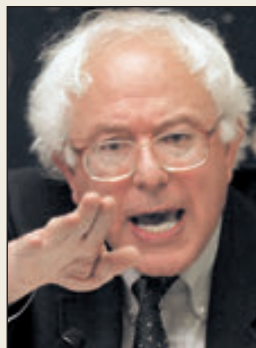
Benefit lobbying groups con-

tend that the whipsaw theory is not grounded in law and has been rejected by at least one federal court. Rep. Sanders' amendment would lock the Treasury and IRS into a position "for which there is little support and less regard," said Mark Ugoretz, the president of the ERISA Industry Committee in Washington.

Treasury Department officials over the last year have said they hope to provide more guidance soon in the entire cash balance arena.

The Sanders amendment, said Larry Sher, a principal and director of research at Buck Consultants Inc. in New York, "undermines the entire regulatory process."

The Senate has not taken up the appropriations legislation. Benefit groups say they will lobby congressional conferees to strip the Sanders amendment after the Senate passes its bill and conferees meet to resolve differences in the measures.



Rep. Sanders

Risk managers: Role is to be a symbol of integrity

Continued from page 1

the soul and the conscience of their corporation. We shouldn't just be looked at as the insurance buyer or crisis management person; we need to truly have a global look as to what our company is doing internally and externally," said Lance Ewing, senior director of legal/risk management for GES Exposition Services in Las Vegas. Mr. Ewing is also first vp of the New York-based Risk & Insurance Management Society Inc.

"As for risk managers' role affecting corporate governance, it boils right back to the basic premises of enterprise risk management, including: Are all significant risks to the enterprise having the risk management model applied to them effectively? Are managers accountable owners of their risks? Is there a process and process owner for making sure that the risk model is applied consistently and effectively?" said RIMS President Christopher E. Mandel.

"If the answers to these questions are positive, then risk managers—as process owners—are providing governance with what they should be requiring to oversee management's activities and would have had a better chance of uncovering company-ending issues early enough to fix them," said Mr. Mandel, who is also assistant vp-enterprise risk management for USAA in San Antonio, Texas.

"Of course, with a crisis of integrity and/or incompetence at the board level, the risk managers won't have any mitigation effect on the results," Mr. Mandel said. "It's un-

likely, in most cases, for the typical middle manager to challenge or question the integrity or honesty of senior managers or board members, as directly evidenced by congressional testimony in the Enron case."

The role of the risk manager in corporate governance issues "varies



'As for risk managers' role affecting corporate governance, it boils right back to the basic premises of enterprise risk management.'

*Christopher E. Mandel
Risk & Insurance Management Society Inc.*

a lot from company to company. It mostly depends on the individual who is the risk manager, and the senior executives' attitudes," said Richard Betterley, the president of Betterley Risk Consultants Inc., a Sterling, Mass.-based risk management consulting firm.

"I've seen risk managers who have the ear of the CEO and have seen others who the CEO doesn't even know who the risk manager is," Mr. Betterley said. "Typically, if you have the ear of the CEO, it's because you have a good relationship with the general counsel."

"I think there is a role beyond making sure there's a D&O policy in place," said Millie Workman, director-risk management for Mueller Enterprises in Memphis.

Before the D&O policy has been purchased, risk managers must first

understand the basics of corporate governance, both in general and how it relates to the corporation specifically, she said.

"They need to be sure that the directors and officers understand what is and isn't covered, what actions could or could not have an impact," Ms. Workman said. "As

putting that kind of information before senior managers, she said.

"There's more to it than just buying the insurance," said Ellen Vinck, vp-risk management and benefits for U.S. Marine Repair Inc. in San Diego. "It means being involved from the top down. If you can get into the boardroom, that's great, but sometimes even being an officer doesn't get you into board meetings," she said.

At a minimum, a good risk manager should be involved in strategic planning, corporate ethics, environmental, safety and budgetary issues, Ms. Vinck said.

