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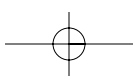
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\$4

27TH ANNUAL SURPLUS LINES MARKET REPORT

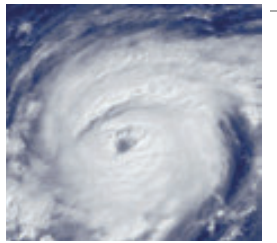
RANKINGS OF LARGEST SURPLUS LINES INSURERS AND WHOLESALERS

NEWSPAPER



**Overtime case may create
new D&O liabilities / 3**

**Bermuda slammed
by Hurricane Fabian / 4**



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\$4

RSA overhauls its strategy

Plans to exit U.S., raise funds for reserves, cut more jobs



PHOTO: NEWCAST

By **NEIL HODGE**
and **RODD ZOLKOS**

LONDON—U.K. insurer Royal & SunAlliance Insurance Group P.L.C. last week unveiled a sweeping restructuring plan that signals an end to its ambitions to be a true global player.

Some market observers expect that the planned changes, including RSA's exit from the U.S. market, will create disruptions for risk managers.

The insurer's plan, announced Sept. 4 in conjunction with the release of RSA's first-half earnings, entails raising more than \$1.5 billion to boost reserve deficiencies, shedding 1,000 more jobs in the United Kingdom and exiting the U.S. property/casualty market.

After a strategic review, the United Kingdom's second-largest multiline insurer said it would increase its reserves by £800 million (\$1.26 billion) and exit the United States to focus instead on business in the United Kingdom, Canada and Scandinavia. RSA also said

that Julian Hance, group finance director, would be leaving the insurer early next year.

RSA said it would offset the reserve boost through a £960 million (\$1.52 billion) rights issue—a private share offering—under which it will offer one new share for every existing one, at a price of 70 pence (\$1.11) per share. This amount is less than half the stock's closing price on the London Stock Exchange Wednesday—the day before the rights issue was made public—of 154 pence (\$2.43) per share. As of Friday, RSA shares had dropped 16.8% to close at 128 pence (\$2.02).

Most of the cash raised will be used to cover reserving shortfalls in the United States, which were identified in a review conducted by actuarial consultant Tillinghast Towers Perrin. The shortfalls include £150 million (\$237 million) related to asbestos and environmental risks in the United States and United Kingdom and a further £500 million (\$790 million) for other U.S. liabilities.

See **RSA/page 55**

Royal & SunAlliance Chief Executive Andy Haste detailed the restructuring plan last week.

Senate likely to move on class-action reform

By **MARK A. HOFMANN**

WASHINGTON—The Senate is likely to vote on class-action reform legislation within the next few weeks, according to one of the bill's chief Democratic backers.

In fact, the Class Action Fairness Act—S. 274—will probably reach the Senate floor next week, though debate could begin this week, according to Sen. Tom Carper, D-Del. With a vote so close, employers cannot afford to relax their efforts to persuade senators to vote for the measure, Sen. Carper told a breakfast gathering at the U.S. Chamber of Commerce in Washington last week.

Sen. Carper stressed to his audience that he believes anyone who suffers injury from a product deserves a day in court, and classes of people who suffer injuries deserve to have their cases heard as class actions. But, he said, "we have lost a sense of balance" in the current system for handling such mass litigation.

"National class-action policy is being set in

venues that seem unlikely," such as Madison County, Ill., said Sen. Carper.

He noted that Madison County and some other jurisdictions are considered particularly friendly to plaintiffs and thus have become inviting places in which to file national class actions. The aim of such class actions is not always to reach a verdict but rather, in some cases, to get a pretrial settlement—a tactic that does not always benefit members of the class, he said.

Passage of the Class Action Fairness Act would give lawmakers a "chance to change that" by helping ensure that a national class action "ends up where it belongs," which could mean federal courts.

Under S. 274, which won Senate Judiciary Committee approval earlier this year, federal courts in most cases would have jurisdiction over interstate class actions that meet certain criteria: any defendant and plaintiff live in different states; the amount involved exceeds

See **TORT REFORM/page 55**

House legislator seeks to bolster PBGC's finances

By **JERRY GEISEL**

WASHINGTON—Amid the rapid deterioration of the Pension Benefit Guaranty Corp.'s financial condition, the head of a key congressional committee is pledging legislative action to shore up the federal agency.

To delay action while the PBGC's condition worsens would be "criminal neglect," says Rep. John Boehner, R-Ohio, chairman of the House Education and the Workforce Committee.

Speaking last week at a panel hearing examining the financial state of the PBGC, Rep. Boehner, whose committee has jurisdiction over the agency, said Congress should work to complete action on a PBGC reform/pension funding package by no later than the end of next year.

"It is my intention that this committee look at

See **PBGC/page 54**

Late News



PHOTO: REUTERS

Verizon expects to reap savings by shifting some health care costs to workers.

Verizon, unions reach agreement

New York-based Verizon Communications Inc. estimates it will save \$500 million over five years after reaching an agreement late Thursday with its two largest unions, ending a clash that centered largely on health care costs. The five-year pact, which Verizon's union employees still must approve, would essentially maintain the current arrangement in which employees and retirees pay no premiums. Under the agreement, covering 79,000 union workers, employees would have to pay slightly higher deductibles and copayments. For Verizon, the deal allows it to add a preferred provider organization to the existing indemnity plan options, as well as more prescription options.

California considering health cover mandate

A conference committee of California lawmakers is working to craft a single bill from several measures that would require most employers in the state to offer health insurance and to pay a significant portion of the cost of the coverage. The main bill, S.B. 2, would require employers with 20 or more employees to offer health insurance to all workers, while employers with at least 200 employees would have to offer coverage to workers and their dependents. California employers that do not provide health insurance would have to

See **LATE NEWS/page 56**

Spotlight

**SURPLUS LINES
MARKET REPORT**

**LARGEST U.S.
SURPLUS LINES
INSURERS**

Ranking on page 12

**SURPLUS LINES
PREMIUMS &
TAXES BY STATE**

Chart on page 31

**LARGEST
WHOLESALERS,
MGAs**

Ranking on page 36

CIGNA settlement offer gets preliminary approval

Deal would resolve docs' class action

By MICHAEL PRINCE

MIAMI—A federal judge has given preliminary approval to a settlement reached last Wednesday between CIGNA Corp. and physicians to end the class-action litigation against the managed care company. Judge Federico Moreno of the U.S. District Court in Miami put his preliminary stamp of approval on the \$140 million settlement after a nearly two-hour court hearing.

Under the settlement, Philadelphia-based CIGNA would pay out up to \$140 million. As much as \$70 million would go to the physicians, with attorneys receiving \$55 million and \$15 million going to a

public health foundation.

Doctors can elect to receive a payout from a \$30 million fund,



with the amounts divided evenly among those that elect this option. Or, they can resubmit claims for reconsideration to two other funds, depending on the physicians' specialty. CIGNA will place \$20 million into each of these funds.

In addition, the managed care company has agreed to speed claims payments to physicians and to make the claims-paying process more open to doctors. Other changes CIGNA agreed to include creating a doctor-only Web site to provide detailed claims information to physicians, limiting changes to fee schedules to once a year and creating an external review system to

See CIGNA/page 56

Reinsurers post better results, but reserves, terror risks loom

By JUDY GREENWALD

Is the reinsurance industry holding a tiger by its tail?

The U.S. reinsurance industry is enjoying stellar results this year as a result of the hard market, and these are expected to continue at least into 2004. But some observers are worried about whether the terrorism coverage reinsurers have assumed is adequately priced, and if this issue will ultimately come back to haunt them.

The 30 reinsurers that reported their first-half results to the Washington, D.C.-based Reinsurance Assn. of America posted a 97.9% combined ratio, compared with the 117.4% combined ratio posted by a comparable group of reinsurers for the same period in 2002.

The 20 largest reinsurers, based on net premiums written, reported a 96.1% combined ratio vs. the 117.6% reported by 18 of the rein-

surers for the same period a year earlier. Bermuda-based Platinum Underwriters Reinsurance Inc., a reinsurer spinoff of The St. Paul Cos. Inc. that was announced in April, and Tarrytown, N.Y.-based

Reinsurers 2003 FIRST-HALF RESULTS

Endurance Reinsurance Corp. of America, which was formed late last year, did not participate in last year's first-half survey.

Bolstered by the hard market, premiums written for the RAA reinsurers totaled \$16.07 billion, a 19.5% increase. The top 18 reinsurers, excluding Platinum and En-

durance, reported \$14.62 billion in premium, up 18.9%.

"Calendar-year results continue to improve," said Jim Bartie, vp at Moody's Investors Service in New York. "Fundamentally, the industry continues to repair its balance sheet" by addressing reserve issues that stem from the most recent soft market, said Mr. Bartie. "And, obviously, the improvement in the rate structure for pricing and terms and conditions is clearly translating into improved operating results."

John Ward, chief executive officer of the Cincinnati-based Ward Group, pointed to the improvement in the combined ratio as well as to the 17.2% increase, to \$44.73 billion, in policyholder surplus. "It was a strong performance by the reinsurance segment, well in excess of last year's performance for the same time period," he said.

Shane Wright, chief financial officer of the Cincinnati-based Ward Group, pointed to the improvement in the combined ratio as well as to the 17.2% increase, to \$44.73 billion, in policyholder surplus. "It was a strong performance by the reinsurance segment, well in excess of last year's performance for the same time period," he said.

See RESULTS/page 52



PHOTO: KRT

California case closely watched

Overtime dispute could create risks for D&O policies

By ROBERTO CENICEROS

SAN FRANCISCO—A class-action lawsuit before the California Supreme Court brought by employees seeking overtime pay could result in new directors and officers liability exposures for companies and their insurers.

The case differs from other so-called "wage-and-hour" lawsuits brought in California and elsewhere in that the plaintiffs are suing individual directors and officers—rather than their employer—for the failure to pay overtime wages.

As a result, if the court upholds their claim, the case could open up a new form of liability for D&O insurers, according to policyholder and defense experts.

Although the case, *Reynolds vs. Bement*, does not address insurance coverage, if the directors and officers are found liable,

they likely would tap their D&O policies, the attorneys say.

The lawsuit resembles a growing number of class-action complaints filed against employers by low-level managers, assistant managers and supervisors around the country. Although these wage-and-hour lawsuits vary somewhat, plaintiffs in such cases typically claim their bosses misclassified them as "exempt" employees and that they are owed overtime wages.

Although employers nationwide have been named in such lawsuits, the majority of these complaints are brought in California. The state's labor laws differ from federal overtime laws that most states follow and therefore favor employees in such cases, say attorneys.

A number of employers have paid out tens of millions of dollars each to settle such claims

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Inside Business Insurance

District of Columbia licenses first RRG

A new risk retention group in the District of Columbia will provide medical malpractice coverage for doctors in Texas. **Page 4**

Rising med mal costs not reducing care: GAO

A government report finds no evidence that med mal costs reduce access to care in some areas. **Page 4**

Maybe the messenger must take some blame

Paul Winston examines whether the media has helped foster litigiousness in U.S. society. **Page 6**

Common sense prevails in FSA rule on drugs

An Internal Revenue Service ruling on FSA use is a victory for common sense, one of this week's editorials says. **Page 8**



Swiss Re funds study of Tokyo quake risks

Swiss Reinsurance Co. is sponsoring research into the probability of an earthquake striking the Tokyo area. **Page 49**

Online

• The **Datebook** calendar lists upcoming industry seminars and meetings and allows you to add info on your own event.

• Searchable **directories of surplus lines insurers and wholesalers**, along with all other listings of industry vendors found in *BI's* Market Sourcebook.

• New **Opinion Poll** for readers: Do you think federal pension funding rules need to be strengthened?

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REPORTING ON CORPORATE RISK AND EMPLOYEE BENEFIT MANAGEMENT NEWS.

District of Columbia adds risk retention group

Houston doctors to cover medical malpractice risks

By JERRY GEISEL

WASHINGTON—The first risk retention group licensed in the District of Columbia will provide medical malpractice coverage to physicians practicing at a major health care system in Texas.

The new RRG—Health Network Providers Mutual Insurance Co., RRG—will issue policies for physicians in the Houston area who are members of Memorial Hermann Health Network Providers Inc. and provide services at the Memorial Hermann Hospital Network.

Limits of up to \$500,000 per claim/\$1 million annual aggregate

will be available to policyholder-owners of the RRG.

The RRG's founders thought that a physician-owned program could provide long-term premium savings, said Gregg C. Waddill III, an Austin-based health care attorney who serves as secretary and general counsel of the RRG.

In fact, an analysis of claims of 2,000 members of the physicians' group over a 10-year period found that their experience was significantly better than other physicians in comparable medical practice areas.

"They were paying for someone else's losses," Mr. Waddill said.

Premiums charged for providers joining the RRG will be based on experience and should be less than what they had been paying in the commercial market, he said.

Mr. Waddill noted that premiums would be invested in high-quality fixed-income instruments. "We intend to preserve the integrity of capital," he said, adding that premiums will not be based on projections of investment income.

Underwriting, claims and risk management services will be provided by Physicians Underwriting Management Group Inc. in Houston. Risk Services L.L.C. of Arlington, Va., is the RRG's manager.

The RRG could, in its first full year, generate premiums of about \$10 million, with as many as 2,000 of the 3,000 members of the provider group participating, Mr. Waddill said. The other 1,000 providers either have malpractice coverage through other health care systems at which they practice or will keep their current coverage, he said.

The appeal of a risk retention group, as opposed to other alternative risk financing vehicles, is that policies can be written by the RRG, Mr. Waddill said. That eliminates the need to use a fronting insurer, whose costs can be very high, he explained.

