

# Business Insurance

August 4, 2008

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**SEN. DODD SAYS CLOCK TICKING ON INSURANCE REFORM ACTION / PAGE 3**

**GM, RSA SETTLEMENT ENDS LEGAL UNCERTAINTY FOR INSURER / PAGE 3**

## In Brief

### Comp claim frequency falls again: NCCI study

Workers compensation claim frequency continued to decline during 2007, although at a slower rate than during the previous two years, NCCI Holdings Inc. reported. While a 2.5% decrease in 2007 claim frequency continues a trend that started during the 1990s, it is "more modest" than the 7.0% drops during each of the previous two years and was the smallest decrease in eight years, the NCCI said. Average indemnity costs per claim rose 4.0% in 2007, up slightly from the average of 3.3% since 2001. Medical costs per claim increased an estimated 6.0% during 2007, the lowest increase since 1995.

### Subprime mess boosts shareholder lawsuits

Federal shareholder class action filings increased in the first half

See **IN BRIEF** page 30

## SCA commutation deal relieves pressure on XL

*Insurer still facing problems of soft market*

By **JUDY GREENWALD**

**HAMILTON, Bermuda**—XL Capital Corp. Ltd. put a major problem behind it with last week's commutation agreement with financial guarantee insurer Security Capital Assurance Inc., which eliminates a key distraction and allows XL to focus on its core business, observers say.

But the Hamilton, Bermuda-based insurer and reinsurer still faces the same problems confronting other companies in the softening market, they note.

XL last week said the commutation agreement with SCA will reduce its maximum exposure to SCA-related losses, which had been \$65.7 billion as of June 30, to \$1.1 billion (see box, page 29). XL said it plans to raise total gross proceeds of about \$2.88 billion by the time securities offerings end Tuesday to

fund the deal. The company noted that the deal is expected to result in a \$1.4 billion to \$1.5 billion charge for the third quarter.

XL also made several management changes and said it plans to explore strategic opportunities related to its life reinsurance operations.

Market response to the commutation has been positive, said XL Chief Executive Officer Michael S. McGavick.

"We've been getting very good news from the market" following the SCA agreement, Mr. McGavick said. "I know of at least one major account that did some more business with us as a result of that being done. That was a good start. We expect a lot more of that, because the bottom line is, it makes the conversation about the insureds and their needs instead of about us, and

See **XL** page 29

## Rebate laws cause stir

*Statutes cited in broker compensation debate*

By **SALLY ROBERTS**

Although contingent commissions and full disclosure took center stage at last month's producer compensation hearings held in New York, the state's anti-rebate statutes had a supporting role in the discussions and could ultimately play a part in any future regulatory outcome.

New York's anti-rebating statutes, similar to those in 47 other states, essentially bar producers from offering any benefit or discount that deviates from the written policy to potential insurance buyers as a

means to induce the purchase of insurance. The statutes apply to policies in virtually all lines of business.

A number of producers testified at the hearings—held jointly by the New York State Insurance Department and the attorney general's office—that clients rarely, if ever, asked about producer compensation. They said if they were required to disclose such information, it would encourage customers to attempt to negotiate their commis-

See **COMPENSATION** page 30



AP PHOTOS

Public entities could lose federal disaster aid in some cases following a policy adjustment at the Federal Emergency Management Agency.

## FEMA modification of disaster aid rules stuns public entities

By **DAVE LENCKUS**

2007; Aug. 27, 2007).

Public entities susceptible to property damage in successive disasters of the same type no longer can count on federal aid to routinely cover their uninsured losses, following a policy adjustment at the Federal Emergency Management Agency.

Under FEMA's modified approach, public entities without adequate insurance after sustaining losses in a national disaster face losing federal aid altogether in some cases and receiving assistance that would cover only a fraction of their uninsured damage in other instances.

Municipalities, school districts, airports and other public entities located in areas that face a high risk of flooding, windstorms or earthquakes are affected most by the development at FEMA, because they cannot afford the high cost of coverage for those catastrophic perils, according to risk managers, brokers and regulators.

FEMA, which distributes aid as provided by the Robert T. Stafford Disaster Relief and Emergency Response Act of 2000, began refining its financial assistance policy in a fact sheet it issued to applicants on June 4, 2007. But the agency rescinded that notice last August in the face of a firestorm of protest from public entities (*BI*, Sept. 3,

But as a FEMA official promised at that time, the agency did not abandon its goal of reducing public entities' dependence on federal financial assistance when disasters repeatedly damage the same properties.

FEMA attempted to clarify its position in another fact sheet it issued on May 29, and an agency official has spoken to several risk manager groups this year about the change.

However, FEMA's message has not gotten through clearly to risk managers and brokers.

While they say they expect FEMA to reduce its financial aid in second and subsequent disasters by the same amount of aid the agency previously has provided, an agency official says aid could be sheared by a multiple of the agency's previous assistance.

"Wow. That's a very important change," said Errol W. Fitzpatrick, risk manager for the San Diego

See **FEMA** page 28

## SPOTLIGHT CATASTROPHE MANAGEMENT

Forensic accountants mind the knowledge gap;

hurricane exposures require year-round planning; Katrina teaches tough "demand surge" lessons; culture affects

risk approach in overseas operations.

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## On the Web



### BI VIDEO

#### Expert offers insights on business interruption

*Business Insurance* interviews John Dempsey, managing partner of forensic accountant and consultant Dempsey Partners, on how to mitigate business interruption risks, which can harm a firm's viability. Watch the new Issues in Risk Management video at [www.BusinessInsurance.com/video](http://www.BusinessInsurance.com/video).

### BI AUDIO

#### Listen to Karen Clark podcast online

A podcast of an expanded interview with catastrophe model pioneer Karen Clark, who is featured in this week's Catastrophe Management Spotlight, is available at [www.BusinessInsurance.com/audio](http://www.BusinessInsurance.com/audio).

## WOMEN TO WATCH

### WOMEN TO WATCH

#### Nominate leading women in the industry

While the insurance industry historically has been led by men, more and more women are taking on leadership roles. To explore this trend, *Business Insurance* highlights the evolving professional opportunities for women in its annual "Women to Watch" report, which will be published Dec. 1. To nominate outstanding women working in insurance, risk management and employee benefits, download a nomination form at [www.BusinessInsurance.com/womentowatch](http://www.BusinessInsurance.com/womentowatch). The deadline is Aug. 11.

## Business Insurance®

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# Time running short for regulatory reform

Senator says passage of surplus lines, insurance information acts possible, but no OFC this year

By MARK A. HOFMANN

**WASHINGTON**—Despite the wishes of many in the insurance industry, passage of comprehensive insurance regulatory reform, including establishing a system of optional federal charters for insurers and producers, appears extremely unlikely during the current Congress.

But targeted reforms that already enjoy widespread support may be achievable, said Senate Banking, Housing and Urban Affairs Chairman Christopher Dodd, D-Conn., during a hearing last week on insurance regulation.

Even modest reforms will depend on what Sen. Dodd called "the 101st senator"—the clock.

"We're looking at a package we might be able to do," said Sen.



**Even modest reforms will depend on 'the 101st senator'—the clock.**

Sen. Christopher Dodd, D-Conn.

Dodd. He noted that the House has already passed the Nonadmitted and Reinsurance Reform Act, which

would streamline the regulation of reinsurers and surplus lines insurers.

He also pointed to strong House support of the Insurance Information Act, which would create an Office of Insurance Information within the Treasury Department.

At the end of the hearing, during which several witnesses called for the creation OFCs, Sen. Dodd said he would see what members of his committee want to deal with that before Congress adjourns before the November elections.

He warned, however, that the clock could block even modest reforms.

The Senate is in recess much of this month and won't return until after Labor Day for a session of unknown duration.

During an impromptu news conference after the hearing, Sen. Dodd again cited the Nonadmitted and Reinsurance Reform Act and the Insurance Information Act as examples of narrow legislation that might pass this year, but added that "at this juncture" the OFC was off the table.

Surplus lines reform legislation supporters, which include most of

See **REFORM** page 26

## Uncertainty ends at RSA with GM asbestos deal

Insurer says settlement won't affect earnings

By ROBERTO CENICEROS

**LONDON**—Last week's settlement between General Motors Corp. and Royal & SunAlliance Insurance Group P.L.C. over coverage for GM's asbestos and environmental claims ends uncertainty over future legal costs faced by RSA, an analyst said.

In 2005, Detroit-based GM sued for payment for hundreds of millions of dollars in claims it said were covered under primary, umbrella and excess comprehensive general liability policies issued between 1954 and 1971 by RSA subsidiary Royal Indemnity Co. and other members of Royal & SunAlliance USA Inc.

Last year, Charlotte, N.C.-based Arrowpoint Capital Corp., a vehicle established by RSA USA's management team, acquired RSA USA's businesses, playing a role in RSA's disposal of its U.S. operations.

In GM's 10-Q form filed on May 8, the automaker said its liability for recorded asbestos matters was \$628 million as of March 31. Additionally, GM reported increasing its reserves by \$349 million during the third quarter of 2007 for potential asbestos claims it faces over the next 10 years, including defense costs.

Neither GM nor London-based RSA commented last week on terms of their agreement and attorneys representing the companies declined to comment. But RSA said the settlement would not affect its earnings.

A financial analyst for A.M. Best Co. Inc. agreed that the settlement would neither impact RSA's earnings nor its financial strength rating, which Best rates as A- with a positive outlook.

"It's not something we are concerned about impacting RSA," said

Catherine Thomas, a Best analyst in London. "It brings finality to this litigation and any uncertainty regarding future legal costs for RSA."

In January 2007, RSA won a favorable judgment when GM's lawsuit was "thrown out of court" by the Michigan 6th Circuit Court judge hearing the case, Ms. Thomas said.

Judge John J. McDonald ruled then that GM's lawsuit was time-barred and granted RSA's pretrial motion to dismiss the complaint (*BI*, Jan. 29, 2007).

But court records show both companies continued to employ teams of attorneys in an appeals fight.

RSA noted in its 2007 annual report, though, that it was still subject to litigation in connection with former U.S. operations of RSA USA.

The annual report said RSA directors did not believe any pending U.S. legal action, which would have included GM's lawsuit, would adversely impact RSA's financial position, "although there can be no assurances."

However, reaching a settlement with GM has provided more assurance for RSA, Ms. Thomas said. RSA's A- rating already reflected the 2007 sale of its U.S. operations to Arrowpoint, Ms. Thomas added. Prior to that sale, Best had greater concerns about RSA's U.S. liabilities, particularly for asbestos claims.

But Best raised RSA's rating to A- in March 2007 following the sale to Arrowpoint and removed the under-review status applied in September 2006 when the sale was announced. The restructuring helped RSA focus on its profitable business and reduced uncertainty over reserves adequacy and earnings volatility, Best said.

**'At a time when New Yorkers are struggling to pay rising health care premiums, today's landmark \$27 million agreement cracks down on PBMs that put profits ahead of patients.'**

Andrew Cuomo  
New York attorney general



AP PHOTOS

## Express Scripts, CIGNA settle N.Y. drug lawsuit

PBM allegedly inflated prescription costs

By KRISTIN GUNDERSON HUNT

**NEW YORK**—Express Scripts Inc. and CIGNA Corp. have settled a lawsuit brought by New York state that accused the pharmacy benefit manager of inflating prescription drug costs for the state's largest employee health plan.

Under last week's settlement, St. Louis-based Express Scripts and Philadelphia-based health insurer CIGNA will jointly pay \$27 million for their alleged fraudulent acts that increased drug costs for Empire Plan members by millions of dollars.

The Empire Plan provides health and prescription drug coverage for more than 1 million active and retired New York state public employees and their dependents. It formerly contracted with CIGNA to manage its prescription drug benefit, and CIGNA then subcontracted with Express Scripts to administer the program.

From 1999 to 2003, the years covered by the contracts, the Empire Plan's prescription drug costs rose from \$455 million to \$1 billion, the lawsuit states.

Empire Plan now contracts with UnitedHealthcare, said a spokesman from the New York State Department of Civil Service.

Both CIGNA and Express Scripts were named in the 2004 lawsuit, and neither company admitted any wrongdoing in last week's settlement. They also did not disclose how much each will pay of the \$27 million.

"We're settling this so we can avoid the cost of the distraction of pursuing this litigation," said a spokesman for Express Scripts.

"We agreed to make a contribution, as prolonged litigation is not in anyone's best interest," CIGNA said in a statement.

The lawsuit claimed Express

See **SETTLEMENT** page 26

1 million

**ACTIVE AND RETIRED**  
New York state public employees and dependents are covered by the Empire Plan

# California ruling strengthens homebuilders' risk management

*High court finds widely used hold-harmless pacts require subcontractors to defend suits against general contractors*

By **ROBERTO CENICEROS**

A California Supreme Court ruling siding firmly with a homebuilder general contractor is based on a widely used hold-harmless agreement that could affect numerous other disputes with subcontractors, attorneys say.

Even though a jury cleared the subcontractor of negligence, the hold-harmless agreement required the subcontractor to provide a defense for the builder when subcontractor negligence is merely alleged, the California high court said last week in the ruling that cited parallels to liability insurance.

The ruling in *Kirk Crawford et al. vs. Weather Shield Manufacturing Inc.* applies to hold-harmless agreements commonly used as part of building industry risk management and insurance purchasing strategies during California's most recent housing boom, attorneys said.

Agreement terms have sparked disputes between some of the nation's largest homebuilders and subcontractors.

In 1999, 122 California homeowners sued Newport, Calif.-based developer/builder J.M. Peters Co., Medford, Wis.-based Weather



Shield and other subcontractors. Homeowners alleged numerous construction defects including leaky windows made by Weather Shield and installed by another subcontractor, court records show.

JMP filed a cross complaint against Weather Shield and other subcontractors. Most subcontractors settled, but Weather Shield

went to trial. In 2002 a jury ruled in favor of Weather Shield and found it was not negligent. JMP's cross-complaint was tried in 2003, with a court ruling that Weather Shield did not have to pay JMP's indemnity costs but was obligated by the hold-harmless agreement to defend JMP.

A state appellate court affirmed the ruling and the California Supreme Court agreed.

The court noted that under general liability insurance policies, an insurer's duty to defend is broader than its duty to indemnify. A duty to indemnify applies only to claims actually covered by a policy. In contrast, the duty to defend extends to "merely potentially covered" claims, the court said.

The high court said Weather Shield must defend the general contractor even if the agreement between the two parties does not require the subcontractor to pay the builder's indemnity costs.

Courts across the country have established the duty to defend under insurance policies, said David B. Goodwin, a policyholder attorney

at Covington & Burling L.L.P. in San Francisco. But prior to last

See **AGREEMENT** page 24



REUTERS

In a ruling that bolsters contractual risk management in California, the state Supreme Court has upheld a subcontractor's duty to defend a general contractor under hold-harmless agreement.

## Suicide compensable if tied to work injury, Nevada high court rules

*Causation at issue in suit seeking benefits*

By **ROBERTO CENICEROS**

**CARSON CITY, Nev.**—A suicide sufficiently connected to an industrial injury is compensable under Nevada's workers compensation system, the state's highest court has ruled.

State law barring family members from collecting workers comp benefits if a worker's death resulted from a "willful intention to injure himself" does not apply when a "sufficient chain of causation is established," the Nevada Supreme Court ruled in *Sharon Vredenburg vs. Sedgwick CMS and Flamingo Hilton-Laughlin*.

To establish such a chain, claimants must demonstrate that the employee suffered an industrial injury that in turn caused a psychological injury severe enough to override rational judgment. Claimants must then establish that the psychological injury caused the employee to commit suicide, the court said.

The decision stems from a back injury Danny Vredenburg, a bartender, suffered from slipping on a flight of stairs, causing disc derangement in several locations along his spine, court records show. Despite surgery and the use of pain medications and anti-inflammatory agents, he continued to experience pain.

A doctor diagnosed Mr. Vredenburg as psychologically destabilized because of his chronic pain and recommended that he claim permanent disability status. When Mr. Vredenburg killed himself, a second doctor opined that Mr. Vredenburg

did so because of the unrelenting pain, and his spouse then filed for death benefits.

But the insurance administrator for Mr. Vredenburg's employer



ruled that the doctor's opinion lacked a medical rationale linking the suicide to his industrial injury and denied the claim.

A workers comp appeals officer agreed, and a district court denied the claimant's petition for judicial review. But the Nevada Supreme Court reversed and remanded the case for proceedings consistent with its opinion.