"If you're involved in those, you have a good pulse of what's going on in the company and can steer anyone who might be headed down the wrong path. The more the risk manager is involved—at the highest levels possible—the more you can get folks to remember that risk evaluation is critical," said Ms. Vinck, who is also RIMS vp-finance and treasurer.

The corporate governance role of the public-sector risk manager is more limited, said James Crockett, manager of risk and benefits for the Denver Water Department. Mr. Crockett noted that individuals working in a management capacity in public entities often enjoy some form of immunity from lawsuits, provided they are not engaged in willful wrongdoing.

But Mr. Crockett said that there exist situations in which public servants do have exposures; for example, individuals who function as trustees of retirement plans may face fiduciary liability.

It's up to the risk manager to explain the extent of the applicable exposures and which insurance coverages would apply, Mr. Crockett said. Then the board members themselves would, with help from the legal division, decide whether to use the agency's money to purchase the coverage, he said.

Sometimes, a risk manager or risk management department has more-direct responsibility, noted GES' Mr. Ewing. GES has a corporate compliance officer within the legal and risk management department, he said.

The program has a toll-free telephone number that any employee can use to report "anything unethical, illegal or something that makes them a little uncomfortable. Our department does the investigation; we do the follow-up, and we delve into it. That's across the board," said Mr. Ewing. "It's called the 'Always Honest' program."

If need be, the investigation is taken to the point where law enforcement gets involved, Mr. Ewing said. "We will do the right thing and be always honest," he said.

As an example, Mr. Ewing cited the hypothetical situation of a risk manager in charge of a workers compensation program in which individual company locations are rated on their performance. A local manager calls and asks the risk manager "to push the claim forward, so I can make my numbers" for a given month.

The risk manager must say no, Mr. Ewing said. "The integrity the risk manager has cannot ever be challenged or questioned," he said.

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In Europe, codes increase accountability

By SARAH VEYSEY

Corporate governance regulations in Europe have prompted greater attention to risk management issues, but the extent to which risk managers take part in the process still depends largely on the organization.

Recent years have seen the introduction of corporate governance codes in the United Kingdom and Germany, and such regulations are currently being developed in Belgium, France, the Netherlands, Spain and Switzerland.

Risk managers in the United Kingdom, particularly those working for publicly traded companies, have become well acquainted with the concept of corporate governance as a result of the 1999 Turnbull Report and subsequent regulations. Those regulations increased corporations' accountability to shareholders, requiring them to report their risks and outline their risk management measures in their annual reports.

"Turnbull has become the benchmark against which risk management frameworks within companies are measured," said Mark Butterworth, group insurance risk manager at Prudential P.L.C. and chairman of the London-based Institute

of Risk Management.

As a result of Turnbull, a company board must be aware of the risks the company faces across the enterprise—and the steps being taken to minimize those exposures. But the extent to which risk managers are involved in corporate governance still varies greatly from company to company, Mr. Butterworth said.

'The risk manager's role, together with internal audit, is very much in identifying risks and putting policies in place. ...The risk manager acts as a facilitator, to get things up to a good standard, and the internal auditor monitors what is being done.'

*David Gamble
Assn. of Insurance & Risk Managers*

While some organizations see the risk manager's role chiefly as that of an insurance buyer, others directly involve the risk manager in corporate governance, he said.

Some in risk management contend that such input is vital.

The involvement of the risk manager is crucial when companies are setting out a corporate governance strategy, said David Gamble, executive director of the London-based Assn. of Insurance & Risk Managers. "As one of the issues in corporate governance is good risk reporting, it is very important that the risk manager is brought into the strategic development (of a corporate governance structure) to assist colleagues in identifying risks and reporting them," he said.

Mr. Gamble said the role of the risk manager should not be to enforce corporate governance policies within the company but, rather, to help develop those policies by aiding in the identification of risks.