The RRG was set up in the District of Columbia because the

group's founders thought the domicile would be well-received by physicians and because regulators there were willing to expedite the licensing process. A total of 12 captives have been licensed in the District of Columbia, many of them in the last year.

With the new formation, a record 117 RRGs now are operating, according to The Risk Retention Reporter of Pasadena, Calif. In the last eight months alone, more than 25 groups have been licensed, with much of the growth coming from physicians and health care systems. Such buyers face especially difficult conditions in the commercial market, given rising rates and a reduction in the number of insurers writing malpractice liability coverage.

IRS gives FSAs more flexibility

Reimbursement of nonprescription drugs permitted

By JERRY GEISEL

WASHINGTON—Employees can tap their health care flexible spending accounts to pay for nonprescription, over-the-counter drugs, the federal government says.

In Revenue Ruling 2003-102, issued last week, the Internal Revenue Service and the Treasury Department make clear that over-the-counter drug costs can be paid using employees' pretax contributions to FSAs or through health reimbursement accounts. HRAs, which typically are funded by employers, are a common component of consumer-driven health plans.

The ruling, which is effective immediately, greatly broadens the appeal of FSAs for many employees. Paying for nonprescription drugs with pretax contributions to FSAs will cut the true cost of those drugs

by more than 30% in many cases.

In addition, with nonprescription drugs now eligible for reimbursement through FSAs, enrollees have a reduced risk of having funds left over in their FSAs at the end of the year. Under an IRS rule known as "use it lose it," unused account balances are forfeited.

The government action, as a result, is likely to boost participation in the plans, benefit experts say.

"Allowing employees to pay for over-the-counter drugs will greatly enhance the use of FSAs in the marketplace," predicts Bonnie Whyte, chief operating officer of the Employers Council on Flexible Compensation in Washington.

Government officials attributed their action in part to the increasing number of drugs that were once

available by prescription but have been converted to over-the-counter availability.

"Since many prescription drugs have moved to the over-the-counter-market, this action today makes paying for them a little easier to swallow," Treasury Secretary John Snow said in a statement.

The ruling provides examples of nonprescription drugs that could be paid for through FSAs or HRAs, including antacids, allergy medicines, pain relievers and cold medicines. However, it notes that nonprescription dietary supplements—such as vitamins—and products used to maintain an employee's general health, such as cosmetics, would not be eligible for coverage through FSAs or HRAs.

Virtually every major employer now offers access to health care FSAs, which means tens of millions of FSA enrollees could benefit from the ruling.



GAO report rebuts anecdotal evidence

Rising med mal coverage costs not hampering access to care

By MARK A. HOFMANN

Rising medical malpractice liability insurance costs have not significantly reduced access to health care, according to study by the General Accounting Office.

The GAO report, "Medical Malpractice: Implications of Rising Premiums on Access to Health Care," studied the experience of physicians in nine states. Five of the states—Florida, Nevada, Pennsylvania, Mississippi and West Virginia—had reported medical malpractice coverage-related problems, while the other four—California, Colorado, Minnesota and Montana—had not.

While the GAO found isolated instances of reduced access to

health care in the five problem states, it also found that "many of the reported provider actions were not substantiated or did not affect access to health care on a widespread basis."

The GAO noted that "some reports of physicians relocating to other states, retiring or closing practices were not accurate or involved relatively few physicians" in the

five problem states. The report added, however, that "continuing to monitor the effect of providers' responses to rising malpractice premiums on access to care will be essential, given the import and evolving nature of this issue."

In addition, the study noted that "limited available data indicate that growth in malpractice premiums and claims payments has been slower in states that enacted tort reform laws that include certain caps on noneconomic damages." However, the agency cautioned that it could not determine the extent to which the differences among states were attributable to tort reform or other factors.

The report is available at www.gao.gov.

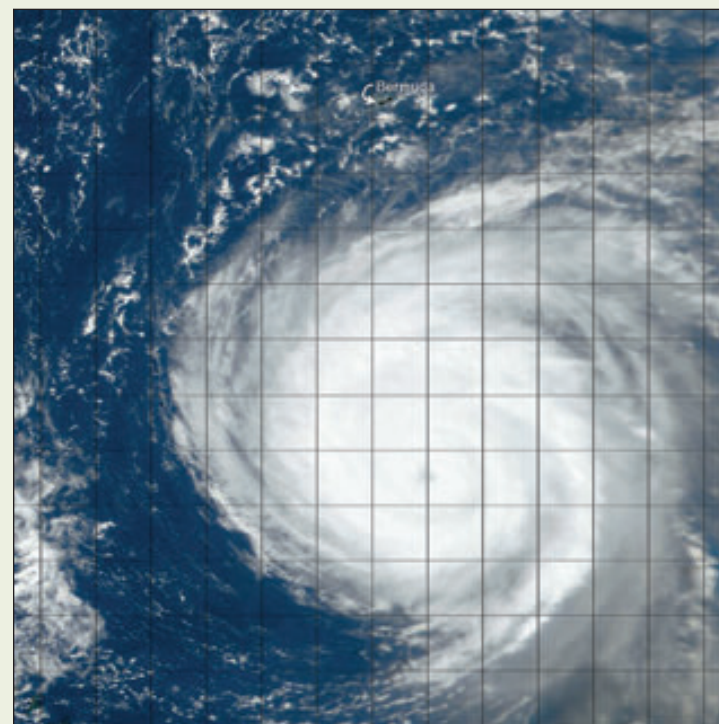


PHOTO: AP/WIDE WORLD

Hurricane Fabian lashed Bermuda late Friday with 120 mph winds. Businesses began shutdowns Thursday in preparation.

Bermuda closes down as strong hurricane hits

By MARK A. HOFMANN

HAMILTON, Bermuda—A swift-moving Hurricane Fabian struck Bermuda Friday afternoon, several hours ahead of initial predictions.

Fabian, a category 3 storm, packed maximum sustained winds of 120 mph as its eye moved directly across Bermuda. The island's businesses began shutting down Thursday in anticipation of the hurricane.

Major insurers, such as ACE Ltd., XL Capital Ltd. and the Bermuda offices of Arch Capital Group Ltd., were all closed Friday. The Bank of Bermuda also

closed, as did the Bermuda Chamber of Commerce. All flights to and from the island were canceled on Friday.

Bermuda's last major encounter with a hurricane-force storm was Hurricane Gert, which brushed the island in 1999. In 1995, Felix swept past with 80 mph winds. In 1987, Hurricane Emily slammed directly into the island, producing an estimated \$75 million in total damages and leaving Bermuda without power for weeks.

By midday Friday, Fabian was expected to make landfall by the evening.

See **FABIAN**/page 6

Errors & omissions

• Due to an editing error, a biography of Perspective author Gerald L. Maatman Jr. in the Aug. 11 issue misidentified his law firm. Mr.

Maatman is a partner in the Chicago law firm Seyfarth Shaw, specializing in employment law. His previous firm was Baker & McKenzie.

Fabian: Storm strikes Bermuda

Continued from page 4

A bulletin from the Miami-based National Hurricane Center's Tropical Prediction Center issued at 11 a.m. Eastern Time on Friday warned, "Fringes of Fabian affecting Bermuda....Worse still to come." Three hours later, the center announced that Fabian was 40 miles south of Bermuda and heading north at 17 mph.

Meanwhile, the Gulf coast of Florida on Friday was bracing for Tropical Storm Henri, which was expected to dump up to a foot of rain on parts of the state.

Earlier last week, hurricane researcher William Gray of Colorado State University in Fort Collins predicted Atlantic hurricane activity should be slightly above average in September and October.

The CSU meteorological team predicts two hurricanes each in both September and October, with a total of seven hurricanes out of 14 named storms for the entire 2003 Atlantic hurricane season, which ends Nov. 30. That total is a decrease of one from the team's August prediction of eight hurricanes but still above the 50-year av-

erage of 5.9 hurricanes per season.

To date, there have been 10 named storms this season, including Fabian and Henri. Mr. Gray's team also predicts a slightly higher than average chance of hurricane landfall in during the rest of the year.

The researchers plan to release a revised October-only forecast on Oct. 2 and expect to release their initial forecast for the 2004 storm season on Dec. 5.

The CSU researchers' forecasts can be viewed online at <http://tropical.atmos.colostate.edu>.

Risk Manager of the Year



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Paul Winston

Blame messenger, among others

"Next thing we'll do, let's kill all the editors."

—Anonymous

After I wrote last week that I believed one problem accounting for all the litigiousness in our society was a glut of lawyers looking for claimants to keep them busy, a reader wrote and observed that maybe there also are too many editors.

After I got over my rage and feelings of insecurity, I grudgingly conceded that perhaps she had a point. Maybe journalists are partly to blame for some of the litigation mess in our society. Not me personally, of course, but if you think about it, maybe there is

some truth to the idea that if lawyers hold the match to light the fire of litigiousness, it is often media that provides the tinder to fuel the flames.

As journalists, we generally think it is our duty to stir things up and shed light on ugly aspects of society. We do this in an effort not only to inform people but also by doing so to correct perceived imbalances of power in society. So, for example, if legislators are voting themselves outrageous pension increases, journalists would make people aware.

Journalism has been called the Fourth Estate within a democratic society, indicating the important role it plays in defending the public interest and guarding democracy. The three previous estates referred to various political elements within 18th century society, including the clergy (First Estate), nobility (Second Estate) and everybody else (Third Estate).

It's a worthwhile pursuit and most of the time I think performs its role well, if I do say so myself.

But even I, at times, am surprised at the extent of coverage the media devote to some topics. This news oversaturation can throw the balance that journalism is supposed to provide out of whack, and may well lead imbalanced people to file lawsuits.

Is it any wonder, for example, that there has been an increase in shareholder litigation given the enormous media resources today devoted to every tick and turn of a company's stock?

Financial forecasts by analysts and earnings projections by companies are analyzed in exhaustive detail by print and television media that treat such fortune telling as fact. And when actual financial results deviate

from those reported projections, new media attention is focused on whether there is something wrong or underhanded to account for the perceived misstep.

Opinions are treated as fact and the truth is sometimes lost in the translation. One would like to believe that the audience for this kind of financial reporting can decide for itself what a stock's true worth is, but no doubt many are sold by what the media are selling.

It would be interesting to conduct a study of the average amount of CNBC watched on a daily basis by plaintiffs in shareholder litigation.

Another example where media coverage may be overwhelming the public is with the current onslaught of reporting on the alleged perils of eating—or of not eating right. Again, it is a situation where a real problem—obesity in society and poor health—is obscured by the volume of stories on various alleged health problem associated with everyday foods, the fast-food menace and the latest position on whether carbohydrates are good or evil.

As with stock reporting, one would hope that people would be able to exercise their own common sense as to what is good for their own diets. But I suspect that the barrage of reporting on alleged health risks out there is bound to cause more than a few people to believe they not only have indigestion, but also have a case.

There are doubtless plenty of other examples where media coverage sparks the litigation fire in people.

I still maintain that most of the time, and for most of the people, the media are still doing a fair job of keeping people informed about things they should know about. Like whether Billy Bob Thornton is covering his Angelina Jolie tattoo. But our audience still has a responsibility, as with stock picks and diets, to apply some common sense and filter the information that comes their way.

I thank the reader for reminding me that there are no convenient scapegoats for the litigation crisis—and that some fellow journalists might be overdoing it as much as some lawyers at times. There is plenty of blame to go around and I am happy to share.

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Editorial

Maintain class-action reform push

SENATE PASSAGE OF class-action reform legislation may finally be within reach.

But reaching that goal may require a little more work by risk managers and others who want to restore some balance to a class-action system that's too often out of whack.

As we report on page 1, as of late last week, supporters of S. 274, the Class Action Fairness Act, thought they had 57 votes for moving the bill to a final vote. That's a clear majority of the Senate's 100 members. But, under Senate rules, 60 senators

must vote in favor of cloture—a parliamentary move that ends debate—to cut off a filibuster. If 60 senators don't agree to end debate, then a determined minority of their colleagues can literally talk a bill to death.

That would be particularly unfortunate in the case of this class-action reform bill. The Senate bill is a modest measure, even more modest than a counterpart passed by the House in June. The measure would give both defendants and plaintiffs in certain interstate class actions the right to have the case removed

to federal court from local courts. It would also ban some particularly egregious legal practices, such as paying higher awards to some members of a class because they happen to live in the jurisdiction in which an action is filed. It would also ban settlements in which members of the class end up with a net loss after paying legal fees.

As Sen. Tom Carper, D-Del., told the U.S. Chamber of Commerce last week, this bill simply seeks to restore balance to the class-action system. That modest goal helps explain why this bill enjoys broad bi-

partisan support. But that support may not currently be quite broad enough to ensure its passage—it still lacks the commitment of three senators to end a filibuster.

That's why Sen. Carper said that supporters can't "relax for a moment and assume the other three votes will materialize" to end debate and move the measure to a final Senate vote. The goal is definitely within reach. It's up to supporters to stretch just a bit more by making the case for class-action reform to all senators to help ensure that the goal is finally reached.

Common sense prevails in FSA rule

WE'RE PLEASED THAT THE Internal Revenue Service finally recognizes how illogical its policy toward reimbursement of certain over-the-counter medicines has been.

But the change in policy on how flexible spending accounts treat reimbursement of nonprescription drugs is only part of needed reform of the tax treatment of FSAs.

Nevertheless, the IRS' recent ruling is a step in the right direction.