The high court said its decision addressed a single issue of first impression.

"We conclude that suicides may be nonwillful deaths under Nevada's workers compensation law if they are sufficiently causally connected to an industrial injury," the court stated in its opinion. "In reaching this conclusion, we adopt the chain-of-causation test to determine whether a sufficient causal connection exists."

*Sharon Vredenburg, surviving spouse on behalf of Danny Vredenburg (deceased) vs. Sedgwick CMS and Flamingo Hilton-Laughlin, No. 49289.*

## Employers spared higher health fees

*Mass. lawmakers pass legislation to help fund state health care program*

By **JERRY GEISEL**

**BOSTON**—Massachusetts employers, at least for now, will be spared from having to make larger contributions to help fund part of the state's health care reform law.

That's because lawmakers approved budget legislation last week that imposes new assessments on insurers and hospitals—but not employers—to help provide funding for the Commonwealth Care



LANDOV

Massachusetts Gov. Deval Patrick said he intends to propose that employers pay more to fund the state's health care program.

program.

The bill does, though, add a new reporting duty for employers.

Massachusetts Gov. Deval Patrick said last month said he intended to propose tightening an existing rule—known as "Fair Share"—that requires employers with at least 11 full-time employees in the state to pass one of two tests to avoid an annual assessment of \$295 per employee.

Revenues from that assessment, which have been running about \$7 million a year, are used help fund the Commonwealth Care program.

See **MASSACHUSETTS** page 26

## Employers to review leave policies

*Court says broad FMLA policies can bind employer to provide leave*

By **JUDY GREENWALD**

**CHICAGO**—An employer that promises its employees leave under the federal Family Leave and Medical Act can be found liable under state law if it fails to provide that leave, even if the employee was not entitled to the benefit, a federal appellate court says.

The July 14 decision in *Steven Peters vs. Gilead Sciences Inc.* by the 7th U.S. Circuit Court of Appeals in Chicago illustrates the necessity for employers to carefully parse what they promise their employees in employee handbooks, observers say.

According to the opinion, Mr. Peters, who worked from his Indianapolis home while representing

and marketing the products of Gilead, a Foster City, Calif.-based pharmaceutical company, was ineligible for FMLA leave, because it excludes employers that have fewer than 50 employees within a 75-mile radius.



After undergoing corrective surgery for a work-related injury to his neck and right shoulder, Mr. Peters requested FMLA leave. Language in both the company's handbook and in letters Mr. Peters received from the firm described

benefits provided under the FMLA, without specifying that employees in Mr. Peters' situation were excluded.

After taking one leave in December 2002, he requested a second leave after having a bad reaction to a drug to treat his condition. The company incorrectly calculated his return date, though, and when he did not return by the date the company had expected, he was replaced. Mr. Peters was terminated after he refused a different position that would have required him to transfer to California, according to the opinion.

Mr. Peters sued the company on a number of grounds, including vio-

See **FMLA** page 6



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# FMLA: Promise of leave carries liability

CONTINUED FROM PAGE 4

lation of the FMLA. A lower court concluded that Mr. Peters did not establish the elements of “equitable estoppel”—a legal concept that relates to a plaintiff relying on an expectation—under the FMLA and granted summary judgment to Gilead.

But a unanimous three-judge panel of the appeals court said although Mr. Peters was not covered by the FMLA, Gilead could still be found liable under Indiana state law.

“Gilead’s employee handbook promised 12 weeks of medical leave—the equivalent of the leave guaranteed by the FMLA—and Gilead repeated those promises in its letters to Peters. It is not clear whether this is sufficient to establish a binding contract under Indiana law,” said the opinion.

Even if there is no binding contract per se, though, “Indiana permits enforcement of Gilead’s promises” to the extent of the damages that resulted from his reliance on them, the opinion stated. Depending on which is the case, “the scope of recovery may differ,” said the appeals court, which returned the case to the lower court for further proceedings.

Experts agree that employers must carefully phrase the guidelines

they include in their employee handbook.

Carl C. Bosland, managing director of the Denver-based Bosland Consulting Group, said many employers offer more generous leaves than those permitted under the FMLA, “but I don’t think they think it through on what that may mean.” By offering these leaves,

**This case ‘would have come out very differently’ if the employee handbook had a disclaimer saying ‘it was not a binding statement of company policy.’**

Jonathan T. Hyman,  
Kohrman Jackson & Krantz P.L.L.

“you may expose yourselves to other forms of liability other than the FMLA.”

“Make sure if you don’t intend to offer employees entitlements above and beyond what the law requires that you’re careful to craft the language of your employee handbook to say as much,” or state law may provide those additional entitlements, said Gerald L. Maatman Jr., an employer attorney with Seyfarth

Shaw L.L.P. in Chicago. Any ambiguity “may give an opening for employees.”

This is an example of the adage, “No good deed goes unpunished,” said Michael W. Fox, an employer attorney with Ogletree, Deakins, Nash, Smoak & Stewart P.C. in Austin, Texas.

Employers “set out these requirements that they’re going to give benefits to everyone without being very detailed and tailoring it to conform later on, hoping, I guess, if it ever becomes an issue, they could use the law as ‘gotcha,’ and it doesn’t work,” said Mr. Fox.

Jonathan T. Hyman, an employer attorney with Kohrman Jackson & Krantz P.L.L. in Cleveland, said, “If you’re going to represent to your employees that a particular statute applies to them and the employee relies upon it to his or her detriment,” it is going to be difficult to defend in court.

This case “would have come out very differently” if the handbook had included a disclaimer stating “it is not intended to be a binding statement of company policy,” Mr. Hyman said.

Attorneys in the case could be reached.

*Steven Peters vs. Gilead Sciences Inc., 7th U.S. Circuit Court of Appeals, No. 06-4290, July 14, 2008.*

## Commentary

# Sustainability requires conservation mindset

Sustainability is generally a good thing, whether in business or natural resources.

The idea of making something last indefinitely, or at least not consuming a resource faster than it can be replenished, is getting a lot of attention these days and is a big part of the “green” movement. The commercial insurance industry is acknowledging this with a variety of products offering favorable rates and terms for “green” buildings, for example.

Sustaining a business is no easy feat, and risks that can end that dream are everywhere. Catastrophes for which a business has no mitigation or recovery plan can darken even the brightest future. Planning for and nurturing continuity is critical. So are prudent use and disposal of resources needed to operate the business, from fuel to paper to computers.

People are beginning to understand that sustainability has a lot to do with our impact on the environment. In short, actions have consequences, sometimes irrevocable ones.

I recently read a fascinating nonfiction book by Mark Kurlansky, a New York-based writer who explores human history and its lessons for modern times. “The Last Fish Tale” paints a disturbing portrait of the effects of overfishing on the commerce and culture of fishing towns such as Gloucester, Mass. Until fairly late in the 20th century, he writes, it was believed that nature’s resilience was supreme; humans could not exhaust the ocean’s resources.

Sadly, we know today that was a fallacy. Shortsighted regulation, political expediency and improved technology that made commercial fishing highly efficient in the past 50 years have virtually depleted stocks of groundfish such as cod and haddock, once so numerous that they were a reason Europeans came to the New World and the Pilgrims settled here. Even past its mid-17th century heyday, Gloucester remains a major fishing port on the Atlantic. Similar ports in Europe died many years earlier, due to overfishing.

The lesson is that when a fish species becomes “commercially extinct,” that is, the population dwindles to being too small to sustain a fishing industry, the ocean ecosystem changes—perhaps permanently. This happens to terrestrial life, too. Pollution and environmental damage don’t help ocean life, though their effects are more apparent to those of us living on land.

Walt Disney Co.’s Pixar Animation Studios’ “Wall-E” movie is a summer blockbuster that’s enor-



**REGIS COCCIA**

Editor Regis Coccia’s commentary appears periodically. He can be reached at: [rcoccia@businessinsurance.com](mailto:rcoccia@businessinsurance.com)

mously entertaining for children and adults, but it conveys a troubling message about humans’ pollution of the planet. The story, set centuries in the future, is about a robot that has spent more than 700 years compacting trash into cubes and stacking them, so high they resemble skyscrapers. In the story, the pollution and garbage force humans to evacuate Earth in huge spaceships, with the idea that they’ll return after robots such as Wall-E clean it up.

How can we avoid such a

**Actions have consequences for the environment, sometimes irrevocable ones.**

nightmare? For starters, we can recycle more and reduce the amount of waste that ends up in landfills and elsewhere. I wonder why some places still don’t bother to cull recyclable bottles, paper, etc. from ordinary trash. It’s a heckuva lot easier if separate containers are available. My family lives in a community where most plastics and metals are collected and recycled and, as a result, our blue recycling bin is always brimming. It’s a larger container than our trash cans, in fact. And I suspect we can still do more.

Humans are creatures of habit, so cultivating a habit of reducing, reusing and recycling materials is something that government and business should encourage, too. Mandates may get a recycling program started, but greater awareness of the positive effects of such efforts will keep it going. If we make it easier to separate recyclables at home, at work and on the street, more people will be likely to do so and keep doing so.

One needn’t accept the argument that human activity is solely responsible for global warming—I don’t—to realize that we should try to conserve and sustain the resources we have.

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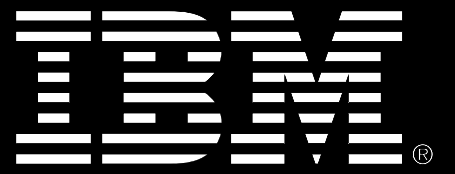
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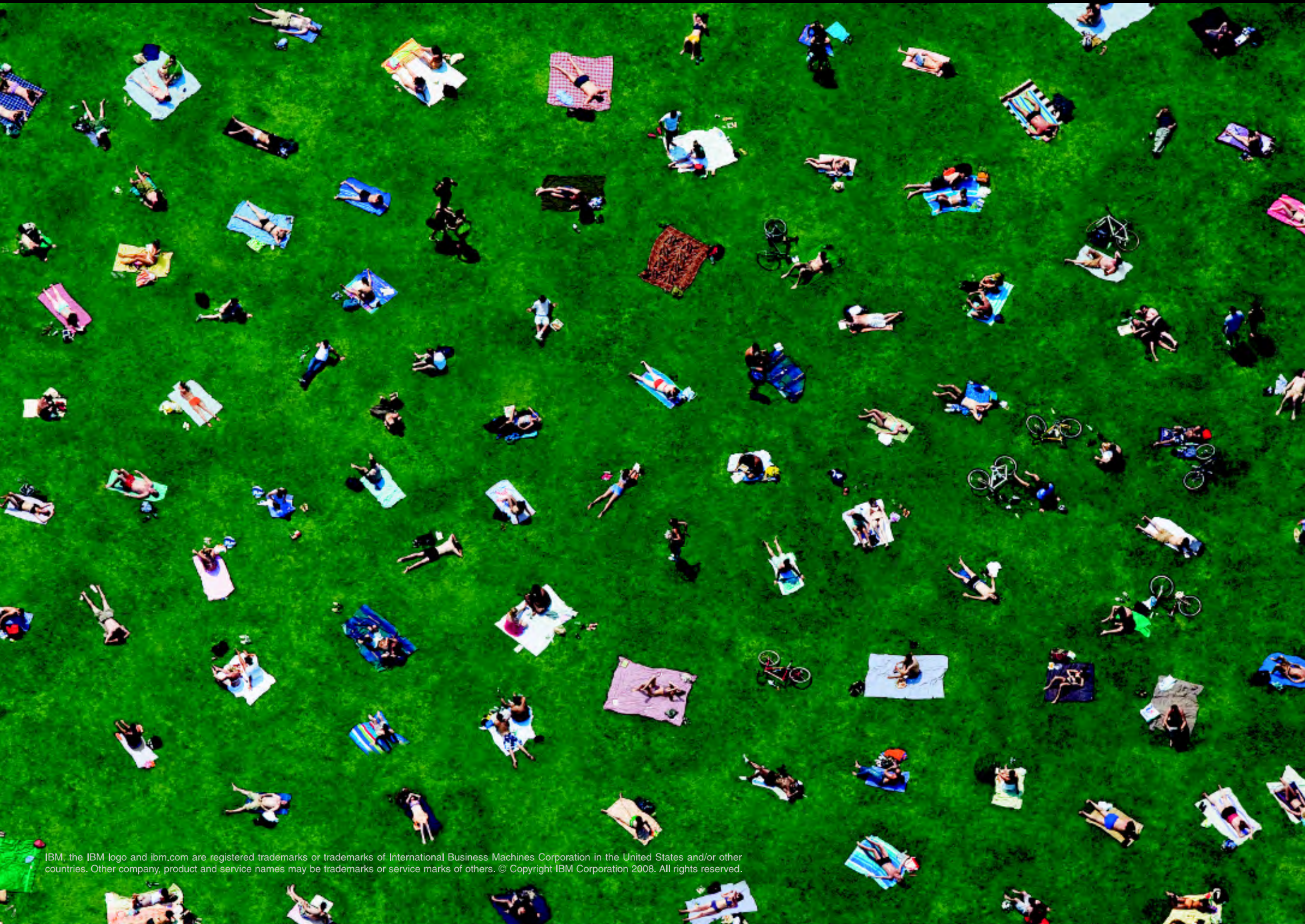
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# Business Insurance OPINIONS

## Congress can make reform efforts a reality

SENATE BANKING, Housing and Urban Affairs Chairman Chris Dodd, D-Conn., fully understands the wisdom of Otto von Bismarck's observation that "politics is the art of the possible."

As we report on Page 3, such an understanding was more than evident last week when Sen. Dodd said he'd still like to get a narrowly focused package of insurance regulatory reform legislation through his committee and the full Senate this year. He indicated that two likely components of such a package could be the Nonadmitted and Reinsurance Reform Act—which passed the House overwhelmingly last year—and the Insurance Information Act.

It's easy to understand why Sen. Dodd would regard both of those bills—as opposed to more comprehensive reforms such as creating a system of optional federal charters for insurers and producers—as doable even in the waning days of this Congress. The House surplus lines bill has the support of insurers, producers and risk managers alike, and understandably so. It would streamline the regulation of both the surplus lines and reinsurance markets in a way that's stirred little controversy.

The Insurance Information Act would create a new office within the Treasury Department to provide expertise on insurance matters and establish federal policy on international insurance issues. While this is somewhat more controversial than the surplus lines bill—some supporters of state insurance regulation fear it's a Trojan horse designed to promote federal regulation—the measure enjoys bipartisan support as well as that of the White House.

Both are common-sense approaches that merit inclusion in any regulatory reform package that might be enacted this year. While we would prefer comprehensive insurance regulatory reform, including the OFC, we're realistic enough to admit that controversial sweeping reform simply is not likely in the last days of any Congress. We'll stick with the possible and hope that this Congress transforms the possible into reality during its final weeks.

*We hope that this Congress transforms the possible into reality during its final weeks.*

## FEMA aid policy must be clarified to public entities

WE'RE ALL FOR governmental accountability, particularly when it comes to mitigating and insuring against disasters. But the Federal Emergency Management Agency's modified policy on when and how much aid a public sector entity may receive after certain federally declared disasters may be taking accountability to an unrealistic limit.

As we report on page 1, FEMA says that public entities could face a partial or total loss of federal disaster aid to cover their uninsured losses if they suffer repeated losses from the same peril, such as flooding. But exactly how this would work is puzzling some risk managers, brokers and others.

That's troubling. Although a mechanism exists for public entities that can't find adequate capacity to assure a continuation of disaster aid, not all state insurance regulators understand how the certification process should work. This could leave some public entities facing huge losses without hope of coverage.

FEMA has reached out to the risk management community, but its message is not clear to all. We believe more outreach is needed to clarify what the changes mean and how risk managers can deal with them. Accountability is key to good government, but public entities must know exactly what they are accountable for before they can achieve that goal.



### WRITE

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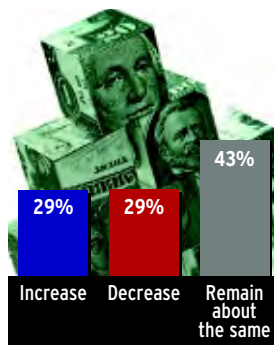
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#### THIS WEEK'S RESULTS

Over the next year, will the budget of your risk management department increase or decrease?



#### NEXT WEEK'S QUESTION

**Q:** Should the Federal Emergency Management Agency reduce or eliminate aid to public entities that sustain uninsured losses from successive disasters of the same type such as repeated flooding?