"The risk manager's role, together with internal audit, is very much in identifying risks and putting policies in place," Mr. Gamble said. "The risk manager acts as a facilitator, to get things up to a good standard, and the internal auditor monitors what is being done."

Indeed, the risk manager's role in corporate governance efforts extends well beyond simply ensuring that the company has adequate directors and officers or fidelity insurance coverage, said Paul Taylor, head of business risk management development at London-based re-

tailer Kingfisher P.L.C. "Risk financing is an important part, but not the key part, in trying to manage those risks," he said.

There are opportunities for risk managers to work more closely with a variety of departments, including internal audit, to find ways to proactively manage corporate governance-type risks, he said.

"Corporate governance is uppermost in a lot of companies' minds in Europe—particularly in the U.K. and Germany, which have specific requirements—and risk managers use their skills to play a vital part in corporate governance," he said.

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For the Record

This roundup of news from the previous week is generated by BI's Daily News reporting. To get breaking news as it occurs, log on to www.businessinsurance.com, or sign up online for free BI Daily News by e-mail.

Butt named chairman of AXIS

Michael A. Butt has been named chairman of Bermuda startup insurer and reinsurer AXIS Specialty Ltd. Mr. Butt, who most recently was a director of XL Capital Ltd., has been a leading figure in the Bermuda and London markets for the past 20 years. From 1993 until its merger with XL in 1998, he was president and chief executive officer of Mid Ocean Ltd. Prior to that, he was chairman and CEO of Eagle Star Holdings P.L.C. in London.

Marsh reports gains in revenues, profits

The hard commercial property/casualty insurance market helped boost revenues and profits for Marsh & McLennan Cos. Inc. for the first half of 2002. The world's largest broker reported a 7.6% rise in brokerage and consulting revenues, to \$4.07 billion, for the first six months of the year. Revenues from risk and insurance services increased 11.8% to \$2.91 billion but revenues from its consulting division—William M. Mercer Cos. L.L.C.—were down 1.8%, to \$1.16 billion. Marsh attributes the



fall in consulting revenues to its management, compensation and communication consulting practices, which declined as a result of the continuing slowdown in corporate discretionary spending.

Asbestos settlement drives loss at St. Paul

The St. Paul Cos. Inc. reported a \$89.7 million loss for the first half of this year, compared with a \$306.3 million profit for the comparable period in 2001.



The loss reflects the \$380 million aftertax impact of St. Paul's settlement of asbestos litigation, which was announced last month. Revenues at the St. Paul, Minn.-based insurer increased 7.1% to \$4.63 billion in the first half.

HRH profits, revenues up in first half

Hilb, Rogal & Hamilton Co. posted record earnings for the first half of 2002. Revenues for the first six months of this year reached \$195.6 million, an increase of nearly 25.7% from the \$155.7 million registered during the same period last year. Net income rose almost 103.2%, to \$27.7 million, during the first half of this year.

Senate rejects two Medicare drug proposals

The Senate last week rejected both a Democratic proposal to add a prescription drug benefit to the federal Medicare program and a



largely Republican-backed measure that proposed federal subsidies for insurers offering the coverage. Both votes were generally on party lines, but Senate

Democratic leaders say they will continue to work to try to win agreement on a compromise measure before Congress adjourns for its August recess.

JCAHO outlines patient-safety goals

The Joint Commission on Accreditation of Healthcare Organizations has released a list of national patient-safety goals and recommendations that health care organizations will be expected to



follow. The organization will begin evaluating hospitals and other health care providers that it accredits as to whether they meet

these six safety goals starting Jan. 1, 2003. The goals include: improving the accuracy of patient identification; improving

communication among caregivers; improving the safety of using high-alert medications; eliminating wrong-site, wrong-patient and wrong-procedure surgeries; improving the safety of infusion pumps; and improving the effectiveness of clinical alarm systems.