Consider this common situation: Two employees participate in health care flexible spending accounts offered by their employers. One employee has a stomach disorder, which is treated with a drug prescribed by his doctor. A second employee also has a stomach disorder, but that individual is able to treat the problem with an over-the-counter product.

Logic would dictate that both individuals should be allowed to obtain reimbursement from their FSAs for the out-of-pocket costs of the drugs they purchased. After all, both have similar ailments—with perhaps only the severity of the problem differing—and both use a drug to treat the problem.

Until now, though, logic didn't enter the picture, as the IRS has long barred the use of FSA funds to reimburse enrollees for their nonprescription drug costs.

Now, however, that is changing. The IRS, perhaps recognizing the growing role of over-the-counter medications, has changed its position. As we report on page 4, effective immediately employees can be reimbursed for the costs of nonprescription drugs—such as cold medicines, allergy medications and antacids—with FSA funds.

The government's change in position truly is a victory for common sense. If, for example, an FSA could be tapped to pay for the popular allergy medicine Claritin when it was available only by prescription, why then couldn't the FSA funds also be used when Claritin became available over the counter? The effectiveness of the product or its use did not change, merely its distribution. Situations like this undoubtedly led to the IRS' change of position.

For FSA enrollees, who number in the millions, the IRS ruling on nonprescription drugs is welcome news. Depending on their tax bracket, employees' true costs for such drugs could be sliced by as much as 30% if those costs are paid through FSAs, which are funded by employees' pretax contributions.

As welcome as the IRS ruling is, it is just one step on the road to com-

mon-sense treatment of FSAs. An even more important step—one that only Congress has the power to take—is the elimination of the so-called "use it or lose it" rule.

That rule requires flexible spending account participants to forfeit account balances that remain at the end of the year. The negative effects of that rule are several. First, the fear of forfeiting unused account balances likely discourages some employees from putting in sufficient contributions to cover medical costs.

Second, employees who find that they have unused balances at the end of the year are likely to engage in spending splurges—such as buying extra and unneeded eye glasses—rather than forfeit the contributions.

The better policy—and one that has been endorsed by the Bush administration—would be to allow employees to carry over at least a portion of unused contributions for use in the next year. This would encourage bigger FSA contributions, giving employees more financial protection against unexpected health care costs, while discouraging spending on unnecessary services or products.

We hope the IRS' common-sense approach to drug reimbursement is only the beginning of a new approach to FSA policy in general.

Schillerstrom



Weekly Online Polls

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SURPLUS LINES MARKET REPORT

Spotlight Editors: Dave Lenckus and Sally Roberts



Hard market gives big boost to E&S industry

By ROBERTO CENICEROS

Business remains brisk for the excess and surplus lines industry, though premium volume gains this year likely will trail the exceptional increases seen in 2002, wholesalers and insurers say.

Accounts flocked to the E&S market last year as standard-lines insurers restricted terms and conditions, in many cases walking away from business that didn't meet underwriting standards. In 2002, the surplus lines industry accounted for \$22.3 billion in premium volume, up 60% from 2001, according to a *Business Insurance* survey.

Although the hard market continues to push business into the nonadmitted market, E&S growth likely has peaked for now, observers say.

"I think every wholesaler had a banner year" in 2002, said Thomas Comer, president and chief executive officer of Swett & Crawford Group in New York, a unit of Aon Corp. "What we are seeing in 2003 is reality checking in."

One factor limiting growth in 2003 is increased competition from the standard market, in part due to new players.

But wholesalers and surplus lines insurers say they still see plenty of demand for their services into 2004. Rates are still climbing for many lines—including most casualty

risks—and even where prices are stabilizing, the underlying rates have risen substantially over the past couple of years.

Property levels off

For property insurance buyers, there is some good news. Recently formed Bermuda-based standard market insurers are helping reclaim a small portion of the property business that market has shed over the past two years, say wholesalers and surplus lines insurers.

"There's a lot of new money out there," said Gary Tiepelman, vp-underwriting at Scottsdale Insurance Co. in Scottsdale, Ariz. "And I think where they want to play is in the property market, so that they know they don't have a tail to contend with and they can evaluate results more quickly."

After seeing the surplus lines market profit from significant property rate increases, admitted insurers have reasoned that they, too, can benefit from higher pricing for some property and casualty risks, say E&S market observers.

Perhaps 10% of the property business that found a home in surplus lines during 2002 has returned to the admitted market, said Mark M. Smith, CEO in New York for Stewart Smith Group, a unit of Willis Group Holdings Ltd.

See MARKET/page 14

Retailers looking to wholesale business

Addition, expansion of E&S operations brings revenues, diversification

By SALLY ROBERTS

Whether to take advantage of hard market conditions or to diversify their businesses, retail insurance brokers are bullish on the excess and surplus lines market.

Because the E&S market has been

thrust into the spotlight by the hard market, many retail brokers are either beefing up their existing wholesale operations or, in some cases, entering the E&S arena in earnest for the first time.

Indeed, unlike the world's largest brokers, which have owned large

wholesale and managing general agency operations for years, many of the next tier of brokers have only recently entered the E&S market.

Those making the move say having their own E&S operations not only allows them to take advantage of current hard market conditions,

but also lets them diversify their business, keep revenues in-house and provide risk managers with more resources.

"It strengthens the team that the insurance buyer is paying for," said Tony Strianese, president of Peachtree Special Risk Brokers

L.L.C., the 3-year-old Stockbridge, Ga.-based wholesale unit of Brown & Brown Inc.

"The risk manager is paying for insurance knowledge, creativity and market knowledge, and a standard agent or broker...is only going to have access to a certain pool of insurance companies," he said. "The surplus lines arena is an en-

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Inside:

Ranking of largest surplus lines insurers page 12

NAPSLO details its position on legislative issues page 22

Surplus lines premiums and taxes by state page 31

Rankings of largest wholesalers and MGAs page 36

Flood of business leaves little time for innovation page 18

Patchwork of premium tax laws frustrates buyers page 24

Lloyd's market bullish about surplus lines page 32

Data standard to ease exchange of information page 40

Largest U.S.-based surplus lines insurers

Ranked by 2002 nonadmitted direct written premiums

Rank	Company/Address/Parent	Phone/Fax/Web site	2002 nonadmitted direct written premiums	% change	2002 gross premiums	% change	2002 net written volume	2002 net income (loss)	Statutory combined ratio	Principal officer
1	Lexington Insurance Co. * 200 State St. Boston, Mass. 02109 <i>American International Group Inc.</i>	617-330-1100 Fax: 617-772-4588 www.lexingtoninsurance.com	\$3,609,162,602	73.2%	\$4,926,059,043	73.6%	\$1,859,961,933	\$115,903,120	92.5%	Kevin H. Kelley, president
2	American International Specialty Lines Insurance Co. 1400 W. Benson Blvd., Suite 315 Anchorage, Alaska 99503 <i>American International Group Inc.</i>	907-277-6693 www.aig.com	\$2,447,694,898	200.5%	\$2,551,047,129	208.3%	\$273,926,511	\$28,138,088	95.2%	Kevin H. Kelly, president
3	Steadfast Insurance Co. * 1400 American Lane Schaumburg, Ill. 60196-1056 <i>Zurich Financial Services Group</i>	847-605-6000 Fax: 847-605-7895 www.zurichna.com	\$1,222,233,413	69.9%	\$1,253,051,482	69.4%	NA	\$4,804,639	NA	John McCartney, president
4	Scottsdale Insurance Co. * 8877 N. Gainey Center Drive Scottsdale, Ariz. 85258 <i>Nationwide Mutual Insurance Co.</i>	480-365-4000 Fax: 480-368-5856 www.scottsdaleins.com	\$868,966,609	42.8%	\$1,985,414,596	26.7%	\$460,818,400	\$28,516,388	98.1%	R. Max Williamson, president
5	Evanston Insurance Co. 10 Parkway N. Deerfield, Ill. 60015 <i>Markel Corp.</i>	847-572-6000 Fax: 847-572-6259 www.shand.com	\$713,193,431	68.0%	\$836,572,381	60.5%	\$568,962,026	\$20,668,796	96.1%	Michael A. Rozenberg, president
6	United National Insurance Co. * 3 Bala Plaza E., Suite 300 Bala Cynwyd, Pa. 19004 <i>American Insurance Service Inc.</i>	610-664-1500 Fax: 610-660-6887 www.unitednat.com	\$514,573,187	34.6%	\$736,075,049	9.8%	\$142,482,756	(\$56,303,978)	155.3%	Seth D. Freudberg, president
7	Essex Insurance Co. 1209 Orange St. Wilmington, Del. 19801 <i>Markel Corp.</i>	804-273-1400 Fax: 804-273-1435 www.essexinsurance.com	\$484,775,500	66.6%	\$510,152,864	64.5%	\$289,710,049	\$32,662,043	85.7%	Stephen J. Vaccaro Jr., president
8	Columbia Casualty Co* CNA Plaza Chicago, Ill. 60685 <i>CNA Financial Corp.</i>	312-822-5000 Fax: 312-817-0040 www.cna.com	\$425,380,377	97.2%	\$346,679,261	-1.6%	(\$89,415,845)	\$48,354,300	NA	Stephen W. Lilienthal, chairman/ president
9	Admiral Insurance Co. 1255 Caldwell Road Cherry Hill, N.J. 08034 <i>W.R. Berkley Corp.</i>	856-429-9200 Fax: 856-429-6572 www.admiralins.com	\$413,467,892	52.2%	\$471,165,011	55.2%	\$422,435,718	\$44,427,802	84.9%	James S. Carey, president/CEO
10	National Fire & Marine Insurance Co. 3024 Harney St. Omaha, Neb. 68131-3580 <i>Berkshire Hathaway Inc.</i>	402-536-3269 Fax: 402-536-3350 www.nationalindemnity.com	\$402,835,697	377.6%	\$1,011,782,661	1,006.1%	\$801,482,825	(\$240,806,800)	133.0%	Donald F. Wurster, president

*Figures reported on a pooling basis

Source: BI survey

The full Directory of Surplus Lines Insurers is available online in the Directories area of www.businessinsurance.com. The searchable directory allows users to locate surplus lines insurers by company name, gross premiums written, nonadmitted premiums written and number of employees among other items. The online database is free to subscribers of Business Insurance. PDF copies of the directory can be purchased by calling the Crain Information Center at 312-649-5476.

Market: Excess and surplus lines industry gets boost

Continued from page 10

While the federal Terrorism Risk Insurance Act requires insurers to offer terrorism-related coverage, wholesalers and surplus lines insurers note that few buyers are purchasing the coverage. Many are still going bare for terrorism risks, they add.

"I just think that a lot of buyers don't think it's going to happen to them," said Kevin Kelley, chairman and CEO of Boston-based Lexington Insurance Co., a unit of American International Group Inc.

"There's still a market for stand-

alone coverage, and a lot of that is driven by the financial community who take mortgages on property where they think there's significant risk, so they are requiring policyholders to buy very specific coverage," Mr. Kelley added.

Because of the added competition in the property market, some E&S market participants say they see property rates falling, while others say the market is only leveling off.

Property rates at General Star Indemnity Co. in Stamford, Conn., probably peaked around the second

quarter of 2003, said Patricia Roberts, president and CEO.

"A year ago this time, there was really only one market putting out \$100 million property limits," she said. "Today, there are five or six and more coming. The increased amount of people who will freely put out \$100 million limits has grown geometrically, and with it the prices are dropping dramatically."

Rates are flat to 9% lower for property risks with a good loss experience, said Stephen Conner, president and CEO of Crump Insur-

ance Services Inc. in Dallas, a unit of Marsh & McLennan Cos. Inc.

Capacity for California earthquake exposures has increased, and rates have dropped 10% to 25%, he said.

For Florida windstorm exposures, wholesalers differ on the market. In some cases, prices are holding steady but insurers are reducing deductible requirements to 2% or 3% from 5%, Mr. Conner said. Other wholesalers say Florida windstorm prices are dropping.

Wholesalers stress that, despite some leveling off in property lines,

a soft market has not arrived.

"I don't want to give the impression that the hard market has already gone," said Steven DeCarlo, president and CEO of American Wholesale Insurance Group Inc. in Charlotte, N.C. "I would say the high end of the hard market, where people were taking a little bit of advantage of pricing, has come back to normal levels," he said. Mr. DeCarlo said he was referring to the soft pricing of the 1990s.

Casualty stays firm

While the property market has seen some softening, casualty rates are showing no signs of following suit.

Rates for casualty umbrella are holding firm, as there are not a lot of new markets holding down pricing, said Charles W. Wood, chief operating officer at CRC Insurance Services Inc. in Birmingham, Ala.

Through July, casualty rates at Scottsdale have increased by about 19% on average over the prior year, said Mr. Tiepelman. That follows a 20% increase in 2002 and a 26% rise in 2001.

In particular, professional liability prices continue to rise, said Alan Kaufman, chairman, president and CEO of Burns & Wilcox Ltd. in Farmington Hills, Mich. "In some cases, it's quite significant," he said.

While property rates at Lexington rose about 5% during the first half of 2003, with some decreases after July, "for our casualty business, we continue to see very, very strong growth," Mr. Kelley said. "We're seeing rate increases in the 35% to 40% range and growth in the 50% range."

Standard market insurers continue adding to their reserves to make up for deficiencies, especially those related to casualty risks, such as asbestos and directors and officers liability, pointed out Seth D. Freudberg, president of United National Insurance Co. in Bala Cynwyd, Pa. In combination with low investment returns, that means admitted insurers will continue raising their rates, which helps feed the surplus lines market, he added. In 2002, United National boosted its own casualty reserves following a review of its reserving assumptions.