BI Online Poll tool is sponsored by Wausau Insurance Cos.

### READ

Perspectives and expert analysis online at  
[www.businessinsurance.com/knowledgecenter](http://www.businessinsurance.com/knowledgecenter)



## Prepare a formal plan to respond to data breaches

Instituting a formal plan to respond to data breaches is a necessity for companies that maintain sensitive consumer information, writes Brad Gow, vp of ACE USA's Professional Risk division in Philadelphia. Although no data is completely secure given the complexity and changing nature of corporate networks, risk managers need to take reasonable steps to prepare for a data breach in order to protect the company's balance sheet, he says.



## ONLINE

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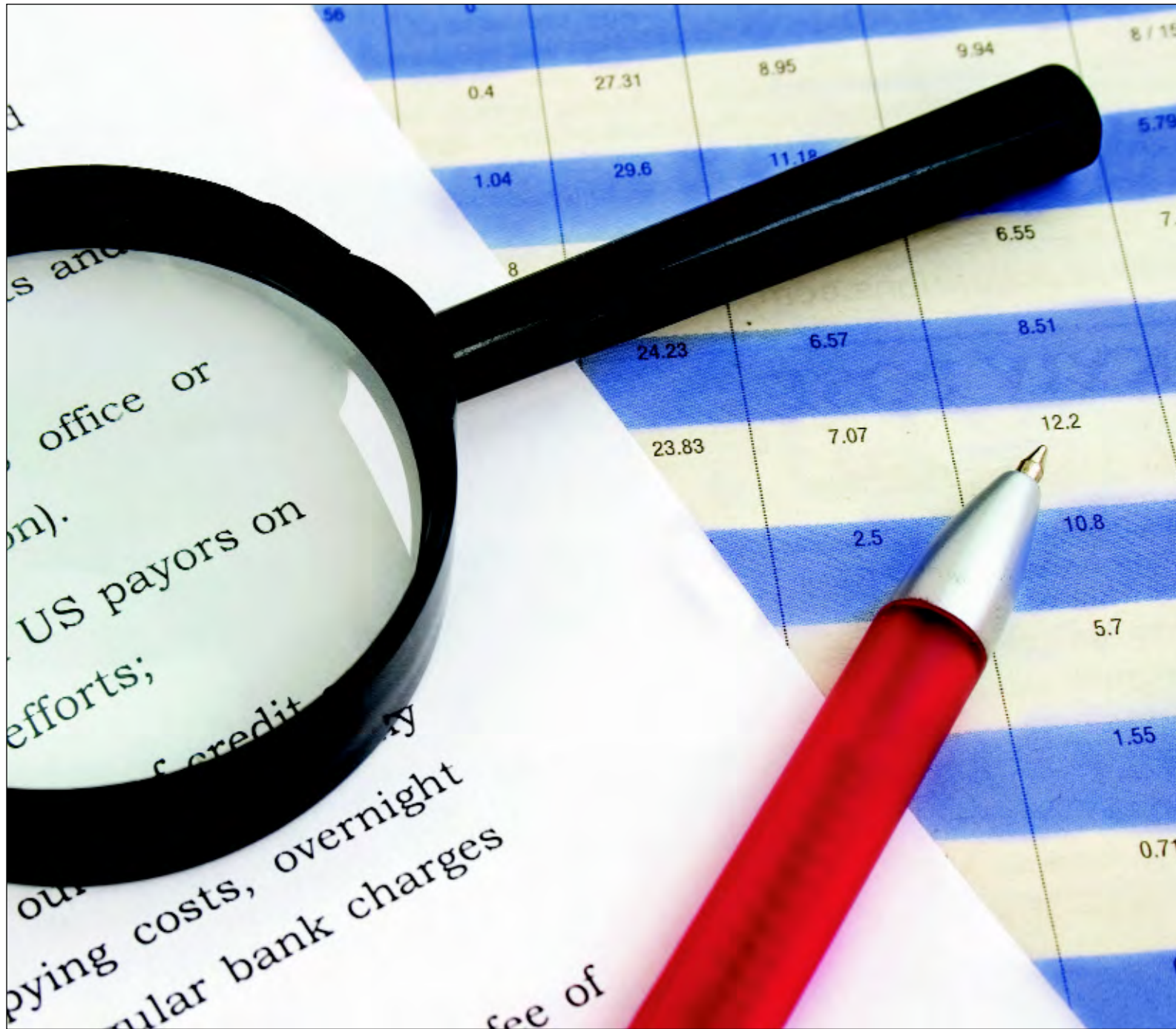
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## Forensic accountants mind the knowledge gap

*Disaster recovery speeded by familiarity with risk managers' business and specific coverage terms*

By **JUDY GREENWALD**

Forensic accountants' expertise in policy language and experience with insurers can help risk managers ultimately receive the maximum payment possible from a business interruption claim, observers say.

They can also significantly relieve the risk manager's work burden in the hectic days following a catastrophe, add observers. And litigation stemming from business interruption claims is rare when forensic accountants are involved, they say.

In preparing a business interruption claim, forensic accountants examine a company's financial records and then work with the firm's risk management and financial departments to determine how much the company would have earned in revenues and profits had the catastrophe never occurred (see story, page 16). Forensic accountants generally work exclusively for either risk managers or insurers.

Risk managers who have worked

with forensic accountants say they were pleased with the results.

"They were absolutely amazing," said Christina Reisinger, risk management director at Frazer, Pa.-



**FORENSIC ACCOUNTANTS:** Experts help buyers sharpen focus of claims from catastrophes, plan recovery before disasters strike. **Pages 16, 17**

based Cephalon Inc., a biopharmaceutical firm that has worked with New York-based Marsh Inc.'s forensic accounting and claims services unit. "I don't think we could have put the claim together without having them assisting us."

"It's invaluable to me to have a good forensic accountant, one that

knows our accounting systems and how they operate," which has allowed the accountant to portray future revenues "so that we can obtain the most accurate amount on any settlement," said W. David Little, vp-risk management for Beverly Hills, Calif.-based Hilton Hotels Corp. Hilton has worked with Marsh on its business interruption catastrophe claims for the past several years.

Lance Ewing, vp-risk management for Harrah's Entertainment Inc. in Cordova, Tenn., said he found forensic accountants helpful after Hurricanes Katrina and Rita in 2005, when the firm had more than \$1 billion in losses, as well as following recent wildfires in California.

"They were invaluable in regards to getting into the weeds and the details of the financial picture, and began to work closely with the adjuster and their forensic accountants, because the carriers certainly will get into your nightmares in regards to financing," said Mr.

Ewing, who works with Wilton, Conn.-based Dempsey Partners L.L.C. The forensic accountants "certainly provided a buffer," he said.

Forensic accounting was also helpful to Indianapolis-based Emmis Communications Corp., a diversified media company, in projecting earnings the company lost as a result of Hurricanes Charley in 2004 and Katrina in 2005, said Jennifer Sage, Emmis' risk manager.

"That's a pretty complex process (of projecting earnings), especially in our industry," said Ms. Sage. The use of a forensic accountant "simplified it in many ways."

Ms. Sage worked with New York-based Aon Horizon Consultants Inc. and its Aon Global Rapid Response program.

Risk managers say forensic accountants' experience in working with insurers has produced positive results.

"I think it's been a tremendous

See **FORENSIC** page 14

Catastrophe  
Management

SPOTLIGHT

**DIRECTORY: PROPERTY  
LOSS CONTROL  
CONSULTANTS PAGE 10**

**DIRECTORY: FORENSIC  
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LESSONS PAGE 20**

**CULTURE AFFECTS RISK  
APPROACH IN OVERSEAS  
OPERATIONS PAGE 21**

**LARGEST BY PROFESSIONAL STAFF**

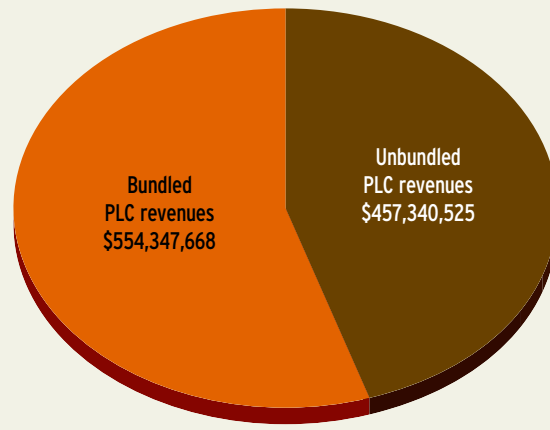
Ranked by number of professional property loss control staff

Company	Professional staff
ABSG Consulting Inc.	550
Aon Global Risk Consulting	480
Marsh-Risk Consulting Practice	260
Arup	240
Global Risk Consultants Corp.	237
Regional Reporting Inc.	175
Zurich Services Corp.	175
Global Asset Protection Services L.L.C.	156
Gallagher Bassett Services Inc.	53
ACE USA Property Engineering	36

Source: BI survey

**BUNDLED VS. UNBUNDLED**

Total property loss control revenues vs. total unbundled property loss control revenues



Source: BI survey

**COMMON CONSULTING SERVICES**

Most common services offered by property loss consultants

Services	Percentage of companies
Client training	100%
General onsite plant loss prevention inspections	100%
Risk and hazard analysis	100%
Building plan review	95.7%
Fire prevention inspections	91.3%
Hazard identification	91.3%
Business interruption consulting	82.6%

Source: BI survey

# Largest property loss control consultants

Ranked by 2007 gross revenues from unbundled property loss control consulting \*

Rank	Company/Address	Phone/Web site	Unbundled property loss control consulting revenue	% of total revenue from unbundled property loss control consulting services	Professional property loss control staff	Branch offices	Unbundled clients	Principal officer
<b>1</b>	ABSG Consulting Inc. 16855 Northchase Drive, Houston, Texas 77060	281-673-2800 www.absgconsulting.com	\$164,400,000	100%	550	20	1,700	Tony Nassif, president/CEO-ABS Group
<b>2</b>	Global Risk Consultants Corp. 100 Walnut Ave., Fifth Floor, Clark, N.J. 07066	732-827-4400 www.globalriskconsultants.com	\$50,735,755	100%	237	33	1,072	William F. Ramonas, chairman/CEO
<b>3</b>	Global Asset Protection Services L.L.C. <sup>1</sup> 100 Constitution Plaza, Hartford, Conn. 06103	860-293-7901 www.xlgaps.com	\$38,500,000	100%	156	16	325	Timothy Heinze, managing director
<b>4</b>	ACE USA Property Engineering 436 Walnut St., Philadelphia, Pa. 19106	215-640-1380 www.aceagen.com, www.ancelimited.com	\$6,200,000	98%	36	8	190	Michael Schmidt, vp
<b>5</b>	Matrix Risk Consultants Inc. 3130 S. Tech Blvd., Miamisburg, Ohio 45342	937-886-0000 www.matrixrc.com	\$4,788,000	100%	18	1	24	Walter P. Luker, CEO
<b>6</b>	Risk Logic Inc. 93 Apple Ridge, Woodcliff Lake, N.J. 07677	201-930-0700 www.risklogic.com	\$1,850,000	100%	7	4	61	John Durante, president
<b>7</b>	Loss Control Associates Inc. 172 Middletown Blvd., Suite B-204, Langhorne, Pa. 19047	215-750-6841 www.losscontrolassociates.com	\$1,179,424	96%	7	N/A	49	Orville M. Slye Jr., president
<b>8</b>	Fire Protection Solutions Inc. 668 N. Coast Highway, Suite 518, Laguna Beach, Calif. 92651	866-777-3473 www.fpsolutions.org	\$765,330	100%	5	5	2	Steve Shabazian, president
<b>9</b>	Allrisk Engineering Inc. 1909 28th St. S.E., Auburn, Wash. 98002	253-670-0898 www.allriskengineering.com	\$650,000	100%	5	4	5	Jesse Wilson, president
<b>10</b>	Donald Mayo-Fire Protection Consultant Inc. 150 Grove Circle, Pleasant Hill, Calif. 94523	925-933-6299	\$440,016	100%	1	N/A	7	Donald Mayo, president

\*Only those companies that derive a majority of their total revenues from unbundled property loss control consulting are ranked. 1. Formerly Swiss Re's Global Asset Protection Services. XL Capital Ltd. acquired the company in December 2007. N/A=not applicable.  
Source: BI survey

Visit [www.BusinessInsurance.com/Directories](http://www.BusinessInsurance.com/Directories) for more information and to access the full searchable Directory of Property Loss Control Consultants. Business Insurance now offers the option to purchase the entire online directory as an Excel file or as a PDF. For our full 2008 Schedule of Issues including rankings and online directories, visit [www.BusinessInsurance.com/EditorialCalendar](http://www.BusinessInsurance.com/EditorialCalendar).

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# Forensic accounting firms

The Directory of Forensic Accounting Firms lists companies that provide forensic accounting services on a direct, unbundled basis. Forensic accounting services may be provided to either insurance companies or policyholders and may include investigative services for allegations of fraud on the part of employees, suppliers and customers. It may include the estimating of losses, damages and assets related to business interruption, product liability, shareholder disputes and other disputes.

Company/Address	Phone/Web site	Revenues	Clients	Staff	Principal officers
<b>Dempsey Partners L.L.C.</b> 426 Danbury Road, Wilton, Conn. 06897	203-762-5052 <a href="http://www.dempsey-partners.com">www.dempsey-partners.com</a>	N/A	200	25	John D. Dempsey, managing partner
<b>Marsh-Forensic Accounting &amp; Claims Services Practice</b> 1166 Ave. of the Americas, New York, N.Y. 10036	212-345-1063 <a href="http://www.marsh.com">www.marsh.com</a> , <a href="http://www.marshriskconsulting.com">www.marshriskconsulting.com</a>	\$50,000,000	N/A	165	Ken Giambagno, managing director/ global practice leader
<b>Joseph Modica &amp; Associates Ltd.</b> 111 W. Maple Ave., Suite B, Mundelein, Ill. 60060	847-566-2240 <a href="http://www.jmodicacpa.com">www.jmodicacpa.com</a>	N/A	N/A	N/A	Joseph Modica, managing partner
<b>RWH Myers &amp; Co. L.L.C.</b> 200 W. Monroe, Suite 1270, Chicago, Ill. 60606	312-739-1800 <a href="http://www.rwhmyers.com">www.rwhmyers.com</a>	\$4,000,000	90	12	Bill Myers, Sharon Pisko Wolfe, Glenn Rand, partners
<b>RGL Forensic Accountants &amp; Consultants</b> 5619 DTC Parkway, Suite 1010, Englewood, Colo. 80111	303-721-8898 <a href="http://www.rgl.com">www.rgl.com</a>	\$27,900,000	420	130	Paul MacPherson Brunner, CEO
<b>Smart Business Advisory &amp; Consulting L.L.C.</b> 4 Penn Center, 1600 JFK Blvd., Suite 1030, Philadelphia, Pa. 19103	215-832-3406 <a href="http://www.smartgrp.com">www.smartgrp.com</a>	\$7,000,000	75	25	Frederick J. Kohm Jr., John J. Swanick, senior managing directors
<b>Walworth &amp; Nayh P.C., CPAs</b> 17800 Newburgh, Suite 101, Livonia, Mich. 48152	734-464-8990 <a href="http://www.walnay.com">www.walnay.com</a>	N/A	1,000	20	Robert Walworth, Gary Nayh, Mark Stephanic, partners

N/A=Not available

Source: BI survey

Researched by Kevin Edison and Karen Tucker

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AP PHOTOS  
What had been the entrance to a Harrah's casino in Lake Charles, La., was swamped by an overflowing Lake Charles following Hurricane Rita, which hit the area in late September 2005.

## Forensic: Specialists aid disaster recovery

CONTINUED FROM PAGE 9

help," said Cameron A. Shirley, director-claims management, for Phoenix-based Starwood Hotels & Resorts Worldwide Inc., which has also worked with Marsh. "Obviously, we've got good, sound business-people at our hotel locations," as well as financial people, "but they're not well-versed in presenting a business interruption claim, so it's been very helpful to go hire a forensic accountant to help put together the actual claim," he said.

"I find the forensic accountants know how to prepare the claim in a manner that is most acceptable to

the insurance companies," said Chris Winterling, vp of risk management at Palm Beach, Fla.-based Flo-Sun Inc. "And they also get to understand your business, so that they can maximize any potential claim dollars that you might have in the claim that you might not have realized," said Ms. Winterling, who has worked with Dempsey Partners.