IPC posts growth in premiums, profits

Property catastrophe reinsurer IPC Holdings Ltd. reported large gains in its gross premiums written and net income in the first half of this year. IPC's gross premiums increased 123.7%, to \$207.2 million, for the six months ending June 30. The reinsurer said it benefited from rate increases and new business. Net income for the first half rose to \$92.2 million, a 106.3% jump from the year-earlier period.

Briefly noted

David L. Mair has left his position as associate director of risk management for the U.S. Olympic Committee in Colorado Springs, Colo. Mr. Mair, who is the immediate past president of the Risk & Insurance Management Society Inc., said he is pursuing other opportunities in risk management. The USOC said it is reviewing its options, which may include not replacing the position....Kemper Insurance Cos.

Chairman and Chief Executive Officer **David B. Mathis** will receive the City of Hope's Spirit of Life Award in October. The award is presented annually to an insurance industry leader in recognition of efforts to raise funds for the Duarte, Calif.-based center's breast cancer research programs....**James Delaplaine**, vp-retirement policy since January 1999 at the American Benefits Council, will leave the Washington-based benefits lobbying group at the end of the current congressional session to become a partner at the law firm of Davis & Harmon L.L.P. in Washington. The council will seek to replace Mr. Delaplaine....**RenaissanceRe Holdings Ltd.** reported profits of \$174.3 million for the first half of 2002, a 104.6% increase over the same period last year. Gross written premiums increased 128.3%, to \$731.1 million....**Allied World Assurance Holdings Ltd.** reported profits of \$44 million for the first half of 2002. The Pembroke, Bermuda-based insurer and reinsurer, which was established following the Sept. 11 terrorist attacks, reported first-half gross premiums written of \$405.2 million....Colorado Gov. Bill Owens signed legislation prohibiting insurers from refusing to issue **fire insurance** policies within a federally designated wildfire disaster area. The measure, S.B. 7, took effect immediately.

Bias: Rulings raise claim bar

Continued from page 3

development coordinator at a Nashville, Tenn., radio station owned by Gaylord. A decision was made to end Ms. Prebilich's employment, and her supervisor, John Padgett, on Nov. 20, 1997, called the human resources department to begin the termination process.

Ms. Prebilich informed Mr. Padgett of her pregnancy on Nov. 24, and he discharged her two days later, according to the decision. The supervisor subsequently placed three memos in Ms. Prebilich's file detailing dates and instances of insubordination, comments from sales people who were dissatisfied with her work ethic and product, and details of 67 accounts on which she had failed to complete work.

"Prebilich argues that because she was discharged only two days after she told Padgett she was pregnant, a reasonable jury could infer that her pregnancy was the reason for her discharge," says the 6th Circuit decision. "But the facts here demonstrate that the decision was made before—not after—the employer learned of the pregnancy, and the inference urged by Prebilich begs the question of the employer's knowledge of the pregnancy at the time material to this inquiry."

The three-judge panel unani-

mously ruled that Ms. Prebilich had "wholly failed to present evidence from which the jury could infer that Padgett had any knowledge of her pregnancy at the time he decided to discharge her."

Ms. Prebilich's attorney, Matthew R. Zenner of Nashville-based Blackburn & McCune, said his client is now considering its options.

Jeremy J. Glenn, an employer attorney with Meckler, Bulger & Tilson in Chicago, said the decision "reinforces the idea that (employment) decisions should be documented. Here the employer was able to establish they made the decision to discharge as of a particular date, and further evidence establishes the date they became aware of the pregnancy was later. Without documentation they would have had a more difficult time establishing a lack of knowledge."

Mr. Glenn said both decisions "bolster the notion that there's consistency in the federal courts requiring actual knowledge of the protected characteristic."