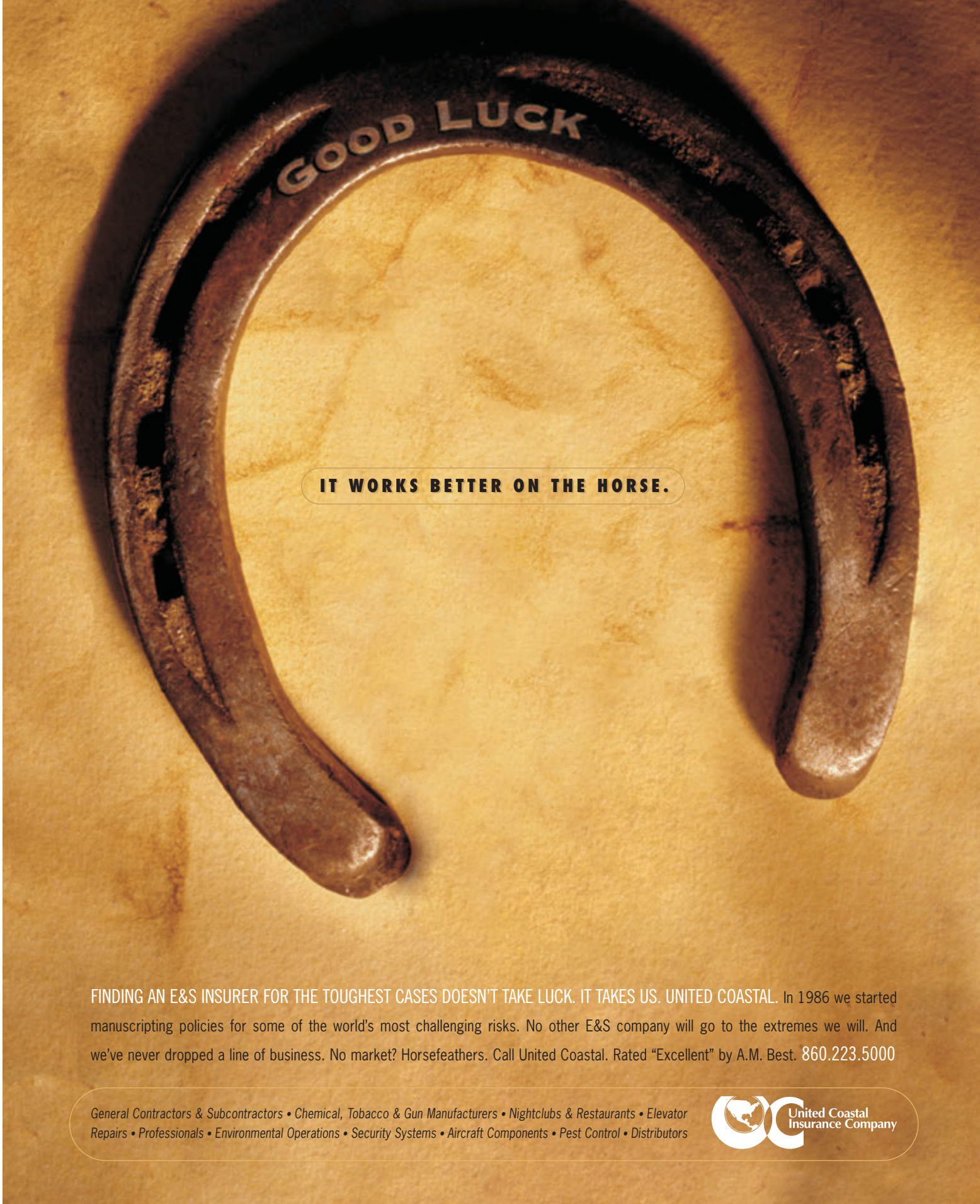
"Casualty rates continue to have a ways to go," Mr. Freudberg said. "We are seeing that in the marketplace. We continue to see substantial increases, particularly in long-tail casualty lines and excess and umbrella. We believe this will continue."

Just how long it will continue depends on how seriously insurers address their reserve deficiencies, he said.

Others, however, see price increases slowing in certain lines.

"In general liability and professional liability, there are also increases, but not as large as we've seen in the past couple of years," said Brad Kiscaden, chief corporate actuary for Richmond, Va.-based Markel Corp., parent of Evanston Insurance Co. of Evanston, Ill. Medical malpractice rates are "still going


See OVERVIEW/page 16



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 United Coastal Insurance Company

Market: E&S industry gets boost

Continued from page 14

up, but not anywhere near" the hikes in 2002 and 2001, he said.

Directors and officers liability coverage, especially for publicly traded entities, continues to have some of the largest rate increases.

D&O pricing for privately held companies is more competitive, but publicly traded companies are seeing 20%, 30% and even 50% increases, said American Wholesale's Mr. DeCarlo.

In public entity D&O business, there is still upward pressure on pricing, "but my belief is it is at or

near its top point," said Mac Wesson, president and chief operating officer of U.S. Risk Insurance Group Inc. in Dallas.

U.S. Risk Insurance has a specialty lines practice that includes public entity D&O, nursing home liability and oil and gas, which are still experiencing hard market pricing and tight capacity, he said.

"Our oil and gas energy program, there's a bit more competition out there in that line, but we're holding our own," Mr. Wesson said.

Transportation risks, residential contractors and nursing homes are

still relying on surplus lines coverage, wholesalers and insurers say.

"Commercial transportation is

'From the beginning of 2002 right to the end, it was an onslaught of new business coming from all directions.'

Mark M. Smith
Stewart Smith Group

not increasing at the same percentage it did last year. Some of the

small business policies, we find that the percentage increase is flattening out. But the more unusual risks, the more difficult placements, still demand pretty significant increases," said Burns & Wilcox's Mr. Kaufman.

Meanwhile, some nursing homes are seeing 100% increases in 2003 following steep increases in previous years, sources say.

Finding capacity for program business is a challenge for some MGAs.

"In our public entity program, we've had trouble finding a mar-

ket," said Marie Solomon, managing director of Victor O. Schinnerer & Co. Inc. in Chevy Chase, Md.

Tony Wittwer, president and CEO of K&K Insurance Group Inc., said the Fort Wayne, Ind.-based MGA spent 2002 focusing "on making sure we had homes for the programs we had." K&K has more than 100 insurance programs covering the sports and entertainment industries.

But, for MGAs, "Generally speaking, business is still very brisk," said Mr. Wesson of U.S. Risk Insurance. "We are, using a baseball analogy, getting a lot of at bats and getting a fair share of hits."

At NIF Group Inc., "business is excellent for us," said Michael A. Orlando, president of the Manhasset, N.Y., MGA. "Rates have been ratcheted up on most of our programs," he said.

Pace of growth slowing

Although continued rate hikes will make 2003 another growth year for the E&S market, increased standard market competition and stabilizing rates for some lines lead industry observers not to expect a repeat of 2002.

Business flooded the E&S segment during 2002 amid general market hardening following the Sept. 11, 2001, terrorist attacks.

"From the beginning of 2002 right to the end, it was an onslaught of new business coming from all directions," said Mr. Smith of Stewart Smith Group.

Among wholesalers, premium volume soared, more than doubling in some cases.

CRC's premium volume jumped to \$1.34 billion from \$575 million in 2001. That growth pushed CRC to the No. 2 spot—up from No. 4 in 2001—in *Business Insurance's* ranking of the largest wholesale insurance brokers.

Surplus lines insurers also benefited from 2002 market conditions.

Lexington's gross premiums written on a direct, nonadmitted basis shot up 73.2% to \$3.61 billion in 2002. The AIG unit's combined ratio also improved, dropping to 92.5% in 2002 from 103.3% the prior year.

Likewise, American International Specialty Lines Insurance Co.—also an AIG company—saw its direct, nonadmitted premiums grow by 200.5% to \$2.45 billion in 2002. Its combined ratio improved to 95.2% from 115%.

Lexington ranked No. 1 on *Business Insurance's* 2002 list of the largest excess and surplus lines insurers, followed by AISLIC.

Schaumburg, Ill.-based Steadfast Insurance Co., a unit of Zurich North America, ranked No. 3 in 2002. Its direct, nonadmitted premiums grew to \$1.22 billion in 2002, up 69.9% over 2001. The largest growth among the top 10 came at No. 9-ranked National Fire & Marine Insurance Co. The Omaha, Neb.-based unit of Berkshire Hathaway Inc. saw its direct, nonadmitted premiums balloon 377.6% to \$402.8 million in 2002, while its combined ratio dropped to 133.0% from 357.8%.

Joanne Wojcik and Rodd Zolkos contributed to this report.

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New products slow to surface in hard market

Wholesalers, inundated with submissions, have little time for creativity

By **ROBERTO CENICEROS**

With wholesalers growing at a dizzying pace—many doubling their premium volume from the year before—there was little time in 2002 to create new products.

Surplus lines insurers also say that, in general, they were so swamped with submissions that few new products flowed from their quarter.

It was a typical hard-market scenario, wholesalers say. They were

pressed to find homes for displaced business or scouring the markets for a better deal when customers called complaining of rapidly escalating rates.

“People were so concentrated on getting their business placed—property, casualty and directors and officers liability—that there wasn’t a lot of creativity,” said M. Steven DeCarlo, president and chief executive officer for American Wholesale Insurance Group Inc. in Charlotte, N.C.

The phenomenon has stretched into 2003 and could continue into 2004, some wholesalers say.

“This is not a period of creating new products,” agreed Mark M. Smith, CEO in New York for Stewart Smith Group. “This is a period of helping the marketplace place what is out there.”

But wholesalers say they know that the hard market’s high-volume times won’t last. So they are looking ahead to diversify their businesses. Some are exploring areas outside

their traditional niches, such as workers compensation coverage and captive consulting.

Birmingham, Ala.-based CRC Insurance Services Inc., for example, earlier this year created a unit to provide its retail agent clients and their customers with captive-formation consulting services, said Mike Johnston, CRC’s senior vp of development.

Surplus lines insurers also have felt the hard market’s pressure as they added staff, particularly under-

writers, to handle an onslaught of submissions.

Scottsdale Insurance Co., for example, recently increased its underwriting department from a staff of 225 to 260. The insurer currently handles 40% more submissions than it did a year ago, said Gary Tiepelman, vp-underwriting for the Scottsdale, Ariz.-based company.

Boston-based Lexington Insurance Co. recently increased its staff from 300 to 550 employees with 80% of the expansion in underwriting, said Kevin Kelley, Lexington’s chairman and CEO.

But observers say a significant portion of insurers’ new growth is aimed at handling business that fell out of the standard lines market or comes from buyers looking for a better deal after incumbent surplus lines insurers raised their rates.

That pressure also has slowed surplus lines insurers from creating new products, market observers say.

But insurers say they continue to improve the products they are offering.

‘People were so concentrated on getting their business placed—property, casualty and directors and officers liability—that there wasn’t a lot of creativity.’

*M. Steven DeCarlo
American Wholesale
Insurance Group Inc.*

“We’re a major market in 2002 for the terrorism product,” Mr. Kelley said of Lexington. “We continue to offer that product on a standalone basis. I would say that we’ve tended to tweak our product offerings as opposed to coming out with new products per se.”

In addition, Lexington’s innovation council looks at new product development, Mr. Kelley added.

While observers say new product creativity often slows during a hard market, exceptions occur.

After exiting a number of unprofitable lines of business, Stamford, Conn.-based General Star Indemnity Co. in 2002 introduced primary liability coverage for “distressed doctors,” or those with prior claims, with a \$1 million limit, said Patricia Roberts, president and CEO.

In early 2002, General Star also began offering excess property coverage with \$25 million limits. General Star is hoping to target property with insured values between \$20 million and \$35 million without catastrophe risk, Ms. Roberts said.

During the third quarter, the insurer added miscellaneous doctors malpractice liability coverage on a primary and excess basis. In the fourth quarter, General Star offered liability coverage for distressed lawyers.

The pace for creating new prod-
See **PRODUCTS**/page 20



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Products : Wholesalers have little time for creativity

Continued from page 18

ucts hasn't slowed in 2003, Ms. Roberts said. General Star, for example, created a criminal justice liability book for private jails, halfway houses and detention centers. It also has launched a standard doctors malpractice liability program on a nonadmitted basis in Oregon and Illinois, and is adding Arizona, Florida and Iowa.

Managing general agents also created new programs and products.

Chevy Chase, Md.-based Victor O. Schinnerer & Co. Inc. in July launched a program for graphic de-

signers. The admitted program with CNA is an outgrowth of Schinnerer's work with architects and engineers, said Lorna M. Parsons, managing director.

In June, Schinnerer also launched EdChoice, a program for small to midsize colleges and universities. It provides employment practices, errors and omissions and directors and officers liability coverage, said Marie Solomon, managing director.

Farmington Hills, Mich.-based Burns & Wilcox Ltd. recently introduced a product to address property

coverage for vacant buildings, said Kenneth A. Schneider, vp and director of product development.

"We have some new umbrella products as well and that's a market that's constantly in flux and constantly changing," Mr. Schneider said. "We just introduced an insurance agents E&O product. That's an area that's in very high demand simply because it's really dried up."

While MGAs have successfully developed some offerings, they also have been stymied by a lack of capacity. During 2002, many insurers

pulled out of the program business and eliminated MGA contracts as reinsurance dried up and insurers opposed contracting out their underwriting judgment.

"In the marketplace, that has been a problem," said Daniel Moggelnicki, vp of NIF Group Inc. in Manhasset, N.Y. "In fact, you look around the marketplace and see a number of carriers that were in programs that are getting out of programs."