The forensic accountant is expert in orchestrating the whole process of organizing a claim, said John D. Dempsey, who is managing partner and founder of Dempsey Partners. "With each loss somewhat different, the forensic accountants prac-

ticing in this area now can really help organize the process, because at the end of the day, it mostly revolves around the numbers," he said.

"There's so much complexity in the way business is conducted and the way policies are constructed—the way businesses interrelate, facilities interrelate—that it is quite a chore to pull in all the financial resources to accurately quantify losses," Mr. Dempsey said.

The forensic accountant also advises the client, said Mr. Ewing. "You can't replace concrete with granite" after a catastrophe. If the client seeks to do so, "the forensic accountant has to stand up as the conscience of the client side" and say, "Wonderful, but the carriers won't pay." The forensic accountant acts as the "Jiminy Cricket conscience for you as you go along with the claims process," Mr. Ewing said.

Forensic accountants also help with the increased work that follows a catastrophe, said Ms. Winterling, who has worked with forensic accountants following Hurricanes Georges in 1998 as well as Katrina and Wilma in 2005.

"When you have a claim, one of the problems is that there is an extreme amount of additional work put on your staff to gather numbers, and this can be mitigated a little bit by having the forensic accounting people in to help drive that and to help pull the numbers together," she said.

"It's still going to be an awful lot of work on the staff that you have, but it helps that they don't have the entire load of keeping up with all this tremendous amount of paperwork that is generated by a claim," said Ms. Winterling.

Ms. Reisinger agreed that forensic accountants were helpful.

"Don't get me wrong. There's still a tremendous amount of work we had to do, but we had four people from that group work for us almost full time" following Katrina and Cephalon "wouldn't have had the in-house capability to do it," she said. "Because they do this day in and day out, they know what insurers are looking for."

Another significant contribution a forensic accountant can make is to "set the tone of the relationship with the policyholder" and the insurer when responding to the questions posed by the insurer and its accountant, said Key Coleman, Chicago-based managing director for SMART Business Advisory & Consulting L.L.C., which provides forensic accounting services.

It is important that the tone "be one of integrity and trust and open communications back and forth," said Mr. Coleman. That "ultimately can get the claim settled faster, which is really in everybody's best interests."

In fact, most observers say business interruption claims handled by forensic accountants rarely lead to litigation.

"Of course, you have disputes with the insurance company, and each side has their own opinions, and that's what the adjustment process really is all about," said Frank Oliver, senior vp at Aon Horizon.

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# Experts sharpen focus of cat claims

*Forensic accountants  
wed policy terms,  
business knowledge*

By **JUDY GREENWALD**

A forensic accountant's job is to determine what a company lost as a result of a catastrophe and to help in pulling together the business interruption claim, say experts.

Forensic accountant Frank Oliver, senior vp at Aon Corp. unit Aon Horizon Consultants Inc. and its Aon Global Rapid Response program in New York, said a forensic accountant "is someone that understands both the insured's business as well as the policy terms and conditions and, therefore, can tailor the claim to fit the coverage."

"One of the first things that needs to be done is to make sure that the company has a clear understanding of what is and is not covered under their policy," said Shauna Woody-Coussens, Kansas City, Mo.-based managing director of accounting firm Grant Thornton's forensic accounting and investigative services practice.

Some risk managers are "going to be more attuned to exactly what is covered" than others, said Ms. Woody-Coussens.

The next step is to collect relevant information to prepare the claim, forensic accountants say. But getting those records can sometimes be a challenge.

"Documents become wet and you have to dry them. Documents get blown away. You have to recreate them by means of other sources, either by virtue of the government authorities or by virtue of banking records," said forensic accountant Howard Zandman, a shareholder with Atlanta-based accounting firm Tauber & Balser P.C.

"You want to get information, certainly, for the 18 months or so leading up to the catastrophe to determine revenue trends and cost trends" in order to develop a "but for" determination as to what profits would have been had the catastrophe never occurred, said Harold A. Asher, who operates a New Orleans-based accounting firm. "Then, you compare that to what they actually did and determine what the actual loss is," said Mr. Asher.

"That's probably what the most difficult issue is—to try to forecast with some degree of reliability what would have happened," said Alan Meyer of Toms River, N.J.-based accounting firm Hutchins, Farrell, Meyer & Allison P.A.

David Gould, president of Baltimore-based American Claims Man-

agement Service, said although a good deal of that process is based on historical accounting, you "have to be sort of a creative accountant" as well.

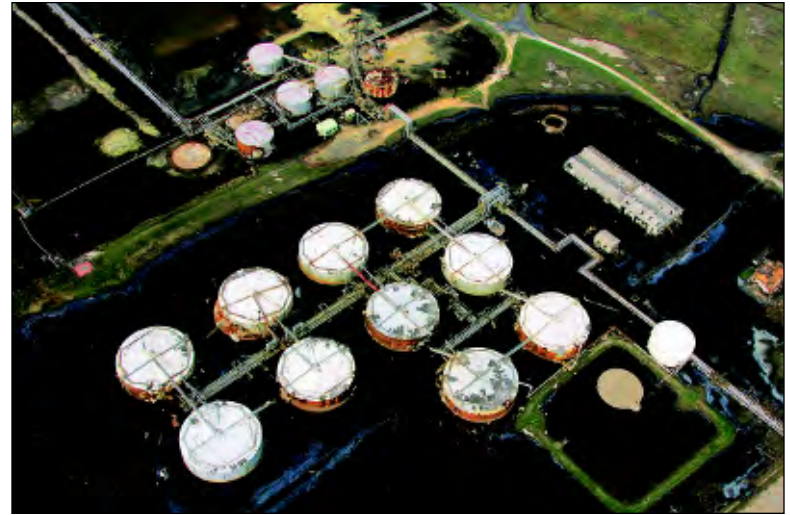
"For instance, suppose that your business just introduced some kind of new product line, maybe as early as the day before the catastrophe. That's not going to show up in business records. Someone's going to have to bring that to the attention of the carrier," said Mr. Gould.

"Suppose there was a drastic reduction in expenses that had been implemented shortly before the catastrophe. That's not going to be reflected accurately as a part of historical accounting documents. That's something the forensic accountant is going to have to develop and present," he said.

Part of the complexity of this process is that "you may not be able to replace the facility exactly as it was, because of technological changes," said forensic accountant John D. Dempsey of Wilton, Conn.-based Dempsey Partners L.L.C.

For instance, if an 80-year-old plant is destroyed, "you may not rebuild with good old-fashioned brick anymore, and there may be things that prevent you from restoring the property the way it was," which will affect the claim.

Furthermore, depending on policy



NY TIMES

An oil refinery south of New Orleans remained under floodwaters in September 2005, a week after Hurricane Katrina slammed the U.S. Gulf Coast.

wording, if a client had a facility that produced 100,000 barrels of oil a day that could be rebuilt to produce 125,000, the insurer may be "only responsible to put back the capacity that existed prior to the catastrophic event," said Ken Giambagno, managing director of Forensic Accounting & Claims Services, a unit of New York-based Marsh Inc.

The catastrophe's effect on others must be taken into account as well, said Mr. Giambagno.

For instance, "if one of our clients just put the proverbial 20-foot wall around the facility and kept the water out, they may be OK," but operations may have been shut down because the natural gas facili-

ty down the block was damaged, "so those claims become very, very complex."

In addition, there may be situations—such as the aftermath of Hurricane Katrina in New Orleans—where even if a retailer client rebuilds its store, there "may not be people there to buy your product," said Mr. Giambagno.

"It's not one cookie-cutter approach," said forensic accountant Bill Myers, of New York-based RWH Myers & Co. L.L.C., of the forensic accountant's work. "It depends a lot on the sophistication of the people. It depends on the nature of the loss," he said. "There's a whole lot of factors that go into it."



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## When to seek outside help

When is the right time to bring in a forensic accountant?

Some observers say such an expert should be involved before a business interruption policy is even signed. A forensic accountant, they say, can help ensure risk managers get the best coverage in their policies before a catastrophe even occurs.

"My viewpoint is that the time to engage a forensic accountant is before the disaster occurs," said Lance Ewing, vp-risk management for Harrah's Entertainment Inc. in Cordova, Tenn. A forensic accountant will value the potential loss "prior to the loss actually occurring."

"It's preventative medicine that sometimes might be hard to swallow, because you have to pay for it out of your own pocket. But it pays invaluable once the occurrence has hit your property," he said.

"Every year, when we enter the renewal process, we look at the policy and talk about losses we've had and ways we might be able to improve the policy," said Cameron A. Shirley, director-claims management for Phoenix-based Starwood Hotels & Resorts Worldwide Inc. He said that Starwood includes in this process claims experts, outside counsel and its forensic accountants—New York-based Marsh Inc.'s Forensic Accounting & Claims Services unit.

"The earlier people get to know each other, the smoother it's going to go when there's a loss," said forensic accountant Bill Myers of New York-based RWH Myers & Co. L.L.C.

It's also a good idea for risk managers to get in touch with their forensic accountant when preparing their catastrophe management plans, said Frank Oliver, senior vp at New York-based Aon Horizon Consulting Inc. and the Aon Global Rapid Response program.

When preparing their plans, risk managers "should have a very good understanding of their exposures, and a forensic accountant can assist them by analyzing those exposures to any kind of catastrophic event," said Mr. Oliver.

As a result, "the risk manager can properly assess those risks and either transfer those risks to an insurance company, or make sure that senior management understands that potential exposure," he said.

—By Judy Greenwald

# Business interruption may cost more than damage

*Arrangements and relationships made before cat strikes set the speed, success of recovery efforts*

By NICK WHITFIELD

Year-round planning and preparation are essential for risk managers with hurricane-exposed properties as forecasters predict an active hurricane season this year.

Two quiet seasons removed from the huge U.S. losses of 2005, businesses with coastal exposures are seeking not only to protect their properties but new ways to minimize interruption of their business, whether due to a direct hit or a break in the supply chain.

"After a hurricane, the physical damage is apparent," said Lou Gritzo, vp and manager of research of Johnston, R.I.-based Factory Mutual Insurance Co., which does business as FM Global. "But the other things businesses might not be thinking about—loss of competitiveness, loss of business share—can be longer-lasting."

While a soft market allows buyers to bulk up their coverage without wrecking their budgets, buyers with exposure to hurricanes agree that the biggest lesson of past disasters is

that hurricane planning extends well beyond finding the right deal at annual renewals.

"The property program has become something I touch every day of my life," said Scott B. Clark, risk and benefits officer for Miami-Dade County Public Schools in Miami.

Mr. Clark was able to reduce his property premiums about 20% this year but still found little capacity for first-dollar coverage for a major buyer with large hurricane risks.

Instead, he, like many buyers

with hurricane-exposed properties, relies on planning and preparation to self-insure anything short of a catastrophic storm and recover quickly from whatever the season may bring.

"Whether or not the market ever really softens to the point where I can make purchases of primary levels of insurance," Mr. Clark said, "I don't think I would do that. We have the ability to insure ourselves, so we're basically self-insuring for a

See **WIND** next page



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## Wind: Outside talent, operational threats

CONTINUED FROM PREVIOUS PAGE

Category 1, 2 or a small 3 storm," he said.

To retain that amount of risk, several property loss control experts recommend taking a broad view of hurricane preparation, looking to minimize risks outside one's own organization.

"There's only so much you can do to protect a building, but the key is to get the customers back in business ASAP," said Ralph Tiede, vp of property loss prevention for Liberty

tractors are prepared for a hurricane in addition to making sure that their own operations can withstand the blow (see story, page 19). Keiretsu is a Japanese word—meaning system or series—that refers to a network of businesses that hold stakes in one another and thus have an interest in one another's security.

"If you're running a resort, for example," Mr. Costner said, "and your laundry is done on a contract basis by someone down the road, even if you're high and dry, you can be shut down because your laundry

age to their own property."

There is little a client can do about supply-chain risks immediately before or after a hurricane, but Mr. Costner said this is exactly the sort of long-term planning that can get risk managers through a disaster.

"The best-managed businesses are taking a much more serious look at preparation for disaster," Mr. Costner said. "The best are formalizing their action plans. They have written formal pre- and post-disaster plans to keep their business running."

In a Miami school district with more than 350,000 students and 54,000 employees, Mr. Clark has learned the value of doing just that.

In his case, the plan needs to work not only within the organization, to get staff and students back in class, but also outside the organization, to maintain contracted functions such as school lunches.

"It's something we have to look at from a standpoint of depth of resources," Mr. Clark said.

"For example, we feed somewhere in the area of 200,000 students a day," he said. "We have to make sure we have contingency arrangements with our vendors to resupply." Those arrangements include written agreements to buy out other entities' supply contracts, he said.

"Sixty-eight percent of our kids get a free or reduced (price) lunch in this district, which means if they don't get their lunch at school, they may not get a lunch," Mr. Clark

See **WIND** next page

### 'The best-managed businesses...have written formal pre- and post-disaster plans.'

James Costner,  
Willis Risk Solutions



Mutual Property, a unit of Liberty Mutual Group Inc., in Weston, Mass.

"It's almost like adopting a 'keiretsu' mentality," said James Costner, senior vp and senior property resource consultant for Willis Risk Solutions in Nashville, Tenn. "Everybody involved in operating the business, regardless of their role, has to come together on a plan to deal with a disaster."

A "keiretsu mentality" means that risk managers have to consider how well their suppliers and con-

is shut down."

Many businesses must manage similar threats to their "intellectual supply chain," or outsourced talent and operations, FM Global's Mr. Gritzo said.

"These might not all be insured losses," said James Breitz, vp of property and boiler and machinery services for Zurich Services Corp. in Schaumburg, Ill., a unit of Zurich Financial Services Group. "Some businesses might have more of a loss from interruption of their supply chain than they have from dam-

## Questions & Answers

Karen Clark is president and CEO of Karen Clark & Co., a Boston consultant specializing in catastrophe risk assessment and model evaluation. Ms. Clark developed the first hurricane catastrophe model and in 1987 founded the first catastrophe modeling company, Applied Insurance Research, now AIR Worldwide Corp. She discussed catastrophe modeling issues with Business Insurance Senior Editor Mark A. Hofmann.



## Modeling rests on data

**Q: What's the biggest challenge for modelers?**

The biggest challenge for the modelers is to better inform the model users on the real uncertainty around the underlying science and, therefore, the catastrophe model loss results. The catastrophe models have certainly been refined over the past 20 years, but more detail does not mean more accuracy. And the models will always be inherently limited by limitations in our scientific information and knowledge. So model users need more transparency around this uncertainty, and they can incorporate this scientific unknowledge into their decision-making. There are many vivid examples of this lack of accurate scientific information. Take, for example, Hurricane Andrew. In 2002, 10 years after this storm occurred, the National Hurricane Center upgraded it from a Category 4 hurricane to a Category 5 storm, and they determined that the peak winds were actually 165 mph, rather than 145 mph as they originally estimated in 1992. And that's a 20 mph difference, which is pretty significant. And what's more interesting is that there is still scientific debate about this, with some meteorologists still sticking to the original wind-speed estimates.

**Q: What are the biggest concerns about data quality?**

There are two problems with respect to the data being used to assess catastrophe risk. One is, insurance companies are not collecting the right data. And two, the data they are collecting is frequently inaccurate. Most of the data collection and processing systems used in the insurance industry today were built to capture information relevant to fire risk. These legacy systems and company internal processes were never designed to collect the building-specific information important for quantifying catastrophe risk. Over the past few decades, fire losses per capita have been decreasing while catastrophe losses per capita continue to increase as we build more, bigger and more expensive properties in hazard-prone areas. And even though the catastrophe models are able to utilize detailed building-specific information, very few companies are collecting this information.

**Q: What should—or can—end users do to vet the quality of the information they get from the models?**

Most model users do not have the technical expertise to fully understand all of the scientific details in the catastrophe model black boxes, but that's OK, because it's more important that model users thoroughly vet the quality and credibility of the model output—the loss estimates generated by the models. These are the numbers companies are using to make very important financial decisions, so these numbers should be benchmarked and tested using other credible information. As you probably know, different model results can differ by more than a factor of

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two. And a model update can change portfolio level results by more than 100%. The average annual loss estimates by location that many companies are using for portfolio optimization are subject to even greater uncertainty and volatility.