"It really goes to support this idea of a causal connection between the adverse action...and the protected characteristic, and it's a very important causal connection," he said. "Otherwise, you would create absolute liability for taking any adverse

action against a member of the protected class, and the defendant would have to defend its decision in court even if that decision was based on a legitimate, nondiscriminatory characteristic, or if it made the decision having no idea whatsoever the individual possessed a protected characteristic," Mr. Glenn said.

Mr. Alley said the decisions make "all the logical sense in the world. How can somebody discriminate against somebody because of a protected status unless they knew about the protected status?"

He said he would advise employers to not let unnecessary information come to their attention.

"It's the old thing: You don't ask, you won't know. And since we don't ask employers to make decisions based on these various kinds of protected status, why would we want to know about them?" said Mr. Alley, who noted that such knowledge serves only to expose employers to claims.

Steven Lubetsky vs. Applied Card Systems Inc., 11th U.S. Circuit Court of Appeals, No. 01-17203.

Cindy D. Prebilich-Holland vs. Gaylord Entertainment Co., 6th U.S. Circuit Court of Appeals, No. 00-5946.

Online Poll [7/22 - 7/26]

Do you believe states should be allowed to tap insurance funds to help avert current budget crises?

Yes

2.8%

No

97.2%

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BI Stock Index [7/22 - 7/26]

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Percentage change of BI Stock Index vs. key indicators



BI Stock Index
1734.69



Dow Jones
8264.39



S&P 500
852.84

Largest gains

| | |
|-----------------------------|-------|
| Penn-America Group Inc. | 20.48 |
| Hilb, Rogal & Hamilton | 17.73 |
| Harleysville Group | 15.42 |
| RenaissanceRe Holdings Ltd. | 12.55 |
| IPC Holdings Ltd. | 12.41 |

Largest losses

| | |
|---------------------------|--------|
| Gainsco Inc. | -40.00 |
| AEGON N.V. | -26.31 |
| SCOR | -22.55 |
| Allmerica Financial Corp. | -15.42 |
| Citigroup | -14.61 |

Weekly change by market segment

| | |
|----------------------------|--------|
| Brokers | 5.94% |
| Insurers/Reinsurers | -0.83% |
| Managed Care Organizations | -3.71% |

Source: CNET Investor (investor.cnet.com)



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Privacy: Handling issues well creates opportunities

Continued from page 3

tributes about \$1 billion to shareholder value and \$700 million to the value of the brand," he said.

In looking to address the privacy exposure while benefiting from the value that could be attached to it, RBC sought to create an environment that would encourage clients to consolidate and share information with RBC, allowing the company to use it for their mutual benefit.

The result is that the entire architecture of RBC's business relies on customers' confidence that their information will be used to bring them greater value, and that the information is safe, Mr. Cullen said. Meanwhile, the company recognizes that achieving the status of a "trusted information user" among consumers could help differentiate RBC in the financial services marketplace.

In seeking such status, a company faces several challenges, Mr. Cullen said. One is the way consumer information is handled by third-party partners to which a company outsources elements of its business. Even if a company avoids

legal liability in regard to a privacy breach by a third-party partner, reputational risk and the loss of customer trust can be serious concerns, he noted.

"We now rely on a tremendous number of partners, alliances, strategic partners, in terms of delivering services to our clients," Mr. Cullen said. "In our view, simply binding them up by contract isn't good enough."

Instead, RBC analyzes all of its arrangements with third-party companies, maintains due diligence procedures on those arrangements, has an ongoing process for review-

ing partners' privacy arrangements and demands that vendors comply

'You can't think of privacy as a separate process; it has to be embedded in the process and part of the actual delivery.'

W. Peter Cullen
RBC Financial Group

with RBC's privacy standards and practices.

So-called privacy "environmental" issues, such as a competitor's customer privacy problems, also can affect a company. "These are things that we really have no control over but, quite frankly, are impacting us," Mr. Cullen said.

He cited the impact that a competitor's well-publicized security breach had on RBC's online banking efforts.