Currently, there is about \$5 billion worth of program business looking for a home, market ob-

servers say.

Consequently, MGAs have spent much of their time looking for new markets for their existing programs rather than creating new ones.

"What's interesting is we spend an awful lot of our time and effort securing replacement markets for our programs," said Mac Wesson, president and chief operating officer for U.S. Risk Insurance Group Inc. in Dallas. "We've been very busy and successfully so."

But along with the pent-up demand, there are some signs that insurers may be softening their stance on program business, particularly for programs that have existed for several years and produce more than \$10 million in premium with good loss records.

'What's interesting is we spend an awful lot of our time and effort securing replacement markets for our programs.'

Mac Wesson
U.S. Risk Insurance Group Inc.

In terms of insurers leaving program business, "I would say last year everyone sort of shut their doors," Michael A. Orlando, president of NIF Group. But now, "as the dust is settling...long-term players are sort of looking around, looking for program administrators that have a program they're interested in."

New programs from NIF include a public entity municipality program covering property, general liability, auto liability and law enforcement liability, Mr. Orlando said. NIF has also introduced a monoline property program for large property investors.

"And that's done quite well over the past year, too," he said.

While finding insurers to cover program business has proved a formidable challenge, it has not been impossible in all cases.

After K&K Insurance Group Inc. in 2002 severed ties with TIG Insurance Group, K&K succeeded in finding insurers for all its programs previously underwritten by Irving, Texas-based TIG, said Tony Wittwer, K&K president and CEO.

Since 1986, Fort Wayne, Ind.-based K&K had been the exclusive MGA for TIG on several sports, leisure and entertainment programs.

In terms of limits, however, K&K historically had limits of \$25 million for their in-house property/casualty programs and has seen that cut to \$10 million, "so there's been a slight reduction on what we've been able to do in-house here," Mr. Wittwer said.

But, "We are in discussions with people who have expressed an interest in increasing our capacity on selected programs, so that's another positive indicator of what's happening now."

Joanne Wojcik and Rodd Zolkos contributed to this story.



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NAPSLO details its position on regulatory issues

By DOUGLAS McLEOD

Surplus lines insurers and brokers may agree on most of the fundamental regulatory issues affecting their business, but until recently they've never had a formal statement of their position on those issues.

That changed in June, when the National Assn. of Professional Surplus Lines Offices Ltd. produced the organization's first statement of regulatory principles, covering issues from rate and form regulation to surplus lines licensing and taxation.

The organization's board decided that it needed to "map out exactly what NAPSLO stands for and what NAPSLO is going to defend on behalf of the surplus lines industry in general," explained Nicholas D. Cortezi, chief executive officer of All Risks Ltd. of Timonium, Md., and NAPSLO's current president.

One catalyst for that decision was last year's federal Terrorism Risk Insurance Act, which required property/casualty insurers to offer terrorism coverage and which was seen by many in the surplus lines industry as an encroachment on their

longstanding freedom from rate and form regulation.

"For an industry that was founded on (the idea) of freedom of rate and form, that was breathtaking," Richard Bouhan, executive director of Kansas City, Mo.-based NAPSLO, said of TRIA.

"Clearly, TRIA was a jolt to the industry. The realization that the federal government with the stroke of a pen could rewrite state insurance laws...was something that was an eye-opener for all of us," Mr. Cortezi agreed.

NAPSLO—which has long been

active on the state level in lobbying and litigating regulatory issues—recently considered the possibility of becoming more active on the federal level as well, either by hiring a Washington lobbying firm or opening a Washington office, Mr. Bouhan said.

However, Messrs. Bouhan and Cortezi both said that NAPSLO is unlikely to go ahead with either step in the near future unless the federal government moves dramatically toward assuming an insurance regulatory role.

That hasn't happened so far. Fed-

eral chartering of insurers, for example—an idea NAPSLO generally opposes—has lost momentum in Congress as more attention has been given to setting federal standards for state regulation, Mr. Cortezi noted.

While NAPSLO continues to follow federal issues that could impact the surplus lines industry—among them TRIA implementation issues—much of the organization's legislative and regulatory work will remain on the state level, Mr. Cortezi predicted.

NAPSLO's statement of regulatory principles is meant to serve as a "beacon" marking the group's position for members, state regulators and legislators, NAPSLO officials say.

The nine-point declaration broadly outlines NAPSLO's stance on these issues:

- Freedom of rate and form regulation. This freedom allows the surplus lines insurers to function as a market for hard-to-place risks, and "it should be defended at all times in all states, even for seemingly minor infringements."

'The realization that the federal government with the stroke of a pen could rewrite state insurance laws...was something that was an eye-opener for all of us.'

*Richard Bouhan
National Assn. of Professional
Surplus Lines Offices Ltd.*

Earlier this year, for example, the New England Surplus Lines Assn. and NAPSLO members helped defeat a proposed Rhode Island regulation that would have barred surplus lines insurers from excluding lead paint liability coverage from certain policies.

- The principle of export, in which risks that can't be placed in admitted markets are exported to nonadmitted surplus lines insurers. The principle establishes the regulatory framework of the surplus lines market, defines the role of the surplus lines broker and separates nonadmitted insurers from 50-state regulation, including rate and form regulation, the NAPSLO statement notes.

- Primacy of surplus lines over state residual market mechanisms. Residual markets should not be given risk placement preference over nonadmitted markets and should be used only after a risk has been declined by both admitted and nonadmitted insurers, the statement says.

In Illinois, for example, the state surplus lines association and NAPSLO earlier this year pushed for legislation requiring that commercial risks be declined by the surplus lines market before being placed in any residual market. While Illinois lawmakers passed the legislation in May, Gov. Rod Blagojevich vetoed the bill Aug. 15.

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Views: NAPSLO details position on issues

Continued from page 22

- Uniform and reciprocal licensing of surplus lines brokers. NAPSLO's goal is uniformity and reciprocity among all 50 states.

While reciprocity has improved since the licensing mandates imposed by the federal Gramm-Leach-Bliley Act of 1999, most states' licensing requirements are still not uniform, and NAPSLO would like to see a single licensing application nationwide, Mr. Cortezi said.

- Standardized taxation of multi-state surplus lines risks. States currently impose a confus-

ing patchwork of rules governing collection and allocation of surplus lines tax on policies covering risks in several states, Mr. Cortezi observed. "It is a system that is so convoluted that it is very difficult to comply nationally in every case," he said (see related story).

NAPSLO favors a revised system in which surplus lines tax on multi-state risks would be paid to a single entity—perhaps an entity set up by the National Assn. of Insurance Commissioners—which would then allocate portions to the various states, he said.

- Guaranty funds. NAPSLO opposes surplus lines guaranty funds for several reasons, including that their coverage is inadequate for most commercial risks and the funds thus promote a false sense of security; they promote the use of financially weak insurers; and they could unfairly burden surplus lines policyholders with premium assessments, according to the statement.

- Commercial lines deregulation. In states that have deregulated insurance for commercial risks, exempt commercial transactions should automatically qualify for ex-

port to nonadmitted markets without declinations from admitted insurers, the NAPSLO statement says.

- State regulation and federal standards. While NAPSLO strongly favors the state regulatory system, states must become more uniform and efficient, particularly in the areas of producer licensing and taxation, the statement contends. Federal standards in those areas "could be a positive step in improving the efficiency and effectiveness of the state regulatory system," the organization argues.

The federal government, howev-

er, should not enact any standard that "curtails, hinders or otherwise prevents the surplus lines market from performing its vital role as a supplemental market for insurance consumers," the NAPSLO statement says.

- Federal regulation, which NAPSLO argues cannot be as effective as the state-based system.

If a system of optional federal charters is created, though, that system should allow insurance holding companies to hold federal and state charters simultaneously "so that insurance can be placed under the regulatory system that offers rates, terms and conditions most consistent with the policyholder's needs," NAPSLO contends.



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Premium tax laws create problems Rules a patchwork

By DAVE LENCKUS

When Ellen Vinck purchases surplus lines insurance for United States Marine Repair Inc., which has shipyards on all three coasts, she and her brokers have to make important premium tax decisions.

There are no clear guidelines on how multistate risks should divvy up their tax liability to all the states involved in the insurance transaction.

Given that the Norfolk, Va.-based company's coverages are written as corporate policies, Ms. Vinck and her brokers have opted to pay 100% of any surplus lines premium taxes to Virginia.

The dilemma for Ms. Vinck—vp of risk management and benefits for United States Marine Repair in San Diego—is not uncommon.

Indeed, a patchwork quilt of conflicting state premium tax laws long has created tax filing problems—including occasional double taxation and a regulatory environment in which states refuse to accept tax filings from some brokers—for surplus lines brokers and insurance buyers.

"Within this industry, it's probably the No. 1 issue I hear: 'How do we get this tax paid?'" said Richard Bouhan, executive director of the Kansas City, Mo.-based National Assn. of Professional Surplus Lines Offices Ltd.

In recent years, a Texas court case on premium tax allocation and federal financial services modernization have further complicated the situation.

After a couple of failed attempts, NAPSLO again is poised to offer proposals for simplifying the tax-filing problem. NAPSLO might be ready to approach regulators with its plan sometime in October, according to Mr. Bouhan, who would

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Tax: Patchwork of state laws creates confusion

Continued from page 24
not provide details.

But while state regulators and insurance legislators say they would be willing to entertain ideas on improving the situation, they also point to several factors that threaten to thwart surplus lines tax reform efforts, including the current budget woes many states face.

The lack of a true champion among state regulators for reform is "one of the problems" brokers and insurance buyers must overcome, Mr. Bouhan said.

The laws on surplus line premi-

um tax filings vary from state to state and sometimes directly conflict with one another.

Some states require that a surplus lines broker file 100% of the premium tax to that state, regardless of whether the insurance buyer's policy is covering risks in several states.

Other states require that the broker remit a portion of the tax based on a formula that identifies what portion of the insurance buyer's risk is located in that state. But even among the states that impose allocation requirements upon brokers, the allocation formulas vary wide-

ly.

For example, if an insurance buyer purchases coverage for risks located in two states, one of those states' tax allocation formulas could be based on the valuation of the buyer's property there while the other state might have a tax allocation formula based on the number of employees that the buyer has in the state.

For insurance buyers, the conflicting rules could lead to double taxation at times, according to Mr. Bouhan and New York Insurance Superintendent Gregory V. Serio,

who chairs the National Assn. of Insurance Commissioners' Surplus Lines Committee.

In addition to those conflicting regulations, surplus lines brokers sometimes cannot legally file taxes with a state where that broker is not a licensed surplus lines broker.

At times, the conflicting state rules have led to ridiculous circumstances. For example, because of the varying state rules, Texas during the mid-1980s returned a six-figure tax payment to the surplus lines broker that filed it in connection

with a policy that covered risks in Texas and other states, according to NAPSLO's Mr. Bouhan. Texas returned the tax payment because it could not reconcile its surplus lines tax laws with those of the other states, Mr. Bouhan explained.

Since that time, Texas has changed its regulations, noted Insurance Commissioner Jose Montemayor. For example, surplus lines brokers no longer have to be licensed in Texas to file taxes with the state's comptroller, Mr. Montemayor pointed out.

But tax-filing problems still exist for brokers and buyers in many other jurisdictions, Mr. Bouhan said.

Meanwhile, a 2001 ruling in Texas raised new questions over whether states in some cases are allowed to impose a premium tax.

Relying on a 1962 U.S. Supreme Court ruling, a Texas state appellate court ruled that an insurance buyer that arranges surplus lines coverage in the state where it is headquartered for a risk located elsewhere does not have to pay a premium tax to its headquarters state (*BI*, April 3, 2001). Both the Texas Supreme Court and the U.S.

NAPSLO would like to see the compact include an agreement to create a single clearinghouse to which brokers would file premium taxes. The clearinghouse then would distribute the taxes to the appropriate states.

Supreme Court refused to review the decision on such so-called independent procurements.

Despite such entanglements, NAPSLO believes there are ways to fix the current premium tax problems, Mr. Bouhan said.

While he could not provide specific details on the approach that NAPSLO is considering, Mr. Bouhan laid out an overview of the changes that the organization would like to see. The plan borrows from some earlier suggestions in which regulators initially expressed interest but ran into problems on how they would be implemented.

NAPSLO envisions an interstate compact under which states would agree to a single tax filing system. That would mean at least some states would have to agree to change their premium tax laws so all state surplus lines premium tax regulation would be standardized.

In addition, NAPSLO would like to see the compact include an agreement to create a single clearinghouse to which brokers would file premium taxes. The clearinghouse then would distribute the taxes to the appropriate states.

"The number of surplus lines risks that cross state lines is growing," Mr. Bouhan noted.

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Tax: Patchwork of state laws creates confusion

Continued from page 26

That means there are a growing number of potential instances when a broker may find that states will bar it from filing taxes because the broker is not licensed in the state.

The Gramm-Leach-Bliley Act, the 1999 law that modernized the financial services industry, took a step toward resolving that problem by establishing a license reciprocity system in which a state could recognize the licenses of a surplus lines broker licensed in another state that recognizes brokers licensed in

the first state.

But in its interpretation of Gramm-Leach-Bliley, the NAIC may have further complicated the situation, Mr. Bouhan said. The NAIC has determined that for a surplus lines broker to obtain a reciprocal license from a state, that broker first would have to obtain an underlying broker and agents license from the state.

In addition, there is some question about the responsibilities surplus lines brokers would have if they obtain all of those licenses, Mr. Bouhan noted. Most signif-

icantly, brokers are concerned about whether they would have to conduct due diligence searches for admitted market coverage in every state where covered risks are located, rather than in one state as they currently do, he said.