**Q: Where do you see modeling five or 10 years from now?**

Right now the industry is challenged with garbage in/gospel out. And obviously this needs to change over the next five to 10 years. Catastrophe risk is the risk of the future, and we believe the successful companies of the future will learn how to underwrite and manage this risk much more effectively. More companies need to start thinking outside the black box. Catastrophe models are a useful tool, but they are just that, a tool—and a tool that needs to be used in conjunction with other important information. In 20 years, it's very interesting we've gone from no models/all underwriter judgment to all models/no underwriter judgment. And obviously neither extreme is optimal. And over the next five to 10 years, we need to develop better processes for incorporating all sources of information into underwriting and risk management decisions. And this will also make business strategies more robust and less subject to abrupt changes every time a model changes.

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# Protect workforce to reinstate post-catastrophe operations

*From employees left homeless to those strapped for cash, personal assistance and nontraditional worksites can pay off*

By **NICK WHITFIELD**

Keeping employees safe and productive can be among the most complex aspects of hurricane management.

"We learned from Katrina that we can't expect people to come to work when they don't have a home themselves," said Ralph Tiede, Weston, Mass.-based vp of property loss control for Liberty Mutual Property, a unit of Liberty Mutual Group Inc.

To get employees back on the job after a hurricane, solutions range from the simple to the elaborate.

For many organizations, it's as simple as getting paychecks out.

"The first thing people think about after a storm, after they and their loved ones are safe, is money," said Ron Hayes, risk manager for the Calcasieu Parish School Board in Lake Charles, La.

"We found out after Rita that we had employees who physically picked up their checks," Mr. Hayes said. "We didn't know where they had all evacuated to, and there were some" who were so far outside the state that the district could not get checks to them until much later.

"After that, we made it mandatory that employees have their checks electronically" deposited, Mr. Hayes said. The hope, he said, is that employees will be willing and able to return to work sooner if they are able to pay for their immediate needs.

"After a hurricane, it pretty much becomes a cash economy," said

John Phelps, director-business risk solutions for Blue Cross & Blue Shield of Florida Inc. in Jacksonville. His company has also worked to move employees to electronic deposit of paychecks as part of the insurer's storm preparation.

Mr. Phelps said the Florida Blues also tries to help employees reduce the time they spend out of their homes after a storm.

"We actually host a continuity fest every year where we bring in maybe Home Depot, Lowe's, the Red Cross, and people get giveaways

and tips on how to prepare," Mr. Phelps said.

## *Hot meals and loans*

In the past, Mr. Phelps said the insurer has promoted awareness of home preparation for storms, helped employees arrange temporary housing, served hot meals at company buildings and facilitated loans to employees in need following a weather event, he said.

In the event a facility is damaged, the best plan to keep employees safe and productive might be to keep

them away from the workplace.

Scott Clark, risk and benefits officer for Miami-Dade County Public Schools in Miami, has a unique perspective in planning for a district with 54,000 employees, 93% of whom are unionized with specific rules governing their work conditions. "We have negotiated strategically to find ways for employees to not be out of work, including working remotely when possible," Mr. Clark said.

Businesses with multiple locations have more flexibility. Blue

Cross & Blue Shield of Florida, for example, has a formal plan to get those employees it needs most back to work, Mr. Phelps said. If a facility is damaged, its most critical employees can be moved to another facility, displacing workers whose jobs are less vital or who can work from home.

"We've also improved our teleworking capabilities. Depending on the neighborhoods that are damaged, we have hundreds of employees who can interface with our customers from home," he said.

EVEN IN THE FACE OF FOUR TYPHOONS, THE FORECAST FOR *AMI SEMICONDUCTOR* WAS REMARKABLY



## Wind: Plan in advance for disasters

CONTINUED FROM PREVIOUS PAGE

said.

In addition to securing the supply chain after a storm, risk managers with hurricane exposures have learned the importance of securing needed repair contracts well in advance of a storm.

"What they don't want (to do) is to wait until it happens, because at that point it's all about supply and demand and they'll be last on the list," Liberty Mutual's Mr. Tiede said.

When Hurricane Rita hit in 2005, Ron Hayes, risk manager for the Calcasieu Parish School Board in Lake Charles, La., had to deal with just such a shortage. In the scramble to rebuild after the storm, prices rose and the school district shopped for repair services in a seller's market.

"There were surprises after Rita," Mr. Hayes said. "We brought in people we weren't familiar with, and we weren't familiar with their rates and fees. That taught us a lesson, and that's that you go into it with your relationships already in place."



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Despite damage to its facility, a Home Depot in Stuart, Fla., was open in early September 2004 for those seeking materials following Hurricane Frances. ZUMA PRESS

# Hurricane lessons of 2004, 2005 spur 'demand surge' model changes

Data differentiated storm damage from soaring repair and services costs

By **ROBERTO CENICEROS**

Today's catastrophe models incorporate a better understanding U.S. "demand surge" than 2004 and 2005, when a series of hurricanes revealed weaknesses in the tools, observers say.

Demand surge refers to price inflation for scarce construction materials, labor and services follow-

ing a significant disaster. The more widespread the damage, the greater the price for the rebuilding resources.

Demand surge costs are influenced by the inability to have resources simultaneously available when damage is widespread, said David Lalonde, senior vp in the Toronto office of catastrophe modeler AIR Worldwide Corp.

The magnitude of the 2004 and 2005 storm losses and the events' close proximity provided catastrophe modeling companies with data on inflation-driven losses they never had before, several observers agreed.

That data led to model improvements of demand surge's potential effect on property and business interruption losses.

The storms also shattered some earlier thinking.

Pre-2004 catastrophe models allowed insurers to estimate their exposure to demand surge losses, but only on single events, said John DeMartini, a principal at Towers Perrin in Stamford, Conn.

Then four very significant events struck Florida in 2004, making it the first time one state experienced that many hurricanes during a single season since 1886 in Texas, according to the U.S. National Climatic Data Center.

The Florida storms compounded demand pressure on finite building materials, supplies and contractors. Then in October 2005, Hurricane Wilma battered Florida again while building contractors were already in short supply because of the 2004 storms.

"The frequency of events is what really caught everybody off-guard," Mr. DeMartini said.

Six hurricanes that hit the United States during 2005, including Katrina, caused estimated insured property losses of \$58.34 billion, according to Gary Kerney, assistant vp at the Property Claim Services unit of Jersey City, N.J.-based Insurance Services Offices Inc. That easily surpassed the \$22.9 billion in estimated insured losses just one year before, when five hurricanes struck the U.S. mainland.

Those storms provided catastrophe modeling companies with new claims data differentiating losses actually paid by insurers and damage that engineers on the ground observed as result of demand surge, which previous models couldn't adequately decipher, Mr. DeMartini said.

Because of previous models' limitations in estimating demand surge exposures, some insurers found they hadn't purchased sufficient reinsurance when the hurricanes of 2004 and 2005 hit, Mr. DeMartini said.

Claims settlement delays and disputes also arose with insureds because of discrepancies between contractors' repair quotes and claims adjusters' assumptions about reasonable settlement amounts.

And when 2006 catastrophe models were released with data gleaned from the 2004 and 2005 storms, the results shocked insurers. They had "very, very tough decisions to make with regard to the retention and limit of their catastrophe programs based on the new



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model results," Mr. DeMartini said.

Policyholders felt the consequences. Catastrophe property insurance capacity tightened and pricing increased as insurers adjusted for new, higher estimations for potential demand surge losses (*BI* June 12, 2006).

There were other problems revealed by the 2004 and 2005 storms. Some insurers were caught off-guard by their hurricane losses because they had run probable maximum loss estimations with the catastrophe models' demand surge function turned off, several observers said.

But because of lessons learned from the 2004 and 2005 events, insurers and rating agencies that review their capital adequacy are much less willing to settle for probable maximum loss estimates that are derived without including demand-surge costs, said John Iten, a director at Standard & Poor's Corp. in New York.

Today's models are also improved because the aggregation of the 2004 Florida storms provided enormous amounts of new economic and time-series data on rebuilding cost increases, AIR's Mr. Lalonde said.

That allowed modeling companies to validate their existing knowledge about demand surge and refine their products, he said.

With tens of billions of dollars in claims data from the 2004 and 2005 storms, models became "dramatically better" at forecasting demand surge, agreed Christine Ziehmman, director for product management, Americas model management in the London office of Newark, Calif.-based Risk Management Solutions Inc.

Before 2004, it was more difficult to quantify demand surge, she said. "We are now in a much better position to model and understand the extent of demand surge," Ms. Ziehmman said.

For instance, RMS now has a better understanding of costs associated with "loss amplification" that can occur when large events overwhelm insurers and their adjusters, she said. Claims inflation can occur under such conditions when insurers hurry to close claims and include damage not insured under their policies.

Thanks to Hurricane Katrina, catastrophe modelers also have a better understanding of how one event can trigger others. Katrina, for instance, triggered flooding.

**'The experience of 2004 and 2005 was mainly confined to Florida and the Gulf region. If there is a major hurricane that affects the Northeast, the demand surge and escalated costs could be quite different.'**

Julie Serakos, Willis Re

But while 2004 and 2005 data provided better measurements and pricing information for demand-

surge losses, catastrophe modeling companies possess various levels of sophistication in their understanding of demand surge, said Julie Serakos, executive vp in Minneapolis for the catastrophe management services of Willis Re, a unit of Willis Group Holdings Ltd.

And all of the catastrophe models still have room for improvement. For instance, there has been no major earthquake in the United States since 2005, so modelers have not had an opportunity to study demand surge stemming that type of event.

Claims data from 2004 and 2005 hurricanes may not apply precisely to earthquake losses, Ms. Serakos said. "Although we can draw a lot of conclusions from a hurricane, we

don't have the real empirical data on the earthquake side to be able to make a real confident estimate," Ms. Serakos said.

Other observers agree that differences would be likely. Earthquakes typically cause more structural damage compared to the roofing and siding that hurricanes more often rip away from buildings, they said.

Regional differences also limit the application of knowledge gleaned from past storms.

"The experience of 2004 and 2005 was mainly confined to Florida and the Gulf region," Ms. Serakos said. "If there is a major hurricane that affects the Northeast, the demand surge and escalated costs could be quite different."

## Obstacles? Opportunities.



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# Global firms aim to implement consistent loss-control culture

*Employers should educate foreign staff on loss control issues*

By MARK A. HOFMANN

Sometimes, the North American emphasis on property loss control gets lost in translation as risk managers work to protect overseas operations.

Where U.S. and Canadian risk managers stress minimizing physical loss as well as promoting life safety, they sometimes find that their international operations follow a different culture of loss control—or perhaps have none at all. That means promoting a comprehensive loss control culture presents a series of hurdles, experts say.

“Loss prevention is really challenging in these emerging markets,” said Tom Lawson, senior vp-engineering and research for Johnston, R.I.-based Factory Mutual Insurance Co., which does business as FM Global. “In a lot of places, there’s a lack of codes. You combine that with sometimes a lack of infrastructure and, lastly, there’s often a lack of a loss prevention culture or lack of acceptance of a loss protection culture.”

“I think the U.S. culture is much more stringent in regards to the

physical loss of sprinklers, fire extinguishers, meeting building codes and meeting regulator requirements for protecting the physical asset itself,” said Lance Ewing, vp-risk management for Harrah’s Entertainment Inc. in Cordova, Tenn. “In other countries, some cultures are much more lenient in regard to protecting the property. We have to instill upon those locations that their assets are just as valuable as those in the U.S.,” he said.

“We are engaging our insurance companies to assist in this engineering process by helping us to make inspections of the properties along with the local management group,” said Mr. Ewing.

Harrah’s has operations in countries as diverse as Macau, Uruguay and South Africa, among others.

Another risk manager with international exposures pointed to differences in fire and building codes as an explanation for the difference in loss control cultures.

“The biggest challenge is you have local management that is dealing with local fire and building authorities, and the differences between risk management-oriented property protection and the property protection requirements of local codes are drastically different,” said Jeff Gehrke, vp-risk and insurance management for office product supplier Corporate Express in Broom-

field, Colo.

“Generally, local codes are based on life safety, so the interest of the local code is simply to get the people out of a burning building. The risk management ethic related to property protection is to protect the overall continuation of your business, not the least of which is the people,” Mr. Gehrke said.

“It’s the view of our company on a worldwide basis that fire behaves the same in Brisbane as it does in Baltimore or Birmingham,” said Mr. Gehrke. “It’s for that reason that any company needs to determine what its standards of protection will be and then apply those universally throughout the enterprise. It could be fire, hurricane, tornado, flood—all of these behave the same without regard to political jurisdiction.”

FM Global’s Mr. Lawson also stressed the need for consistency across borders.

“The starting point is you want to hold your subsidiaries to the same level as your North American or European operations,” Mr. Lawson said. “You wouldn’t give people options on cash management. The same things should apply with risk management.”

The approaches to property loss control have varied considerably, noted Joe Stavish, senior vp-property risk control at Willis Group Holdings Ltd.’s Willis Risk Solutions in

Florham Park, N.J. While North Americans embraced the highly protected risk concept, Europeans focused on prevention, loss containment and manual fighting of fires, he said. This included physical separation of assets rather than relying on sprinkler and foam systems. Europeans focused on the human aspects of loss prevention, which reflected a lack of physical infrastructure to support water-suppression systems.

But in less-developed countries, risk managers face facilities that lack physical fire protection and cultures that have not “embraced a loss control mentality,” said Mr. Stavish. Managers adhere to local codes that stress life safety rather than property conservation, he said. As a result, managers “may sprinkle a small office building but leave a large warehouse” unprotected.

“The transition is one of education and orientation,” Mr. Stavish said. Some North American companies have the overseas resources to educate foreign employees about loss control. Others may rely on brokers, he said.

Getting upper management to buy in to the loss-control culture is critical as well, said Steve Goodman, director-property risk control-east sector, Aon Global Risk Consulting in New York.

“The risk management team typi-

cally has a budget for insurance, but they don’t typically have a budget for risk improvement,” Mr. Goodman said. Risk managers have to appeal to upper management to spend the money to upgrade facilities and build new ones at “perhaps a higher standard than what’s required locally,” he said.

“It’s not always easy. Companies want to spend money where they see an immediate return on investment,” said Mr. Goodman.

He said Aon arms its clients with an array of arguments to promote property loss control, including the effect of lost market share. Insurance can cover business interruption, but it doesn’t bring customers back who switch to a competitor’s product while a manufacturer’s facility is closed, he said.

“We appeal to the decision-makers to spend the money upfront, to protect their assets and facilities that have these significant exposures to their income,” Mr. Goodman said.

But even that isn’t always enough. Risk managers who make a commitment to provide a higher level of protection can run into issues involving corruption, lack of local technical expertise and general mismanagement, he said.

“The best intentions don’t always reach the expected results,” Mr. Goodman said. “All of this requires a huge investment in oversight.”



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## Market Moves

### TPA acquires benefits firm

**MEMPHIS, Tenn.**—Mutual Assurance Administrators Inc., a third-party administrator focusing on claims administration for self-funded benefit plans in Oklahoma City, has acquired employee benefits firm and TPA Pittman & Associates Inc. in Memphis, Tenn.

As a result from the acquisition, Mutual Assurance now operates five TPAs in Arkansas, Missouri, Oklahoma, Tennessee and Texas. Pittman & Associates will continue operating under that name. Existing staff will remain in place and business operations will remain unchanged, the companies said in a statement.

Mutual Assurance also offers Utilization Review Accreditation Commission-accredited medical management programs, flexible spending account administration and workers compensation administration.

URAC is an independent non-profit that promotes health care quality through accreditation and education programs

### Broker Hylant opens office in Chicago

**CHICAGO**—Hylant Group, a Toledo, Ohio-based commercial insurance brokerage, has expanded to the Chicago market.

The privately held firm opened its 12th U.S. office at 303 W. Madison St., Suite 700, Chicago, IL 60606. The office can be reached by phone at 312-283-1350 and by fax at 312-283-1351. Thomas O'Connell has been named president of the Chicago office.

Hylant also has offices in Bloomington, Fort Wayne and Indianapolis, Ind.; Ann Arbor, Detroit and Grand Rapids, Mich.; Cincinnati, Cleveland, Dublin and Toledo, Ohio; and Nashville, Tenn.

### Canada's CGI selling unit to Shumka Group

**MONTREAL**—CGI Group Inc., an information technology and busi-

ness process services firm based in Montreal, said it will sell its unit that provides Canadian property/casualty claims adjusting and risk management services to the Shumka Group of Cos.

The Shumka Group is a large privately owned claims management services provider in Edmonton, Alberta.

CGI said the sale is expected to close in August. The unit's revenue is estimated at \$70 million.