Consumer concerns spurred by the competitor's problem temporarily brought his own company's efforts to enroll new online banking customers to a screeching halt, Mr. Cullen said.

In managing its own privacy matters, RBC took numerous steps, including developing group and employee privacy policies, forming privacy management committees and training employees on privacy issues. All, though, are part of a broader philosophy that customer privacy is an essential element of the business, Mr. Cullen said.

"Our view is you can't think of privacy as a separate process; it has to be embedded in the process and part of the actual delivery," he said. "Every new initiative in our organization has to be viewed through the lens of privacy if it's going to work."

Fourth Annual Global Risk Management Summit

IT risk management should prevent 'big surprises'

By **RODD ZOLKOS**

CHICAGO—An effective information risk management program must reflect the risks and expectations of the overall business, not just the considerations of the information technology department, one major corporation's IT risk manager suggests.

"The wrong people often pick what information is critical," said Rolf Moulton, head of IT risk management at consumer products manufacturer Unilever P.L.C. in London. IT risk management, he

said, "has to be based, in our view, on what business expectations are and business risks are, not as the IT people see them."

Mr. Moulton discussed his company's philosophy on managing information and IT risk management earlier this month at the Economist Conferences' 4th Annual Global Risk Management Summit in Chicago.

"Our view is that we want to manage risk, not necessarily minimize risk," Mr. Moulton said. "In terms of risk management...the key for us is really expectations."

Within the Unilever business model, business process leaders within the enterprise have objectives they're expected to meet or comply with, Mr. Moulton said. Within that framework, he said, risks can include failing to meet targets, experiencing major losses, implementing incorrect strategies or providing the wrong products or services for the market.

"Big surprises" are another concern, he said.

"In our view, big surprises are just not acceptable," Mr. Moulton said. "And that's what risk management

is all about: avoiding big surprises."

In crafting an information risk management plan, a company must determine whether information and IT are critical to achieving strategic objectives, vital to meeting operations objectives, simply important to the operation or have some other status within the enterprise. The next consideration is how the company quantifies the value or importance of information and IT, the IT risk manager said.

"We didn't have an answer," Mr. Moulton said. "We can tell you it's important, but we can't put a num-

ber on the value of IT."

One key question in assessing that value is whether information or IT problems could become a "big-ticket item" or "show stopper," the Unilever IT risk manager said. Such problems could occur if information isn't available when needed; isn't accurate or timely; isn't properly collected, protected or disclosed; or is damaged, lost or stolen.

"You need to look at what industry you're in," Mr. Moulton said. "For us, IT, when it fails to perform, can be a real problem."

Information and IT risks can stem from people, operating environments, events, government or the company itself, Mr. Moulton said.

"The company itself can create risks, particularly when the company doesn't understand what it is doing," he said.

To achieve a minimum effective level of information and IT risk management, it's essential to determine who in the company makes decisions about information and IT value and risk.

The next step is to set priorities on how the company wants to manage responsibility for information and IT risk decision-making, critical information and IT applications and services, and the ongoing "governance loop" for the process, Mr. Moulton said.

And in Unilever's view, all of that must be done within the context of overall business expectations and risks and a clear knowledge of who will evaluate the program's performance.

The program also must be based on an understanding of what's critical to the company and why, Mr. Moulton said, and it must fit within the company's ongoing business process management.



Fourth Annual Global Risk Management Summit

Meeting attracts over 75

CHICAGO—The Fourth Annual Global Risk Management Summit, presented by Economist Conferences, drew more than 75 attendees to Chicago July 16-17.

David L. Mair, 2001/02 president of the Risk & Insurance Management Society Inc., was the chairman of the conference, which focused on the theme "A New Context for Managing Enterprise Risk." Among the topics discussed at the conference were insurance market trends, business continuity planning, information risk management, privacy issues and financial risks.

For information on next year's Global Risk Management Summit, visit www.economist-conferences.com or call 212-554-0655.

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