And, three states with a huge business base—California, Florida and New York—have decided not to be reciprocal states under Gramm-Leach-Bliley, Mr. Bouhan noted.

Referring to the act, Mr. Bouhan observed, "The cure may be worse than the disease."

Some of the principals who would have to drive the changes needed to standardize the premium taxation system nationwide say they are open to it, but they also point to many factors that raise questions whether this decades-old problem ever can be resolved.

The Albany, N.Y.-based National Conference of Insurance Legislators has not taken a stand on the issue because no one has approached the organization about it, said Robert E. Mackin, executive director. "If legislation is brought to our attention, it certainly would receive atten-

tion," he said.

Texas' Mr. Montemayor said that he sees no more premium tax filing problems in the state and that he is unaware of any details of the proposal NAPSLO is putting together. But he stressed that if NAPSLO were to make a proposal that could aid the industry, "if it's within my power, I would grant it." Texas has the second-largest surplus lines premium volume among U.S. jurisdictions, after California (see chart, page 31).

New York's Mr. Serio said that premium tax filings are not a problem in his state, which has the fourth-largest surplus lines premium volume, and that other insurance commissioners have not voiced any concerns, though he knows that "it's been an issue over the last 10 years" for brokers.

More problematical for surplus lines brokers would be the potential cost of putting together a clearinghouse, according to Mark Presser, assistant deputy superintendent and chief examiner in the New York department's property bureau.

The NAIC considered such an endeavor during the mid-1990s, but the regulators' organization, states and the industry could not afford the millions of dollars needed to fund such a clearinghouse, Mr. Presser said.

The NAIC also investigated a scaled-down approach that would have involved offering brokers computer software to guide them through the tax-filing process. But because software development costs would have had to be spread over only a few thousand brokers, it would have been extremely expensive for brokers, Mr. Presser said.

And, there would be no guarantee that states would accept the filing guidelines that the software would produce, he said.

Just as the NAIC picked up the issue again a few years later, the Texas appellate court handed down its decision in the independent insurance procurement case. Regulators again dropped the issue, because they thought the court ruling created an obstacle to reform, Mr. Presser said.

In addition, state comptrollers or legislators—not insurance regulators—would have to implement the necessary reforms in some states, Mr. Presser noted. Regulators in those states would face a Herculean effort pushing those reforms through, he said.

And, certainly not the least of the brokers' hurdles to reform would be changing the tax regulations in the handful of states that now seek 100% of all premium taxes and bar brokers from allocating any premium taxes to other states where covered risks may be, Mr. Serio noted.

Considering states' current budget problems, none would likely give up a source of funds, he said.

"I think there's a general agreement among regulators that some reform would be beneficial, but that it's beyond our capabilities to effect those changes," Mr. Presser said.

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Surplus lines premiums and taxes by state

State	Gross surplus lines premiums written			% change		Surplus lines taxes collected			
	2002	2001	2000	'01-'02	'00-'02	2002	2001	2000	% tax rate
Alabama ¹	\$240,701,250	\$200,899,467	\$156,758,967	20%	54%	\$14,442,075	\$12,053,968	\$9,405,538	6.00%
Alaska	72,531,707	45,847,711	39,477,611	58	84	1,759,067	1,052,202	932,193	2.70
Arizona	325,010,401	172,507,523	117,397,235	88	177	5,324,242	3,457,128	3,396,121	3.00
Arkansas	145,170,159	86,777,229	74,305,884	67	95	5,936,522	3,579,853	3,069,802	4.00
California ²	4,352,803,039	3,036,441,969	2,131,239,862	43	104	113,256,417	79,080,740	56,381,748	3.00
Colorado ¹	333,973,113	246,350,133	162,451,700	36	106	10,019,193	7,390,504	4,873,551	3.00
Connecticut	223,520,388	106,533,596	103,397,060	110	116	8,596,938	4,097,446	3,976,810	4.00
Delaware	49,214,553	30,964,049	32,661,244	59	51	984,294	619,306	653,224	2.00
District of Columbia	135,857,606	90,898,982	99,585,887	49	36	2,064,742	1,360,697	1,781,879	2.00
Florida ³	2,164,379,308	1,355,899,753	1,023,295,458	60	112	97,452,284	62,087,822	47,122,313	5.00
Georgia ⁴	702,336,050	478,034,750	330,966,100	47	112	28,093,442	19,121,390	13,238,644	4.00
Hawaii ^{4,5}	148,244,136	79,594,037	55,832,026	86	166	6,928,597	3,711,915	2,593,620	4.68
Idaho	37,614,763	29,290,548	25,364,963	28	48	972,804	766,846	676,236	2.75
Illinois	511,056,626	299,021,608	224,646,485	71	127	15,334,825	8,973,021	6,741,643	3.00
Indiana	304,760,006	148,721,150	109,250,643	105	179	7,619,000	3,718,029	2,817,916	2.50
Iowa	91,136,381 ⁶	64,895,603	58,029,035	40	57	1,822,728	1,297,912	1,160,581	2.00
Kansas	120,416,422	74,568,367	45,142,763	61	167	7,379,692	4,474,197	2,709,524	6.00
Kentucky	115,717,619	69,902,515	47,409,185	66	144	3,448,162	2,114,889	1,443,549	3.00
Louisiana	655,954,021	502,346,254	352,856,029	31	86	32,797,701	25,117,313	17,642,801	5.00
Maine ^{4,7}	31,972,767	21,710,100	16,676,267	47	92	959,183	651,303	500,288	3.00
Maryland ⁴	241,541,456	150,300,340	122,880,240	61	97	7,192,837	4,507,183	3,684,127	3.00
Massachusetts	567,188,409	340,105,870	271,704,829	67	109	21,269,437	12,785,001	10,178,229	4.00
Michigan	391,021,000	330,259,596	280,249,307	18	40	9,775,525	8,250,721	7,006,234	2.50
Minnesota	200,879,867	123,505,964	91,798,882	63	119	6,026,396	3,705,179	2,753,966	3.00
Mississippi	160,594,026	104,283,125	80,735,413	54	99	6,423,332	4,171,351	3,229,904	4.00
Missouri	384,312,337	258,705,441	196,928,870	49	95	18,832,251	12,636,590	9,715,688	5.00
Montana	30,400,052	14,579,919	8,211,824	109	270	973,272	455,568	258,685	2.75
Nebraska	63,737,200	44,351,962	30,604,934	44	108	1,912,116	1,330,559	953,620	3.00
Nevada	173,213,016	82,536,538	47,422,917	110	265	6,062,476	2,886,268	1,653,310	3.50
New Hampshire	56,410,300	34,862,600	32,560,472	62	73	1,128,206 ⁶	697,252	651,209	2.00
New Jersey	894,667,076 ⁶	537,021,111	338,415,025	67	164	21,842,082	14,178,928	10,302,220	3.00
New Mexico ⁷	75,242,699 ⁸	43,745,755	21,301,000	72	253	2,257,281 ⁸	1,312,373	639,030	3.00
New York	2,033,273,510	845,133,607	681,070,099	141	199	47,675,088	24,674,333	18,647,437	3.60
North Carolina ⁵	336,569,618	214,109,734	130,782,977	57	157	16,828,482	10,705,489	6,539,149	5.00
North Dakota	31,774,062	12,357,381	7,434,780	157	327	556,402	216,256	130,121	1.75
Ohio ⁴	375,528,946	180,879,491	270,699,089	108	39	8,447,409	5,502,964	3,998,887	5.00
Oklahoma ⁴	155,328,300	119,471,283	99,034,616	30	57	9,319,698	7,168,277	5,942,077	6.00
Oregon	173,341,174	99,328,251	75,989,129	75	128	3,466,972	1,986,565	1,519,930	2.00
Pennsylvania ^{3,4}	844,023,000	466,000,000	342,000,000	81	147	18,744,009	10,206,000	8,502,000	3.00
Rhode Island	55,526,822	38,085,795	32,488,100	46	71	1,665,805	1,142,524	974,643	3.00
South Carolina	309,162,181	221,768,291	174,470,832	39	77	12,366,506	8,870,736	6,978,842	4.00
South Dakota	28,962,824	12,867,202	10,618,888	125	173	724,071	321,680	265,472	2.50
Tennessee	260,875,306	186,087,653	237,735,896	40	10	7,102,070	4,885,353	5,194,418	2.50
Texas	2,506,197,148	1,508,379,298	1,127,375,550	66	122	122,541,462	75,411,705	55,367,427	4.85
Utah	106,155,026	68,014,805	52,711,955	56	101	4,511,588	2,890,629	2,240,258	4.25
Vermont ⁵	16,948,138	11,524,496	8,691,943	47	95	345,734	260,758	253,779	3.00
Virginia	384,869,134	273,217,950	183,432,034	41	110	8,787,988	6,526,735	4,307,765	2.25
Washington	408,328,588	264,100,028	183,324,211	55	123	8,166,572	5,283,302	3,668,449	2.00
West Virginia	94,868,976	63,172,286	32,256,542	50	194	3,390,768	2,332,648	1,148,339	4.00
Wisconsin	163,239,526	106,770,218	108,522,807	53	50	4,878,067	3,203,106	3,263,678	3.00
Wyoming	15,297,450	11,635,265	6,055,027	31	153	437,184	343,316	177,010	3.00
Totals	\$22,301,847,482	\$13,908,366,599	\$10,494,252,592	60%	113%	\$748,842,994	\$483,575,830	\$361,263,884	

¹ Fiscal years ending 9/30. ² Numbers revised following new information. ³ Figures include independently procured coverage premiums and taxes collected. ⁴ Fiscal years ending 6/30. ⁵ Net surplus lines premiums written. ⁶ Estimated. ⁷ Former years were B/estimates. ⁸ B/estimate.

Market working to streamline placements for U.S. risks

Lloyd's market bullish about surplus lines business

By SARAH VEYSEY

Lloyd's of London executives and underwriters alike are bullish about the market's surplus lines business and are taking steps to make it easier to place such risks in the Lloyd's market.

As are other surplus lines markets, Lloyd's currently is attracting considerable business that has left or been dumped by admitted insurers because of hard market conditions. But Lloyd's also strives to

build on existing relationships with U.S. coverholders—the wholesalers that have binding authority for Lloyd's syndicates—that endure regardless of market conditions.

U.S. surplus lines business is of critical importance to Lloyd's, according to Julian James, director of worldwide markets at Lloyd's.

"Lloyd's is now the No. 1 surplus lines carrier in the United States, with a 22% market share; and in 2002 Lloyd's underwrote just over \$4 billion of surplus lines business,"

Mr. James said.

Despite its premium volume, the market is not ranked by *Business Insurance* among the largest surplus lines insurers because the ranking is limited to U.S.-based insurers.

"Surplus lines represents 50% of Lloyd's total business transacted in the U.S.," Mr. James said. "I think if you look at the industry as a whole, our belief is that the surplus lines industry is key to the U.S. economy, and its overall importance is growing," he said.

Mr. James noted that in recent years, as the traditional market has hardened, surplus lines premium growth has outstripped the growth of premiums in the U.S. admitted market.

"If you look at premium growth during 2001, it was 35% in the surplus lines market compared with 11% in the overall U.S. property and casualty industry," he said. "In California, which is the largest surplus lines state, the total surplus lines volume doubled between

2001 and 2002 to \$3.6 billion," he said.

This growth is also apparent over a longer term, according to Mr. James. In 1981, surplus lines accounted for about 3.9% of total commercial lines premiums, a figure that by 2001 had more than doubled to 8.4%, he said.

Surplus lines business is very important to the Lloyd's market, agreed Robert Chase, director of underwriting at Kiln P.L.C. in London. "There are really strong relationships between many of the producers or coverholders over in the United States and the Lloyd's underwriters," he said.

When the domestic markets are very hard in the United States, a lot of new surplus lines business finds its way to Lloyd's, Mr. Chase noted. But when the domestic markets soften, some of that business returns to the U.S. market, he acknowledged.

'There are really strong relationships between many of the producers or coverholders over in the United States and the Lloyd's underwriters.'

Robert Chase
Kiln P.L.C.

Lloyd's is able to build and maintain more lasting business relationships than these, though, because of its reputation for writing complicated or nontraditional types of business, Mr. Chase said.

"From America, with its entrepreneurial and economic growth, the tough and more difficult risks for which Lloyd's is renowned tend to find their way into the surplus lines market," agreed Mr. James.

"What you have got are producers or agents in America who are specialists in handling business which is not ideally suited to the local market; there is something slightly unusual about it," noted Mr. Chase.

So those producers tend to look to Lloyd's to get the business written, he said.

"And suddenly they find a market where, yes, there are underwriters who seem capable of talking reasonably intelligently about difficult pieces of business and are prepared to offer them some cover. This is usually done by means of a binding authority," he noted.

"And over the years, the relationship builds up, and regardless of whether the market is soft or hard, generally these coverholders value the relationship they have with the Lloyd's underwriter and will do their damndest to write the business during the soft market in such a way that it will still generate a reasonable return," Mr. Chase asserted.

Kiln, for example, deals with some coverholders who have had

See LLOYD'S/page 34

We are people of integrity.



Jerry Ludwig, chairman and owner of Ludwig-Walpole Company, Sarasota, Fla., enjoys the torchlight by the backyard pool of an RLI personal umbrella policyholder in Sarasota. The torch of his family business will eventually be passed to a third generation of Ludwigs.

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Lloyd's: Market bullish about surplus lines business

Continued from page 32

relationships with Lloyd's for more than 50 years, he said.