### AlphaStaff partners with Zurich on workers comp

**FORT LAUDERDALE, Fla.**—Human resource outsourcing company AlphaStaff Group Inc. has forged a partnership with Schaumburg, Ill.-

based commercial property/casualty insurance provider Zurich North America and now will offer Zurich's 50-state workers compensation coverage to its clients.

AlphaStaff, which is based in Fort Lauderdale, Fla., said it has grown from 7,000 worksite employees to approximately 50,000 worksite employees during the past five years.

### United National picks N.C. for principal U.S. office

**CHARLOTTE, N.C.**—United America Indemnity Ltd. said it has established a Charlotte, N.C., office to handle the U.S. operations of United National Group, one of three divisions that are operated by the

Georgetown, Cayman Islands-based insurer.

With the addition of the North Carolina office, UAI's U.S. businesses have facilities in six states.

Scott Reynolds, who recently was appointed president of the division, will be based in Charlotte.

Most recently, Mr. Reynolds was president of the specialty underwriting division of AmWINS Group Inc.

### CPA launches forensic accounting firm

**MUNDELEIN, Ill.**—The president of the Illinois chapter of the National Assn. of Certified Valuation Analysts announced he is launching a forensic accounting firm that

provides forensic accounting as well as auditing, business valuation, litigation and expert witness services.

Joseph Modica & Associates Ltd. in Mundelein, Ill., will be led by Joseph Modica, who is president of the self-named firm.

Mr. Modica most recently worked for certified public accounting firm Dam, Snell & Taveirne Ltd., supporting small and midsize businesses with valuation, forensic accounting, litigation and damage calculation services.

The firm is located at 111 W. Maple Ave., Suite B, Mundelein, Ill. 60060.

Mr. Modica may be reached by phone at 847-566-2240 or by e-mail at [joem@jmodicacpa.com](mailto:joem@jmodicacpa.com).



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# Agreement: Sparks ongoing dispute among contractors, subcontractors

CONTINUED FROM PAGE 4

week's ruling, it was unclear whether subcontractors in construction hold-harmless agreements had similar obligations.

"No one was really quite sure what the duty of the person giving the hold harmless (agreement) was," Mr. Goodwin said. "Were they kind of an insurance company? Were they something less?"

Weather Shield argued that large developers use superior bargaining power to unfairly shift their liability onto faultless subcontractors that, unlike liability insurers, lack a staff of

attorneys.

The high court, however, said Weather Shield's multistate operations undermined assertions that it lacked sophistication. It said Weather Shield's subcontract imposed a defense duty as soon as a suit was filed against JMP.

Similar hold-harmless agreements have sparked disputes between contractors and subcontractors over obligations to pay for lawsuits filed across California, which has a 10-year statute of repose for home construction defect claims, attorneys said.

Until the early part of the decade, homebuilders commonly employed

a two-part risk management practice, said John O'Hara, a partner at Newmeyer & Dillion L.L.P. in Newport Beach, Calif., which filed an amicus brief on behalf of six builders.

The builders first obtained a defense and indemnity agreement from subcontractors. They also required subcontractors to name them as additional insureds on the subcontractor's liability policies, Mr. O'Hara said.

"It's like a belt and suspenders insurance risk management program," he said. "(The Supreme Court) decision will bolster the first

component, which is the contractual duty to defend."

But around 2002, homebuilders began using owner-controlled insurance programs that also cover their subcontractors, attorneys said.

Under OCIPs, contractors and subcontractors typically mount a joint defense against construction defect claims, said George Dale, chief executive officer of DBH Resources, a risk management consultant in El Segundo, Calif.

Additionally, a California homeowner construction defect law that became effective this year narrowed homebuilders' ability to shift risk

onto subcontractors, said Tami Boeck, a partner and construction expert in Sacramento, Calif., for Bullivant Houser Bailey P.C.

While last week's decision will apply mainly to older agreements, "there are still a live body of disputes in court now and (more) coming up," Ms. Boeck said.

Courts in other states have yet to rule on the matter, but are likely to do so, attorneys said.

*Kirk Crawford et al. vs. Weather Shield Manufacturing Inc. et al., California Supreme Court, S141541, July 21, 2008.*

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# International NEWS

## Space market rates rise, but less than expected

*Despite losses, market operating 'at two speeds'*

By **STACY SHAPIRO**

The space insurance market is not demanding the stellar rate increases some brokers and underwriters were predicting earlier this year.

Although some satellite launch and in-orbit losses have continued to trickle in over the past few months—which normally would give rise to premium increases—these losses have not caused the space insurance market to increase rates exponentially.

market has seen several losses this year, but the market is not in bad shape, and capacity is still high," said Peter Elson, senior managing director of Aon Space at London-based Aon Ltd., which is a division of Aon Corp.

Although insured space claims of \$840 million surpassed space insurance premiums of \$660 million in 2007, "working" insurance capacity for each satellite launch is still \$532.7 million this year, and \$445 million for each new in-orbit policy, according to Aon statistics as of the beginning of July.

"The market is operating at two speeds at the moment," said Mr. Elson. "On the satellite launch side, insurers have increased rates by about 20% from what those rates were last year...Insurers are also seeking to differentiate between risks, so satellites on some launch vehicles are seeing bigger rate increases than others," he said.

Satellite in-orbit rates, however, are either the same or reducing as a result of a continued surplus of capacity, said Mr. Elson. In-orbit insurance "pricing has reduced significantly in the past 18 to 24 months," he said. Normally, in-orbit insurance rates are less than 2% of the insured value of the spacecraft, and many operators self-insure their satellite in-orbit.

Others agree that satellite launch rates are not significantly higher than last year, considering the losses that have occurred.

"The losses appear to have had a minimal effect on rates," said one space underwriter who did not wish to be named. "It is a very competitive market, and with the delay in launches caused by the losses, insurers are quoting lower prices to keep the premium flow coming."

As of the beginning of July, 2008 premiums of \$410 million have outstripped claims of \$290 million in the space insurance market, according to Aon statistics.



LANDOV

A Fengyun-3 satellite was launched in May from Shanxi Province, the second such weather forecasting satellite to aid forecasters for the Beijing Olympic Games.

In fact, current satellite launch insurance rates are nowhere near the 14% or 15% of insured value range that experts were predicting just a few months ago for the rest of the year, experts agree. They are more like the 10% or 11% that satellite operators were being charged last year, according to the experts.

"Overall, the (space insurance)

## London MGA challenges borough's right to place cover with mutual

*Issues raised include whether such U.K. public entities must seek bids*

By **STUART COLLINS**

Legal wrangling over how public sector organizations use mutual insurers is set to take the European stage, as one insurer brings the issue to the European Court of Justice.

Earlier this year, the United Kingdom's High Court sided with public sector insurance provider Risk Management Partners Ltd., which challenged the London Borough of Brent over its participation in the London Authorities Mutual Ltd., the mutual insurer established last year to provide property and casualty coverage to local authorities in the capital.

Interest in public sector mutual insurers was renewed last year with the launch of the London Authorities Mutual and the creation of the Fire & Rescue Mutual Ltd. Plans were also announced for the creation of the Councils Alternative Risk & Insurance Group, a second local authority mutual insurer.

But one insurance provider, concerned that insurers would be excluded from the public sector insurance market, challenged the use of such mutual insurers and began legal proceedings in May last year.

Risk Management Partners brought two complaints against the London Borough of Brent, the London Borough of Harrow and the London Authorities Mutual. The complaint challenged whether Brent—under its statutory powers—had the right to join the mutual insurer, and whether it should have followed European rules that require public sector entities to put large procurement contracts out to bid.

Risk Management Partners—a London-based managing general agency owned by Itasca, Ill.-based Arthur J Gallagher & Co., with capacity provided by American International Group Inc.—has no general objection to local authori-

ties participating in mutual insurers, said Jolyon Patten, London-based partner at Manchester, England-based law firm Halliwells L.L.P., which represented Risk Management Partners in the case.

In two decisions, the judge upheld Risk Management Partners' complaints, Mr. Patten said. There were two parts to the claim, he explained. First, that Brent had acted ultra vires—beyond the scope of its own charter—in that its participation in the mutual insurer was outside the powers granted by Parliament. And even if participation were within its powers, it was not entitled to sidestep the Public Contract Regulations 2006—rules that enact certain E.U. public sector procurement laws—which require contracts of large enough size to be put to an open tender, he said.

Following the court's declaration that Brent's participation in the

See **MUTUAL** next page



AFP PHOTO/PATRICK LIN

Typhoon Fung-Wong, which means "phoenix" in Chinese, hit portions of Taiwan (above) and China last week, causing damage, flooding and some deaths.

## Typhoon insured losses put at less than \$100 million

Typhoon Fung-Wong is likely to cause less than \$100 million in insured losses in Taiwan, catastrophe modeler AIR Worldwide Corp. estimated last week.

The typhoon hit central Taiwan early last week, packing

winds of 100 mph, according to Boston-based AIR. Some affected areas received more than 2 feet of rain, and more than 150,000 households lost power.

The typhoon then hit China's Fujian Province, with maximum

sustained winds of 74 mph.

Fung-Wong was the eighth northwest Pacific basin tropical cyclone of 2008 and the second to hit Taiwan in two weeks, AIR said.

—By Mark A. Hofmann

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**'We're encouraged by Sen. Dodd's suggestion that a package of bills including the Nonadmitted Reinsurance Reform Act and perhaps the Insurance Information Act could possibly move in this Congress.'**

Frank Nutter, Reinsurance Assn. of America



**'We're always encouraged when House and Senate committees want to move on meaningful insurance reform.'**

Leigh Ann Pusey, American Insurance Assn.

## Reform: Congress running short on time

CONTINUED FROM PAGE 3

the property/casualty insurance industry as well as risk managers, welcomed Sen. Dodd's comments.

"We're encouraged by Sen. Dodd's suggestion that a package of bills including the Nonadmitted and Reinsurance Reform Act and perhaps the Insurance Information Act could possibly move in this Congress," Frank Nutter, president of the Washington-based Reinsurance Assn. of America, said after testifying at the hearing.

"Neither standing alone is sufficient, but together they would be a dramatic improvement in insurance regulation," he said.

Another witness, Richard Bouhan, executive director of the Kansas City, Mo.-based National Assn. of Professional Surplus Lines Offices, said he was "very encouraged" by Sen. Dodd's remarks about

the reinsurance and surplus lines reform bill. But he pointed out that, as Sen. Dodd observed during the hearing, that the problem is time constraints.

"As enthusiastic backers of that legislation, we couldn't have been more pleased with the chairman's comments and apparent determination to get some regulatory work done this year," said Joel Wood, senior vp of the Council of Insurance Agents & Brokers in Washington.

"We've got a fighting chance on the surplus lines bill," said Mr. Wood, who added that Sen. Dodd was "exactly correct" in stressing time concerns.

"But given the range of extremes on every other insurance regulatory issue, it's gratifying an obvious consensus exists with respect to the surplus lines legislation," Mr. Wood said. "This isn't horseshoes—

we still have to have full Senate action. We're close, but we're not there yet."

Other observers stressed the desirability of broad reform.

"We're always encouraged when House and Senate committees want to move on meaningful insurance reform," said Leigh Ann Pusey, chief operating officer of the Washington-based American Insurance Assn.

She added that the AIA would prefer comprehensive legislation.

Alessandro Iuppa, Washington-based senior vp-government and industry affairs for Zurich North America, made the same point.

"They're going to be better served by comprehensive reform," said Mr. Iuppa, a former president of the National Assn. of Insurance Commissioners who presented AIA's concerns to the banking committee last week.

## Mutual: U.K. public entities face legal challenges

CONTINUED FROM PREVIOUS PAGE

London Authorities Mutual was outside the scope of its charter, Brent has placed its coverages in the open market, said Martin Fone, chief executive of Charles Taylor Consulting Ltd.'s nonmarine mutuals department in London, which manages this mutual.

Final decisions on whether a local authority has the statutory power to participate in a mutual insurer, and whether local authorities are exempt from the U.K.'s Public Contract Regulations of 2006, will have to wait until they are heard by the

Court of Appeal before February, and could go on to the House of Lords or the European Court of Justice, Mr. Patten said.

The London Authority Mutual members are resisting Halliwells' application for the procurement

**'I do not think that it follows' that 'no local authority has the power to participate in the London Authorities Mutual.'**

Lord Justice Burnton, U.K. High Court

case to be referred to the European Court of Justice, Mr. Fone said.

The High Court's recent decisions do not spell the end of public sector mutual insurers in the United Kingdom, as the particulars the Brent case do not mean that it is illegal for local authorities to participate in insurance mutuals, experts say.

Section 2 of the Local Government Act gives local authorities wide powers to take part in activities that benefit their local communities, Halliwells' Mr. Patten said. But while Lord Justice Stanley Burnton's judgment in April argued that the premium savings Brent attributed to its participation in the mutual insurer were not to the benefit of the community, the same may not be true of other local authorities, he said.

"I do not think that it follows from my above finding that no local authority has the power to participate in The London Authorities Mutual," Lord Justice Burnton wrote in his judgment. He added that local authorities that purchased risk management services from the insurer could also enter a contract of insurance with the same company.

## Massachusetts: Officials levy assessments

CONTINUED FROM PAGE 4

That program, which was created by the state's 2006 health care coverage reform law, subsidizes health insurance premiums for roughly 175,000 previously uninsured lower-income state residents.

If revenues from the tightening of the rule didn't generate \$38 million in revenue, Gov. Patrick had proposed that legislators give a state agency authority to raise the \$295 assessment to a level it projected would meet that target.

But the state's House and Senate declined to include the governor's proposal in budget legislation they approved last week.

Legislators, though, did adopt proposals that levy assessments of \$33 million on health insurers and \$20 million on hospitals, and a proposal to divert \$35 million from an employer-paid fund that pays health insurance premiums for the unemployed. Those funds would be

used to help support Commonwealth Care.

The legislation, however, does require employers to report their

**Reporting employees quarterly is 'a large administrative burden for all business owners.'**

Bill Vernon, National Federation of Independent Business

number of employees on a quarterly—rather than the previous annual—basis, pointed out Bill Vernon, state director of the National Federation of Independent Business in Boston. That is "a large administrative burden for all business owners," he said. And because the number of

employees in some businesses fluctuates during the year, some might pay fees some quarters that they would not have on an annual reporting basis, he said.

Business lobbyists have already warned that they expect Gov. Patrick to propose a tightening of the fair share test through regulation (BI, July 21).

Under the current rule, an employer is exempt from the annual assessment if at least 25% of full-time employees are enrolled in its group health insurance plans.

If that primary test is not met, employers that pass a secondary test—by paying at least 33% of the premium for individual coverage for employees within 90 days of their starting work—are exempt.

Gov. Patrick has proposed that employers be required to pass both tests to be exempt from the \$295 assessment. According to business groups, this change would result in more employers, such as those in

## Settlement: PBM, insurer to pay \$27M

CONTINUED FROM PAGE 3

Scripts:

- Inflated the cost of generic drugs.
- Kept millions of dollars in manufacturer rebates that belonged to the plan.
- Engaged in fraud and deception to induce physicians to switch patients from one prescribed drug to another for which Express Scripts received money from the second drug's manufacturer.
- Sold and licensed Empire Plan data to drug manufacturers, data collection services and others without the plan's permission and in violation of the state's contract.
- Induced the state to enter into the contract by misrepresenting discounts the plan would receive for drugs purchased at retail pharmacies.

New York Attorney General Andrew Cuomo said the settlement

will help prevent PBMs in New York state from engaging in drug switching.

"At a time when New Yorkers are struggling to pay rising health care premiums, today's landmark \$27 million agreement cracks down on PBMs that put profits ahead of patients," Mr. Cuomo said in a statement.

Express Scripts also must make its business practices transparent to health organizations and consumers under the settlement, according to the attorney general's office. It is required to disclose its pricing methods, payments received from manufacturers, the percentage of manufacturer payments it retains, factors it uses to calculate targeted discount rates and the current discount rate for each generic drug.

In May, Express Scripts and 28 state attorneys general and the District of Columbia reached a separate

settlement that also involved switching prescription drugs. Express Scripts agreed to pay \$9.3 million to the states and reimburse up to \$200,000 to patients who incurred expenses related to the prescription switches (BI, June 2).

Similar to the New York case, the PBM may have overstated to physicians and patients the cost benefits of switching medications. The company then would obtain rebates and other payments that it allegedly kept rather than passing on the savings to patients, the lawsuits stated.