"I would say that quite a bit of Lloyd's reputation over in the (United States) is partially made by these coverholders," said Mr. Chase. "In a sense, they sort of sell Lloyd's. It is their lifeblood in some sense, and they are very proud of their association with Lloyd's. And that sort of approach spreads to their clients as well."

The fact that Lloyd's is a subscription market likely gives coverholders an extra sense of security and

continuity, noted Mr. Chase. If a coverholder relies solely on one large insurance company to give it binding authority, it could face problems if that company decides at some point to cease giving that binding authority. But with a subscription market such as Lloyd's, "if the leader or one of the followers changes their mind in two or three years' time, it is not a total collapse."

The amount of surplus lines business coming to Lloyd's has been substantial during the current hard insurance market, said Mr. Chase,

who added that such growth probably reached a peak two or three months ago.

"What is tending to flow back (to the United States) is some of the 'bigger ticket' items, in which the local markets are beginning to show interest again," he said. "But on smaller pieces of business, the domestic markets are still sticking to their hard market rules and regulations and saying, 'No, that's not for me. You'd better try the surplus lines market.'"

Since 2001, Lloyd's syndicate 190 has seen a large increase in the

amount of surplus lines business it underwrites, according to Richard McCarthy, specialty class underwriter for Liberty Syndicates, which manages the syndicate.

The syndicate has seen an increase in income from large U.S. property accounts such as Fortune 500 companies and also for binding authority business made up of smaller property/casualty contracts. That growth has been fueled by a migration of business from the United States' admitted market to the surplus lines market, Mr. McCarthy said.

"And we are still seeing an increasing amount of business coming out of the admitted business into the surplus lines market due to admitted insurance companies in the U.S. still withdrawing from certain classes and certain territories; this has been particularly pronounced in the Northeast this year, places like New Jersey and Massachusetts," he said. "Coverholders over there have seen enormous increases in business being offered."

Rates are holding firm, particularly on smaller business at the moment, noted Mr. McCarthy, though he could not predict how long hard market conditions would last.

In recognition of the importance of surplus lines to the market, Lloyd's is taking steps to streamline the process for coverholders seeking to place surplus lines risks at Lloyd's.

'We have been working on trying to improve the quality of our relationships with coverholders and binding authorities.'

*Julian James
Lloyd's of London*

"We have been working on trying to improve the quality of our relationships with coverholders and binding authorities," said Mr. James. "Our objective is very simply to only approve coverholders who are well-managed, financially secure, who will not only enhance the reputation of Lloyd's in the country in which they operate, but also lead to a long-term—hopefully profitable and successful—partnership," he said.

Over the past year or so, Lloyd's has been working to improve the standards of admission for coverholders and to put in place simplified rules covering underwriters, he said. The market is also introducing a direct contractual relationship between coverholders and underwriters in addition to the contract between coverholder and binding authority.

Lloyd's correspondents department examines the capital adequacy, credit rating and business plans, among other things, of potential coverholders, rather than just relying on individual syndicates to screen them, explained Mr. McCarthy.

"We have introduced an online binding authority registration system," he said, which helps Lloyd's with the process of approving new binding authorities.

This should speed up the approval process, noted Mr. McCarthy.

"When a coverholder comes up for his review—after from one year, to three years to five years, depending on who it is—that process should be streamlined," he said.

"And when there is someone applying for the first time to be a Lloyd's-approved coverholder, that should speed that process up, too," he said.

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Largest wholesale brokers* based on 2002 wholesale premium volume

Rank	Company/Address/Parent	Phone/Fax/Web site	2002 premium volume	% change	2002 gross revenues	% change	% surplus lines	Broker	MGA	Lloyd's of London coverholder	Total employees
1	Swett & Crawford Group Wall Street Plaza, 88 Pine St., 10th Floor New York, N.Y. 10005 <i>Aon Corp.</i>	212-493-7374 fAX: 212-742-1280 www.swett.com	\$2,900,000,000	33.6%	\$256,891,980 ¹	28.1%	56%	77%	21%	2%	910
2	CRC Insurance Services Inc. 1 Metroplex Drive, Suite 400 Birmingham, Ala. 35209 <i>BB&T Corp.</i>	205-870-7790 Fax: 205-879-3739 www.crcins.com	\$1,339,000,000	132.9%	\$108,000,000	102.2%	75% ²	89%	6%	5%	383
3	American Wholesale Insurance Group Inc. 4064 Colony Road, Suite 450 Charlotte, N.C. 28211	704-554-4850 Fax: 704-943-9000 www.amwins.com	\$1,054,206,672	54.6%	\$71,686,054 ¹	50.2%	45%	74%	24%	2%	325
4	Crump Insurance Services Inc. 7557 Rambler Road, Suite 350 Dallas, Texas 75231 <i>Marsh & McLennan Cos. Inc.</i>	214-265-2660 Fax: 214-265-2683 www.crumpins.com	\$987,000,000	31.6%	\$75,012,000 ¹	31.6%	55%	65%	20%	15%	440
5	Stewart Smith Group Wall Street Plaza, 88 Pine St., 17th Floor New York, N.Y. 10005 <i>Willis Group Holdings Ltd.</i>	212-509-2700 Fax: 212-952-8505 www.stewartsmith.com	\$919,425,000	64.7%	\$65,882,893	40.5%	52%	91%	5%	4%	227

* Companies deriving more than 50% of their wholesale premium volume from wholesale brokerage. 1 *BI* estimate. 2 Estimated.

Source: *BI* survey

MGAs/underwriting managers

Largest MGAs/underwriting managers* based on 2002 wholesale premium volume

Rank	Company/Address/Parent	Phone/Fax/Web site	2002 premium volume	% change	2002 gross revenues	% change	% surplus lines	Broker	MGA	Underwriting manager	Lloyd's of London coverholder	Total employees
1	The Schinnerer Group 2 Wisconsin Circle Chevy Chase, Md. 20850 <i>Marsh & McLennan Cos. Inc.</i>	301-961-9800 Fax: 301-951-5444 www.schinnerer.com	\$797,000,000	15.5%	\$66,948,000 ¹	16.9%	5.0%	1.0%	0.0%	99.0%	0.0%	548
2	Burns & Wilcox Ltd. 220 Kaufman Financial Center, 30833 Northwestern Highway Farmington Hills, Mich. 48334 <i>H.W. Kaufman Financial Group Inc.</i>	800-521-1918 Fax: 248-932-9046 www.burnsandwilcox.com	\$540,000,000	21.4%	\$137,063,000	20.9%	90.0%	30.0%	60.0%	0.0%	10.0%	830
3	U.S. Risk Insurance Group Inc. 10210 N. Central Expressway, Suite 500 Dallas, Texas 75231	214-265-7090 Fax: 214-265-2454 www.usrisk.com	\$336,520,000	37.2%	\$38,211,000	20.4%	95.0%	49.7%	25.5%	0.0%	24.8%	274
4	K&K Insurance Group Inc. 1712 Magnavox Way Fort Wayne, Ind. 46804 <i>Aon Corp.</i>	260-459-5000 Fax: 260-459-5967 www.kandkinsurance.com	\$232,000,000	-36.3%	\$50,112,000 ¹	-36.0%	15.0%	5.0%	95.0%	0.0%	0.0%	340
5	NIF Group Inc. 30 Park Ave. Manhasset, N.Y. 11030	516-365-7440 Fax: 516-365-7392 www.nifgroup.com	\$225,445,000	37.3%	\$18,200,000	34.8%	37.0%	37.0%	60.0%	0.0%	3.0%	110

* Companies deriving more than 50% of their wholesale premium volume from acting as a managing general agent, underwriting manager and Lloyd's of London coverholder. 1 *BI* estimate.

Source: *BI* survey

The full Directory of Insurance Wholesalers is available online in the Directories area of www.businessinsurance.com. The searchable directory allows users to locate brokers, MGAs or underwriting managers by company name, premium volume, gross revenues and wholesale revenues, among other items. The online database is free to subscribers of *Business Insurance*. PDF copies of the directory can be purchased by calling the Crain Information Center at 312-649-5476.

Wholesale: Retailers adding, expanding operations

Continued from page 10
tremely different arena of insurance companies that retail agents and brokers don't have access to."

While retail brokers can access other wholesalers and MGAs, "to really align with the actual buyers' needs, having your own (operation) is a pretty good concept," Mr. Strianese said.

And double-digit growth in the E&S market, brought about by standard-market constrictions in recent years, certainly is another attraction.

"There's no bones about it—

they're making a lot of money right now," said Randy Screen, chief insurance marketing and sales executive officer for BB&T Insurance Services Inc. in Raleigh, N.C.

Although Mr. Screen acknowledged that "timing is everything," he said BB&T saw expanding its E&S operations last year—through its acquisition of Birmingham, Ala.-based Cooney Rikard & Curtin Insurance Group—as an opportunity to diversify its insurance operations.

"When the market goes soft again, (wholesalers and MGAs) will

not be minting the money that they have the opportunity to do in

'To really align with the actual buyers' needs, having your own (wholesale operation) is a pretty good concept.'

*Tony Strianese
Peachtree Special Risk
Brokers L.L.C.*

this market," he said. But because BB&T offers other products and ser-

vices, including title insurance, employee benefits and personal lines coverages, "when something is not going well, the other ones can be, so it picks you up," said Mr. Screen.

Since the January 2002 acquisition, BB&T's wholesale unit—CRC Insurance Services Inc.—has made three more purchases, expanding its geographic reach and product offerings.

Prior to buying CRC, BB&T owned a small wholesale operation, which it obtained through another retail brokerage acquisition. Mr.

Screen said BB&T estimates that CRC will generate close to \$100 million in revenues by the end of the year.

BB&T is not alone in recently making a splash into the E&S market.

Glen Allen, Va.-based Hilb, Rogal & Hamilton Co. made a major move into the surplus lines market in June when it created Lake Mary, Fla.-based Dominion Specialty Group. Since then, HRH has expanded its E&S capabilities with the acquisition of Richmond, Va.-based

Continued on next page

Continued from previous page
New World E&S L.L.C. and Dallas-based Maclean, Oddy & Associates Inc.

Dominion Specialty hopes to generate \$25 million in E&S revenues in 2004 and to double that in the next three to four years, said Martin L. Vaughan III, HRH's chairman and CEO.

Mr. Vaughan said diversity was a key factor behind HRH's decision to enter the E&S market now.

"It really has a lot to do with broadening our business lines," he said. "It seemed to us that we were missing a great opportunity not being in the surplus lines business."

At the same time, Mr. Vaughan acknowledged that, given current

MGA operation.

"It gives us...an advantage to be able to access the (E&S) market that we certainly could access if we didn't own (an E&S operation), but we do," said BB&T's Mr. Screen. "So, obviously, we think of our brethren first."

Chicago-based Acordia Inc., which has had a wholesale operation—American E&S Insurance Brokers—since the early 1990s, now is making a "concerted effort internally" to direct more retail business to American E&S, said Kevin W. Conboy, Acordia's president and CEO.

"We think the growth area there is rather attractive for the next year and beyond," he said.

"Wholesale business has always been an integral part of our overall business strategy," Mr. Conboy said.

He noted that "It's becoming more and more of an important part of our business plan, simply because the world is changing. The markets have been through a lot of pain and suffering over the past few years. There are some players that do not exist anymore and a few that are in difficult financial situations."

"So, the emergence of the surplus lines market affords our sales professionals access to the nonstandard market to address the needs and risks of our customer base," he said.

The E&S arena also is becoming

more important to Arthur J. Gallagher & Co.

Risk Placement Services Inc., Gallagher's 6-year-old wholesale unit, in the last two years has added numerous offices and several specialties, such as medical malpractice and various professional liability lines, said Joel D. Cavaness, president of Itasca, Ill.-based RPS. Although the growth was planned, it's "obviously a lot easier to do when the market is more difficult," he said.

"The services of a wholesaler are needed a little more than in the soft market, so it makes sense to try to add to your capabilities, staff and programs," he said.

But unlike other retail brokers

that access the E&S market through their own wholesale operations, RPS takes a different approach.





"Our focus is not Arthur J. Gallagher," Mr. Cavaness said. "We do about 75% of our business outside of the Gallagher family," he said. "They are a customer of ours and that's the way we view it, but it's not just Arthur J. Gallagher business that we're looking at. We want Gallagher offices to go to a wholesaler that can best serve the needs of their clients."

Although Mr. Cavaness acknowledged that the broker is missing out on revenues by taking that approach, RPS posted a 40% increase in revenues in 2002, generating roughly \$60 million.

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'The services of a wholesaler are needed a little more than in the soft market, so it makes sense to try to add to your capabilities, staff and programs.'

*Joel D. Cavaness
Risk Placement Services Inc.*

market conditions, its lack of an E&S operation meant that HRH often was adding to the coffers of its competitors, rather than lining its own pockets.

"When we looked at our peer group and other agents and brokers of our size, it seemed to us they were all in the E&S business, and in a lot of cases, we were giving them a lot of our business," he said.

Indeed, retail brokers say they welcome the chance to hold onto revenues by owning a wholesale or

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Data standard to help ease exchange of information

ACORD, NAPSLO project to standardize surplus lines policy data for London underwriters

By MICHAEL BRADFORD

A new data standard is making it easier for the surplus lines market in the United States to exchange policy information with London underwriters.

ACORD—the Assn. for Coopera-

tive Operations Research & Development—has completed its work with the National Assn. of Professional Surplus Lines Offices Ltd. and other groups to establish the standard, which is expected to speed up the way nonadmitted business is handled in London. The standard

was approved by Pearl River, N.Y.-based ACORD in July and is being implemented on both sides of the Atlantic.