A spokeswoman for Express Scripts said its "business practices already comply with essentially all requirements of the settlement" and that neither the May agreement nor the recent New York settlement will affect its second-quarter or future earnings because it already has reserved the necessary funds.

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A top forensic accountant and consultant offers tips on managing business interruption risks.

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## A Spotlight Report

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# FEMA: Agency's modified approach unclear to some public entities

CONTINUED FROM PAGE 1

County Regional Airport Authority. "I respect the fact that they are the experts on the Stafford Act, but I didn't see that in the Stafford Act at all."

"There is a huge misunderstanding among risk managers with how this works," said Nancy Sylvester, the Baton Rouge, La.-based co-managing director of the Public Entities & Scholastic Division at Arthur J. Gallagher & Co. Ms. Sylvester said she and risk management clients

did not understand from a FEMA official's explanation how much the agency intended to reduce second and subsequent aid payments.

Other brokers thought the policy applies only to property damaged during flooding, even though it applies to damage caused by any kind of catastrophe that the president declares a national disaster.

In addition, more than two months after FEMA issued its revised statement on financial assistance, the agency's message had not gotten to many public entities.

While a National League of Cities representative said last year that a line of communications had been established with FEMA to ensure that the agency considered public entities' input, an NLC official in late July said the organization was unaware of the latest development.

"It sends alarm bells because of the shift in burden" that FEMA's policy would place on public entities, the "same as before" the agency backed off of its position last year, said Mitchel Herckis, senior legislative counsel in Washington for the NLC.

The Alexandria, Va.-based Public Risk Management Assn. was aware that FEMA was modifying its position and arranged for an agency official to speak at a Louisiana chapter conference in April and the organization's national meeting in Anaheim, Calif., in June.

Incoming PRIMA President Ron Hayes said the agency is making a concerted effort to educate risk managers, but still "FEMA is doing the same thing" it attempted last year.

A FEMA official maintains that the agency is not changing how financial assistance to public entities works. Instead, FEMA merely is trying to apply the Stafford Act uniformly and as Congress intended, said James Walke, the Washington-based director of FEMA's Public

Assistance Division, which is part of the Disaster Assistance Directorate at the U.S. Department of Homeland Security.

That means that after FEMA has covered the uninsured damages that a public entity sustained in a national disaster, the agency would limit its future assistance to that entity if its same properties were damaged in a subsequent disaster of the same nature.

Under FEMA's formula, a public entity would be eligible for federal assistance after the second disaster only to the extent that the entity's insurance deductible for that second loss exceeds the entity's total damage in the first disaster—regardless how much of it FEMA had covered—and only if the damage total from the second disaster exceeds the earlier loss (see related story).

In addition, before receiving FEMA aid after the first loss, a public entity would have to demonstrate that it has insurance to cover a subsequent loss caused by the same type of peril.

That is a problem for many public entities, because flood, windstorm and earthquake insurance are budget busters in catastrophe-prone regions such as Florida, the Gulf Coast and California, brokers report.

Public entities unable to obtain adequate coverage can avoid losing federal assistance if their state insurance department will certify that the FEMA-required coverage is not reasonably available. That would include when either market capacity is inadequate or available capacity is unaffordable.

Nearly a year after Louisiana Insurance Commissioner James J. Donelon submitted a global certification plan to the Bush administration, the Louisiana Insurance Department was hoping to obtain final FEMA approval for it the last week of July, according to Warren Byrd, executive counsel at the department. The plan would establish the percentage of its budget that a public entity would have to dedicate to property insurance before claiming that purchasing additional coverage would be unaffordable.

Regulators in Florida, Mississippi and California examine applications for certifications on a case-by-case basis, depending on, among other things, an applicant's efforts to procure coverage and the quoted premiums, according to regulators in those states.

But regulators in Iowa, where towns including Cedar Rapids and Des Moines flooded this summer, "don't have a handle on how this certification is supposed to occur," an Iowa Insurance Department spokesman said. He said the department would begin examining how the process should work.

None of this would matter, however, if the same properties were damaged in different types of disasters—for example, a flood one year

followed by an earthquake the next year—or if different properties were damaged in separate disasters of the same nature.

"This is the way we've meant it to work," FEMA's Mr. Walke said.

"I can't say this is how we've done it in the past," because FEMA previously had not conducted audits to ensure that the agency provided financial assistance consistently across the country, he said.

But now, "we're trying to make this as clear as we can and reach as many people as we can," Mr. Walke

said. "Whether everyone agrees with it is another matter."

FEMA's new approach "could really impact us," said PRIMA's Mr. Hayes, risk manager for the Calcasieu Parish School Board in Lake Charles, La., about 50 miles from the Gulf Coast. The school board's property sustained about \$24 million of damage in Hurricane Rita in 2005, and the board recovered nearly \$13 million of assistance from FEMA, Mr. Hayes said.

Without additional education about FEMA's financial assistance plan, "it's going to be a bitter lesson, I think" for risk managers who expect their aid in subsequent disasters would be reduced only by the previous aid FEMA provided.

Under FEMA's recently announced method for calculating aid, the agency would reduce assistance it would offer the school board after its next flood loss—assuming the same buildings were damaged—by \$24 million, not the \$13 million of aid FEMA provided.

"It's a much bigger number" than risk managers expect, said Gallagher's Ms. Sylvester, who is Mr. Hayes' broker. "People don't realize it."

Like hundreds of other public entity risk managers in Louisiana, Mr. Hayes is awaiting his certification letter that would waive FEMA's flood insurance requirement.

If a second disaster hits an area before a risk manager's pending waiver request is approved, "we'll just deal with that on a case-by-case basis," with "due consideration" given to the waiver process that was under way at the time, Mr. Walke said.

Despite the concern that risk managers and brokers are raising about FEMA's policy, one regulator raised doubts whether some public entities—especially school districts—have much to fear.

"FEMA's checkbook is Congress' checkbook," said Mississippi Insurance Commissioner and State Fire Marshall Mike Chaney. "Congress has the right to reverse that. Will Congress stand firm with that? I don't know."



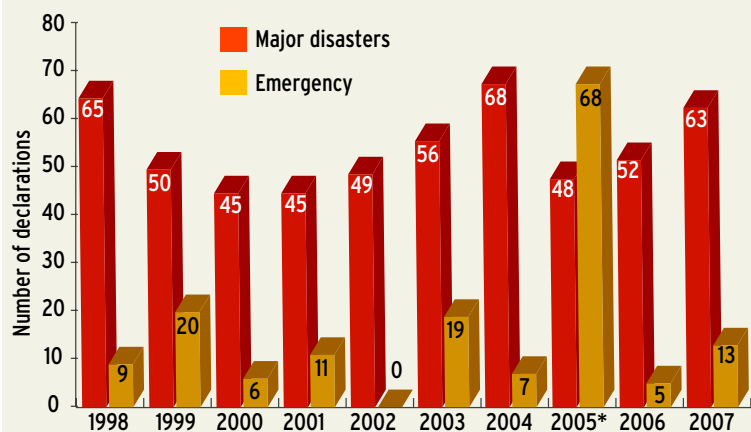
FEMA

**'We're trying to make this as clear as we can and reach as many people as we can.'**

James Walke, FEMA

## A DECADE OF PRESIDENTIAL DECLARATIONS

Declaration of both major disaster and emergency situations triggering FEMA's public assistance program, per calendar year.



\*Hurricane Katrina and Rita related emergencies

Source: FEMA

## FEMA's modified formula for calculating aid limits assistance if a second loss occurs

After the Federal Emergency Management Agency has covered uninsured damage that a public entity sustained in a national disaster, it will limit its future assistance to that entity if the same properties are damaged in a subsequent disaster of the same nature.

After a second flood loss, for example, a public entity's eligible FEMA assistance would be reduced by the amount of damage that the entity's property sustained in the first flood—even if the deductible that FEMA previously covered was a small fraction of that first loss.

As a result, FEMA would assist a public entity suffering a second loss only to the extent that the entity's insurance deductible for that second loss exceeds the entity's total damage in the first disaster and only if its second loss exceeds the earlier loss.

In all cases, FEMA's assistance would total 75% of the eligible damage on which aid would be calculated.

According to James Walke, the Washington-based director of FEMA's Public Assistance Division, this is how the agency would determine the level of assistance it would provide a public entity damaged in catastrophes that the president declares national disasters: Both

disasters would have to be of the same nature—both floods or both earthquakes, for example. In addition, the same properties have to be damaged in each disaster, which brokers say is fairly common in catastrophe-prone areas.

In the first disaster, the public entity sustains \$10 million of damage. It has \$30 million of insurance with a \$5 million deductible. FEMA would pay the deductible. The agency also would require proof that the public entity had insurance for a second loss before releasing the aid.

In addition, if the loss was due to a flood and the properties were located in special hazard zones, FEMA's aid would be reduced by the available National Flood Insurance Program limits—regardless of whether the public entity purchased the NFIP coverage. The NFIP offers \$500,000 of limits for building damage and \$500,000 of limits for contents.

If the public entity maintains the same insurance program and sustains a second \$10 million loss, FEMA would not provide any financial assistance, because the \$10 million of total damage from the first loss would exceed the public entity's \$5 million deductible for the second loss.

Even if the public entity had a higher deductible for the second loss but total damage in that loss was less than in the first disaster, FEMA would not provide any assistance. For example, a public entity would be ineligible for FEMA aid after a second disaster that caused \$8 million of damage, even if the entity's deductible was \$20 million.

However, if in the second loss the public entity sustains \$14 million of damage and has a \$12 million deductible, FEMA would cover \$2 million of the loss. That aid would be calculated by subtracting the \$10 million of total damage in the first disaster from the public entity's \$12 million deductible for the second loss.

If the public entity sustained damage in a third disaster of the same nature, FEMA would use the greater of the two damage totals from the first two disasters in determining the amount of aid it would provide the public entity.

FEMA would waive its insurance requirements for inadequately insured public entities that sustain damage in subsequent disasters if the entities had obtained a certification from their state regulator that the insurance FEMA required was not reasonably available.

—By Dave Lenckus

# XL: Commutation deal with SCA relieves pressure on insurer

CONTINUED FROM PAGE 1

that's how it should be."

At least one insurer—Warren, N.J.-based Chubb Corp.—recently had asked reinsurance intermediaries to remove XL from Chubb's facultative security list, the list of reinsurers automatically eligible for cedents' business, because of concerns about SCA (*BI*, July 28). SCA, the holding company for financial guarantee units that XL spun off in 2006, has suffered huge losses from adverse developments in its structured finance collateralized debt obligations and its residential mortgage-backed securities loss reserves.

A Chubb spokesman could not be reached for comment.

Mr. McGavick said the facultative issue had "a very modest effect, and it was only in very recent days, so we don't see it as something that

will disrupt the franchise."

Observers agree the commutation puts a major XL problem to rest.

Cliff Gallant, managing director of insurance research with Keefe, Bruyette & Woods Inc. in New York, said it "was the deal that they had to make. I think essentially this saves XL from the worst-case scenario, and I think it gives them a chance to rebuild and fight another day."

"There was a serious risk, if there hadn't been a deal, that a lot of their customers would have gone elsewhere. The XL franchise could have been troubled," Mr. Gallant said. But XL "still enjoys a good brand name in the marketplace, and now that the SCA issue is behind them, I think their customers will not hesitate to use them and McGavick does have an opportunity to rebuild a franchise."

"The resolution with respect to SCA is a good outcome for everybody," said John L. Ward, CEO of Cincinnati-based Cincinnati Partners L.L.C. "It brings more certainty to an otherwise uncertain situation" while effectively closing out XL's exposure to SCA business.

Steven K. Bolland, president of New York-based reinsurance intermediary Gill & Roeser Inc., said the fact that XL has "taken an unknowable number and actually valued it and come up with a solution, works well for everybody."

The deal allows XL "to focus back on their core business, straight property/casualty insurance and reinsurance," said Jeffrey Berg, an analyst with rating agency Moody's Investors Service in New York.

Aon Corp. said in a statement that "we are pleased by the steps XL Capital has taken recently, and we expect XL to remain a strong trading partner and market for some time to come."

Paul Newsome, an analyst with Sandler O'Neill & Partners L.P. in Chicago, echoed those comments. While issues remain, including dealing with including the rating agencies, "this was clearly the most

important issue that they needed to deal with." Now, "they just need to run the insurance company well," he said.

"This should alleviate a lot of fears about the viability of the company," Mr. Newsome said. "Essentially, the company's back to where it was prior to the problems with SCA. That was a pretty good company, so people should be OK with it."

Major rating agencies last week responded to the news of the com-

XL in the past five years has not "grown the business and capital base like others did in the hard market, and now it's a tougher market and will continue to get tougher, so they'll have plenty of challenges just running the business going forward."

New York-based Standard & Poor's Corp. has said it expects to have a negative outlook on XL even after completion of the capital raising.

Neil Stein, S&P managing senior financial analyst, said, "This is just due to some concerns that we have regarding the adequacy of the enterprise risk management functions and

To fund the commutation deal, XL said it expects to sell 125,000 ordinary shares priced at \$16 per share, and that underwriters have already exercised an option to buy an additional 18.7 million shares at the same price.

XL also said it will sell 20 million equity security units, while underwriters have already exercised an option to buy an additional 3 million units, all of which are priced at \$25 per share. The units consist of: a forward-purchase contract that requires the holder to purchase, and XL to issue, a variable number of ordinary XL shares; and an ownership interest in an XL debt security.

In addition, XL said it would exercise a put option under its Mangrove Bay contingent capital facility entered into on July 2003 that will result in net proceeds to XL of about \$500 million in exchange for the issuance of shares.

The New York Insurance Department, among other regulators, has signed off on the deal. Insurance Superintendent Eric Dinallo was closely involved in the plan's development, according to XL.

XL said it is exploring strategic operations for its life reinsurance business. Business written by XL's life operations, which reported \$375.1 million in net written premiums for the first half of 2008, is primarily European life reinsurance, according to its Securities and Exchange Commission filings.

The company also has announced a five year "operational transformation program" for XL Insurance, XL Group's global business segment, that includes consolidating multiple business processes and technology systems into a unified global architecture.

Furthermore, it has embarked on an expense reduction program to reduce its operating expenses, which will include job eliminations, XL said.

XL's shares closed Aug. 1 at \$18.47, down from the previous week's close of \$18.77.



**'Any time you get to a softening market, it's more challenging for all of us.'**

Michael S. McGavick,  
XL CEO

mutation agreement by either placing the company's financial strength ratings under review or maintaining existing reviews.

Mr. McGavick said that XL "expected the rating agencies would put us on watch" during this period. He said the company expects watches will be removed "some reasonable time after the deal closes."

XL still faces the challenges of a softening market, observers say.

"Any time you get to a softening market, it's more challenging for all of us to make sure we continue to hold our underwriting standards," Mr. McGavick said. "We have, and we will continue to do so."

He said the SCA commutation is part of a larger effort to make XL's earnings less volatile. Already, Mr. McGavick said, "an event like Katrina would now cost 40% less than it did. We have done the job, I think, of making this franchise less risky, but we'll still be writing complex risks. That's our job."

James Auden, senior director with Chicago-based Fitch Ratings, said

capabilities, along with uncertainty regarding the pricing trends in the marketplace, and some of the management changes that have taken place not only now but also over the last few quarters."

Mr. McGavick joined XL in May, replacing longtime CEO Brian O'Hara. Last week, the company also announced the retirement effective Aug. 1 of Chief Operating Officer Henry C.V. Keeling, who once was considered by market observers as a potential successor to Mr. O'Hara. The role of COO will be eliminated.

In addition, XL said Michael Lobdell will leave as executive vp and chief executive of global business services effective Aug. 31 because of a planned realignment of its global business services.

In addition, Fiona Luck, executive vp and chief of staff, will become a special adviser to the CEO with a reduced time commitment. Global Chief Actuary Susan Cross was added to XL's senior leadership group.

## DEAL TERMS

*XL Capital Ltd.'s commutation deal reduces its exposure to financial guarantee insurer Security Capital Assurance Ltd. to \$1.1 billion. Provisions include:*

- XL will pay SCA \$1.78 billion in cash.
- XL will provide 8 million newly issued Class A ordinary shares to SCA.
- All XL-owned SCA shares—about 46% of SCA's issued and outstanding shares—will be put in a trust.
- SCA will use "commercially reasonable efforts" to commute agreements by its operating subsidiary, XL Capital Assurance Inc., with the European Investment Bank. Those agreements represent XL Capital's remaining \$1.1 billion exposure.
- Terminate eight Merrill Lynch & Co. credit default swap agreements with SCA and related financial guarantee insurance policies issued by XLCA, with an insured gross par outstanding of \$3.74 billion as of June 30. SCA will pay Merrill Lynch \$500 million for the termination.

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## News In Brief

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of 2008, chiefly due to the credit crisis, a report shows. In the first half of 2008, 139 suits seeking class action status were filed, up from 77 in the same period of 2007, according to the report by NERA Economic Consulting, a unit of Marsh & McLennan Cos. Inc. Given that filing rate, the study projects 278 class action filings for all of 2008, a 43% increase from last year and the most since 2002. NERA's study notes that "51% of filings through June 30 have allegations related to the subprime collapse." The average settlement was virtually unchanged from 2007, at just over \$30 million.

### Light losses expected in Los Angeles quake

Last week's Los Angeles-area earthquake should not result in insured property losses of more than \$100 million, catastrophe modeler EQECAT said in a note to its clients. Meanwhile, AIR Worldwide Corp. said that the quake should not result in significant insured losses, in large part because of California's building codes. "Building codes in California are among the strictest in the world," Mehrdad Mahdyiar, AIR's director-earthquake hazard, said in an analysis of the earthquake's likely impact. The U.S. Geological Survey said the magnitude 5.4 earthquake was followed by nearly 50 aftershocks.

### DOL, SEC agree to share info on retirement plans

The Labor Department and the Securities and Exchange Commission have signed a memorandum of understanding to make permanent

what is now an informal agreement to share information affecting retirement plans. Among other things, the memorandum establishes a process under which staff of the DOL's Employee Benefits Security Administration and of the SEC will share information and meet regularly. Among other things, the agreement will expand the ability of the Labor Department to access nonpublic SEC enforcement information.

### PBGC takes over hospital plans

The Pension Benefit Guaranty Corp. has taken over and terminated four pension plans sponsored by Auburn Memorial Hospital, a bankrupt nonprofit medical center in Auburn, N.Y. The PBGC stepped in after a bankruptcy court found that the hospital could not emerge from Chapter 11 unless the plans were terminated. Together, the four plans have liabilities of \$66.5 million and assets of \$37 million. The PBGC

estimates that it will be responsible for \$28.2 million of the \$29.5 million funding shortfall. The PBGC said assuming the plans' liabilities will not have a material effect on its financial statements.

### Comp insurer must pay for weight-loss surgery

An obese worker's gastric bypass surgery is compensable under Oregon's workers compensation law because the procedure was necessary to treat a job-related knee injury, an appeals court ruled last week. Doctors told the injured worker that his weight of 350 pounds would prevent successful treatment of the knee condition, so he sought workers comp medical benefits for the gastric procedure. The court ruled in *SAIF Corp. and Jerry's Specialized Sales vs. Edward G. Sprague* that the injury was more than a minor cause of the claimant's need for gastric surgery and was therefore compensable.

## Compensation: Anti-rebate statutes play role in debate

CONTINUED FROM PAGE 1

sion levels and lower their premium, which violates the state's anti-rebate statutes.

Kermitt Brooks, first deputy superintendent of insurance in New York and chair of the hearings, said in an interview last week that he does not want the state's anti-rebate statute to be "used as a shield" by producers to preclude serious consideration about whether broker compensation should be disclosed to clients.

"I think it's an appropriate time when we're looking at broker compensation disclosure to also look at whether or not we need to amend, or change or even repeal the anti-rebate statute," he said.

"The first cousin to the issue of disclosure is anti-rebates," Mr. Brooks said. "If you ask yourself the question, 'Am I going to give the consumer information about broker compensation,' the next logical question is 'What can she do with that information legally?' And that gets you to the anti-rebate statute," he said.

New York Insurance Superintendent Eric Dinallo and New York Attorney General Andrew Cuomo held three hearings last month to gather information before issuing new regulations that address the compensation system established by their predecessors in 2005 and 2006 settlements with certain brokers and insurers.

The hearings primarily focused on the permissibility of contingent commissions and whether producer compensation disclosure should be mandated industrywide. Currently only the world's largest brokers do not accept contingents and their settlement agreements subject them to rigorous disclosure requirements. They complain that the two-tier market puts them at a competitive disadvantage.

Authorities still are considering whether to amend, change or repeal the state's anti-rebate statute while enforcing new producer compensa-

tion regulations.

Calls to the attorney general's office were not returned.

Some agents say a repeal of the statute would be "detrimental" to the marketplace, while others remain open to potential amendments.

The Risk & Insurance Management Society Inc., for one, supports open and free dialogue when it comes to producer compensation.

"RIMS thinks buyers are entitled to know the amount of the commission paid and should have the ability to negotiate the commission," Terry Fleming, RIMS director of external affairs, said in an e-mail response. "Depending on the amount of premium and percentage of commission, it gives the risk manager a clearer view of the total compensation paid to the broker."

The Council of Insurance Agents & Brokers also supports removing some of the current constraints under the state's anti-rebate statute that inhibit negotiations between brokers and clients on filed-rate policies.

"Producers are largely in a 'take it or leave it' world because they cannot tailor or negotiate compensation and services with their clients," Shad Steadman, president and chief operating officer of Alexandria Va.-based Rutherford Inc. and chairman of the CIAB, said in testimony given at the July 23 hearing in Albany. "Clients must either accept the level of commission or find another producer. It is hard to understand how this is in the best interests of consumers or producers."

Removing these constraints in tandem with robust disclosure "will free producers and their clients to negotiate a level of compensation that fairly represents the value provided by the producer to the client," he said.

Joel Wood, senior vp-government affairs for the CIAB in Washington, said that while the CIAB accepts "the historical importance of anti-rebating laws," especially as

it pertains to the personal lines and life insurance industries, they "get in the way of and constrain free and open competition" within the more sophisticated commercial insurance marketplace.

"We constantly hear about the inability for our member firms to fully provide goods and services of value to their clients with the complexity of the anti-rebating laws" in New York, Mr. Wood said.

A group health insurance producer, for example, cannot provide a client free access to an online employee benefits management system that provides a customized

**'It is hard to understand how this is in the best interests of consumers or producers.'**

Shad Steadman,  
Council of Insurance Agents & Brokers

Web site for human resources administration and benefit communications, unless that service is spelled out in the policy. That, in addition to human resource consulting services, was deemed to be an unlawful rebate or inducement by the New York insurance department in 2007.

While the CIAB does not necessarily believe that the anti-rebating laws should disappear, "we think it's right for regulators to focus on it," Mr. Wood said.

The Professional Insurance Agents of New York State Inc., testified that if New York's anti-rebate statute were repealed it would be "detrimental" to the marketplace.

Matthew F. Guilbault, government and industry affairs counsel for the Glenmont, N.Y.-based PIANY, noted that anti-rebate statutes "level the playing field" by preventing discrimination against

smaller policyholders who do not have a lot of leverage in that market to negotiate a smaller premium. It also prevents the discrimination against smaller insurers that might not have the ability to lower the premium like its larger counterparts, he said.

"In one instance, they're talking about the level of regulation to mandate disclosure or looking at the propriety of contingent arrangements and in the same breath, they're talking about regulation that I think has been acknowledged pretty fairly across the board as being a good thing for the insurance marketplace, and doing away with it," Mr. Guilbault said of the hearings.

"It was interesting from an academic standpoint, but from a practical standpoint, it was not necessarily an insightful line of questioning," he said.

Mr. Guilbault stressed that the PIANY supports voluntary disclosure at the client's request.

Kathy Weinheimer, senior vp of industry relations and education for the Dewitt, N.Y.-based Independent Insurance Agents & Brokers of New York Inc., said the association is remaining "open minded" on the anti-rebate debate.

Those that are looking to repeal the anti-rebating statutes "are looking to get to a system where producers and their clients will negotiate the individual commission level on every policy," Ms. Weinheimer said. "We don't necessarily believe that's the right way, at least at this time."

There are "other important consumer protections that we think can't just be tossed aside while looking at this one narrow aspect of it," she said. "We're looking to see where this might lead after the hearings."

Mr. Brooks noted that the purpose of the anti-rebate statute indeed "reflects sound public principals."

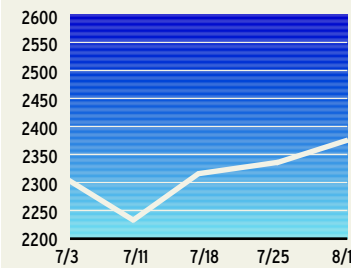
"We will make sure that we're mindful of those if we make any changes," he said. "But that doesn't mean no changes will be made."

## Stock Index

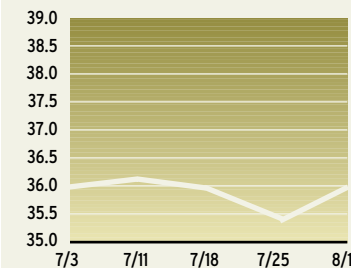
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Up-to-the-minute data for all 82 companies that comprise the BI Stock Index can be found at [www.IndustryFocus.com](http://www.IndustryFocus.com).

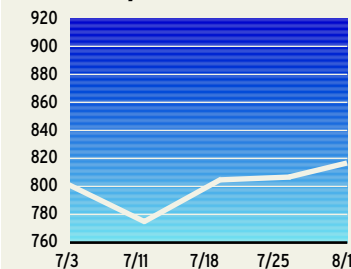
### BI STOCK INDEX



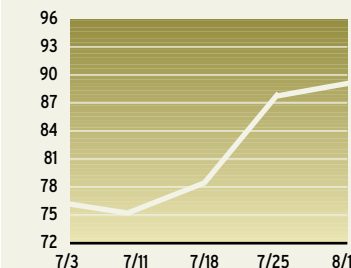
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### BI INSURER/REINSURERS INDEX



### BI MANAGED CARE ORGANIZATIONS INDEX



Percentage change of BI Stock Index vs. key indicators

<b>BI STOCK INDEX</b>	▲
2371.68	1.46%
<b>DOW JONES</b>	▼
11326.32	-0.39%
<b>S&amp;P 500</b>	▲
1260.31	0.20%

### LARGEST GAINS

Ambac Financial Group	76.28%
MBIA Inc.	57.49%
Meadowbrook Insurance	16.21%
PartnerRe Ltd.	8.67%
CNA Financial Corp.	8.53%

### LARGEST LOSSES

Gainsco Inc.	-7.12%
United Fire & Casualty	-6.68%
Navigators Group Inc.	-5.96%
PMA Capital Corp.	-4.16%
CIGNA Corp.	-4.02%

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## Lies, betrayals, fall at fictional Titanic Insurance

Corruption, with deadly implications, at the highest levels of management.

A level of deceit so pervasive in the organization that sales staff can't trust management, management can't count on what sales tells them and clients have no idea what they're buying.

It's just another day at the office at fictional Titanic Insurance Co. of Kansas in author John Patrick Lamont's new novel, "The Worst Kind of Lies." The book, which was published by *Booklocker.com* Inc. and is available on *Amazon.com*, is the first installment in the new author's Sum of Life trilogy.

The first novel in the murder/ thriller series

establishes the main plot against numerous subplots and a plethora of characters: Upper management loses a piece of incriminating evidence that

would expose its corruption, and top executives suspect the material has fallen into the hands of someone in the company's sales force, Mr. Lamont explained. A sales team manager, against his own antihero instincts, is drawn into the drama as top management plots to recover the material by any means necessary. Meanwhile, various sales agents—all victims of industry corruption in some way—try to maintain as much professional integrity as they can while balancing personal lives in which they haven't always made the right choices.

Mr. Lamont, a pseudonym, said he uses that plot to open a window to the insurance world, where he was an agent for 14 years before moving to the securities brokerage industry. Mr. Lamont, 56, now works for a small, family-run brokerage in the Quad Cities area of Iowa and Illinois, he said.

The author stresses that the novels are not meant to provide readers financial advice. But an overriding theme of the project is that consumers have to take greater care in understanding the various kinds of insurance products they purchase and how much personal risk those products create.

He said he is close to finishing two more books in the series, "Betrayals of the Heart" and "Fall From Grace."



# Business Insurance END PAGE

Contributing staff:  
Roberto Cenicerros,  
Jerry Geisel,  
Dave Lenckus  
and Joanne Wojcik



COURTESY: NUPHYSICIA L.L.C.

## When the doctor isn't in the house

The same kind of sophisticated technology that doctors have been using to treat sick researchers at the South Pole is helping heal patients in a handful of Texas retail clinics.

NuPhysicia L.L.C., a Galveston, Texas-based provider of telemedicine services, entered into a joint operating agreement with My Healthy Access Inc., a Houston-based retail clinic operator, to open so-called telemedicine clinics in several Wal-Mart Stores Inc. locations in the Houston area. The first one opened last month.

The clinics will be staffed by paramedics trained to use such high-tech gadgetry as an electronic stethoscope or devices that can see down the throat or in the ears, said Glenn Hammack, president of NuPhysicia.

The images from the devices and cameras positioned around the examination room are transmitted in real time via the Internet to an offsite doctor contracted by NuPhysicia to provide telemedicine services.

"This is very high-quality equipment, very similar to that used in video conferencing," Mr. Hammack said. "It's not just two laptops and a Web cam from Best Buy."

NuPhysicia evolved from the telemedicine programs of the University of Texas Medical Branch in Galveston, which has been operating telemedicine care since 1997.

Because one physician can cover multiple locations remotely, the medical services will be low-cost, with exams starting at \$59, Mr. Hammack said. If a clinic is overwhelmed by too many patients, more doctors can be wired up.

Although this high-tech equipment sounds like something you'd more likely see on an episode of "Star Trek" than in a traditional doctor's office, it still is very high-touch, said Mr. Hammack.

In addition to the touch of the paramedic serving as the doctor's hands, the patient also can see the doctor's changing expressions on the video screen.

## Oldest profession looks for coverage

The operators of a Victoria, British Columbia, escort service say they are looking for an insurer to provide their "sex trade workers" with health and dental benefits.

But the workers are independent contractors, which is making the search for an insurer challenging.

"We are still looking," said Harvi Wallbanger, chief executive officer for the escort service, Victoria Independent Providers. "A lot of the insurers actually want the girls to be employees."

Harvi Wallbanger isn't the CEO's real name, which she declined to disclose. "We all work with aliases in this industry," she said.

Her intent is very real, though.

Victoria Independent Providers is a legal escort service licensed in British Columbia and a registered Canadian corporation. Its founders are former directors of the Victoria-based Prostitutes Empowerment Education and Resource Society, which provides services for what it calls sex trade workers.

They created Victoria Independent Providers to help impoverished prostitutes by donating part of the company's profits to worthy social programs. Workers also can acquire shares in the corporation, Ms. Wallbanger said.

The operation already purchases workers compensation insurance from the Workers Compensation Board of British Columbia for employees, such as those who take client telephone calls to connect them with prostitutes.

It may also need property insurance.

Victoria Independent Providers plans to buy a property to operate a brothel "where the girls will sit in-house as well," Ms. Wallbanger said.

## Transit mandate could 'green' Bay Area air

Perhaps, one mandate isn't enough.

San Francisco, which is being sued over its first-of-its-kind 2006 law that requires employers with employees in the city to spend about \$3,600 per worker on annual health care coverage, is considering another employer benefit mandate.

The city's Board of Supervisors this month is expected to consider an ordinance that would require companies with at least 20 employees to set up programs allowing employees to pay commuting expenses with pretax dollars.

Pretax contributions of up to \$115 a month could be used to pay for such mass transit expenses as taking the bus or train. Employers also could obtain transit passes for employees, with employees paying for the transit checks through salary reduction.

According to Supervisor Ross Mirkarimi's

proposal, making pretax commuter programs mandatory could help San Francisco achieve by 2012 its goal of reducing carbon dioxide emissions to 20% below 1990 levels.

San Francisco's first foray in the benefit mandate arena requires larger employers to spend at least \$1.76 per hour per employee on health care. That mandate can be satisfied in a variety of ways, including the employer paying at least that much on the employee's health insurance premium or making a contribution of that amount to a health savings account.

The health care spending law is being challenged by a local restaurant trade association, which contends that federal law pre-empts the statute. A ruling on that challenge is expected to be handed down soon by the 9th U.S. Circuit Court of Appeals.



San Francisco is weighing a mandate that employers provide payroll deduction plans for mass transit.



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