Once the standard is widely in place, U.S. brokers and underwriters will be able to swap common information related to surplus lines policies with underwriters in London.

Agents and brokers can prepare the same reports for all London insurers, and, 'this way, everybody gets the same information.'

*Mike Ardis
National Assn. of Professional
Surplus Lines Offices Ltd.*

Not only are processing functions expected to be faster but London underwriters also are hoping that the standard will give them a way of more accurately establishing the market's exposure to U.S. catastrophes.

Those who helped develop the standard hope for wide implementation in the coming months.

Over the next year, "we hope to see a high take-up rate," said James

Orr, manager of loss modeling in the risk management division at Lloyd's of London. "We don't think that's unreasonable to expect."

Benita Gayton, London-based program manager for commercial and specialty lines at ACORD, said the surplus lines market is being urged to adopt the standard and its importance will be emphasized during NAPSLO's annual conference in San Diego in September. She said many in the London market want to have the standard in place as they begin negotiating 2004 renewals.

Mike Ardis, NAPSLO's director of communications and technology, said he expects many users to have the standard in place this fall, a time when year-end renewal negotiations begin to heat up.

Ms. Gayton said the effort to develop the standard began in June of 2002, when some ACORD members brought up the idea of looking to standardize some surplus lines transactions. At the time, most London underwriters were "asking for lots of different data," she said, making it difficult for agents and brokers in the United States to respond to all the varying requests.

The idea behind the standard was to figure out what common information London market underwrit-

ers needed and develop a format for easily meeting those data requirements. The end result is "a set of agreed-on data fields," explained Mr. Ardis, and includes policyholder names, addresses, coverage limits, deductibles and other information.

The standard, which is written for commercial property and homeowners coverages, replaces a host of other methods of data exchange, according to Ms. Gayton. "Right now, the London market is receiving it in all different manners," via both electronic channels and paper submissions, she said.

Having one set of data requirements that meets all underwriters' needs should make the submission process to the London market much more efficient, the standard's developers say. Agents and brokers can prepare the same reports for all London insurers, and, "this way, everybody gets the same information," said Mr. Ardis.

The standard's data requirements are split into two different views, called implementation guides. One is known as the binding authority implementation guide, and the other is the exposure reporting implementation guide.

The binding authority standard
See STANDARD/page 42



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Survey finds document management tools popular

Imaging technology embraced

By MICHAEL BRADFORD

A clear technological trend in the surplus lines marketplace is the

move by agents, brokers and insurers toward greater use of document imaging systems.

A survey by the National Assn. of

Professional Surplus Lines Offices Ltd. shows, though, that there is still plenty of room for imaging systems vendors to grow among brokers and managing general agents. Surplus lines insurers are a little further along in their use of the systems, according to the survey.

The 2003 NAPSLO Technology Survey showed that 16% of brokers that responded have imaging systems in place and 28.8% of MGAs have the systems. Insurers, though, are much more likely to use imaging systems, with 58.6% saying they have them.

MGAs also are enthusiastic about the systems, according to members of the American Assn. of Managing General Agents.

"Imaging really is the biggest thing going on," said Matthew Letson, vp of Hanover Excess & Surplus Inc. in Wilmington, N.C., and co-chairman of the King of Prussia, Pa.-based AAMGA's automation

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USE OF TECHNOLOGY

What percent of retail agents have formal imaging/document management system in place

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Broker



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Insurers



Total

Source: NAPSLO



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Standard: Easing info exchange

Continued from page 40

accommodates commercial property and homeowners property business for U.S.-based risks. The exposure reporting standard, for commercial property coverages, is to be used for international risks.

Users have the option of employing the standard as a spreadsheet or in extensible markup language, or XML, format.

There's no reason users shouldn't adopt the standard quickly, said Mr.

'It's no real rocket science,' but simply a 'standard protocol. If you follow it, others will also follow it.'

James Orr
Lloyd's of London

Orr of Lloyd's. "It's no real rocket science," he emphasized, but simply a "standard protocol. If you follow it, others will also follow it." As a result, he said, both sides of the process will save time and expense in submitting and manipulating data.

The new standard could also help London market insurers get a clearer idea of their total exposure, according to those who participated in its development.

During a panel discussion in July in London, Phil Brown, reinsurance standards manager at ACORD, agreed with other speakers that the terrorist attacks of Sept. 11, 2001, made it clear that insurers need a more consistent approach to accumulating risk-location data as a way to accurately establish the market's exposure to U.S. catastrophes.

Because the standard will provide

a more consistent and efficient way of gathering, processing and reporting that information, Mr. Brown and London market professionals at the meeting agreed that the new process should provide a better way for insurers to monitor risks and understand their total exposures.

Meanwhile, both ACORD and NAPSLO continue to work on a standard for state stamping offices. Those offices collect policy and underwriting information from surplus lines brokers and insurers to keep track of the amount of business written in the state. Only around 13 states have stamping offices, with the duties being handled by insurance departments in other states.

Much like the standard being used for the London market, the new standard for stamping offices would allow insurers and brokers to submit the same data to all the offices. As of now, ACORD and NAPSLO are working to bring all the offices on board and define the common data set.

"Our role is to help get people together to work out a solution," said Mr. Ardis. ACORD is involved in the nitty-gritty of working out the standard's details.

Ms. Gayton said eight states have agreed on common information that could be used in a standard, leaving five others to come on board.

And, she noted, the stamping offices would like to see more state insurance departments also get involved in such a standard.

Mr. Ardis pointed out that the Florida Surplus Lines Service Office is considered a leader in the effort to make submissions more efficient, with an electronic submission system already in place.

Imaging: Survey details most popular technology

Continued from page 42

and technology committee.

An imaging system generates efficiencies and cost-savings because it "enables every employee to have every file on his or her desk at the same time," Mr. Letson explained.

"Everybody is gravitating to imaging systems to manage their paperwork," said Kevin Tromer, vp at the MacNeill Group Inc. in Sunrise, Fla., and co-chairman of the

AAMGA committee.

He explained that part of the savings from imaging systems comes from the decreased workload on customer service representatives. While those front-line employees previously responded to telephone requests for information from a file or document by either requesting the paperwork from another person or retrieving it themselves, with an imaging system the information can be quickly re-

trieved for the client.

But while such efficiencies are obvious, "what you are doing to service your customer is unquantifiable," said Mr. Tromer.

Tech spending up

There were few surprises in the NAPSLO survey, although "the amount people were spending on technology was a little higher than we expected," said Mike Ardis, director of communications and technology at Kansas City, Mo.-based NAPSLO.

"It might be representative of the hard market," he noted, with members spending additional revenue generated by rising insurance costs on technology improvements.

Overall, the survey showed that respondents budgeted 4.9% of net revenue on technology for this year, slightly more than the 4.8% in 2002. Ten MGAs reported spending more than 10% on technology in 2002 and budgeting the same amount this year.

Turning to outside help

Outsourcing information technology functions remains the most popular way to handle those responsibilities among brokers and MGAs. Seventy percent of brokers let others handle technology functions and 60% of MGAs outsource, according to the survey. Among insurers, though, just 25.8% preferred such outsourcing.

An imaging system generates efficiencies and cost-savings because it 'enables every employee to have every file on his or her desk at the same time.'

Matthew Letson
Hanover Excess & Surplus Inc.

marked.

"We're not a big shop," he said of Southern General, and "we outsource most of our IT services" like the 60% of respondents to the NAPSLO survey. There are other similarities, as well, Mr. Moore confirmed. His agency uses a T1 high-speed Internet connection, as do 59.2% of the MGAs surveyed, and all his employees have e-mail capabilities, just as do those at 97.2% of the responding companies to the NAPSLO survey.

Mr. Moore's company is a little more cutting-edge in its computer operating system. Southern General just upgraded to Microsoft Corp.'s Windows XP, which just 18.6% of MGAs that responded to the NAPSLO survey have in place. Windows 2000 was the clear leader in operating systems, in use by 46.6% of respondents.

Security concerns

Surplus lines companies are doing a pretty good job of computer security, according to the survey, but some problems are slipping through.

Nine percent of the respondents have lost or had data compromised by a virus or worm. Computer hackers have struck the systems of 2.6% of respondents, and 2.1% reported they have had data damaged by a disgruntled employee, the NAPSLO survey found.

Copies of the survey can be obtained within the "technology" area of NAPSLO's Web site, at www.napslo.org.

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GAO advises monitoring of Superfund performance

By MARK A. HOFMANN

WASHINGTON—The Environmental Protection Agency should develop specific indicators to measure the Superfund program's performance, the General Accounting Office recommended in a report released last Tuesday.

In "Superfund Program: Current Status and Future Fiscal Challenges," the GAO noted that the Superfund trust fund revenues from

taxes, cost recoveries, interest, fines and penalties declined from about \$2 billion in fiscal 1995 to less than \$370 million in fiscal 2002.

That has meant that the Superfund trust fund—which pays for cleaning up hazardous waste sites—has had to rely on appropriations by Congress because the program's ability to collect special Superfund taxes expired in 1995 and has not been renewed. Meanwhile, the program's National Priorities List—which contains highly contaminated sites—has continued to grow.

Because of the funding challenges facing the program, the EPA should develop "indicators" to measure how well the program is working, according to the GAO. The office noted that the EPA has recently implemented two indicators, including controlling contaminated groundwater migration and human exposure to contaminants, and is working on others.

The full report is available at www.gao.gov.



PHOTO: KRT

The GAO advises the EPA to monitor the performance of Superfund at sites such as this mining waste dam in Strafford, Vt.

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New York getting tough on health care plan scams

By LAURA B. BENKO

NEW YORK—New York regulators have become the latest to crack down on bogus health insurers that have proliferated in the past two years to prey on uninsured individuals and small businesses desperate to find affordable coverage.

According to a new report by the New York-based Commonwealth Fund, the United States is facing an unprecedented influx of unlicensed health plans posing as legitimate insurers. These fly-by-night companies, which tend to crop up when

insurance prices are high, typically entice new members with rock-bottom rates, collect premiums and then disappear when bills come due, sticking consumers and providers with heaps of unpaid medical bills.

Since 2001, just four of the largest coverage scams have left 100,000 people with \$85 million in unpaid claims, and more casualties are expected as premium increases continue to climb at double-digit rates, the report states.

Others argue that the problem could be exacerbated by likely pas-

sage of federal legislation allowing small employers to buy group coverage through association health plans that are exempt from state laws.

"This is an extremely serious national epidemic," said Mila Kofman, assistant research professor at Georgetown University's Health Policy Institute in Washington and the study's lead author. "No state has been immune."

According to the report, the U.S. Department of Labor reported in December 2002 that it had 107 civil and 19 criminal investigations under way into allegedly fraudulent insurers. The Texas Insurance Department alone has shut down 129 unauthorized health plans and their affiliates during the past two years.

Traditionally, health insurance schemes have come in waves. The current one comes at a time when even legitimate insurers are increasingly targeting the growing ranks of the uninsured. The last spike in illegal plans, which occurred from 1988 to 1991, left more than 398,000 people with \$123 million in unpaid claims.

But the toll could be much worse this time, because the con artists involved are much more savvy and because the crooked plans are now operating on a national rather than regional scale, said James Quiggle, a senior executive at the Coalition Against Insurance Fraud, a Washington-based consumer advocacy group.

Mr. Quiggle pointed to Employers Mutual, an unlicensed insurer based in Carson City, Nev., which operated in every state for 10 months before it was shut down in February 2002. In that time, the company collected \$15 million in premiums, paid out \$3 million in claims and left some 22,000 people with \$50 million in unpaid medical bills.

"The current generation of swindlers have perfected their busi-

ness model," he said. "They've learned how to market their products better and to reach more people faster, robbing them of more money in a shorter time."

The consequences for providers could be dire. By the time a bogus plan is shut down, it usually has little or no assets on which to place a lien, Ms. Kofman said. And patients can rarely gather enough money to cover the outstanding bills themselves.

"Even after taking out second mortgages and using their credit cards, there's usually no way consumers can pay the entire bill" for medical procedures that can cost as much as \$300,000, Ms. Kofman said. "More times than not, providers are stuck with all these claims that are never paid and have to be written off."

Rural hospitals could be hit the hardest, because they often operate on tight budgets and have less means to shift costs. "One cancer patient (who can't pay his bill) can force a small, rural hospital out of business," Ms. Kofman said.

Fortunately, officials in many states are taking swift action against the latest crime wave.

In New York, a recent flurry of consumer complaints prompted the state attorney general, the state insurance superintendent and the state health commissioner to jointly sue a family of health plans for operating without a license and engaging in widespread fraud and deception.

"This is an excellent example of state agencies moving together against a real threat," New York Health Commissioner Antonia Novello said in a statement.

The lawsuit, filed Aug. 22 in New York Supreme Court, alleges that the plans—known as Metro Managed Care, Metro Health Plan, Metro Health Care Plan, MHMC and Metro Health Care Services—falsely represented themselves as nonprofit and charitable organiza-

tions, touted a fictitious network of providers, failed to pay claims, discouraged members from using benefits and terminated policies to avoid payment.

In one case, Metro Health declined to cover a member's prescription for Fosamax, claiming the popular and federally approved osteoporosis drug was still "experimental." Consequently, the member spent \$860 in premiums and \$296 on Fosamax before dropping the plan and enrolling in Medicaid, which covers the drug.

How many members the plans had and how much money they illegally collected and withheld before being shut down isn't known, said a spokesman for state Attorney General Eliot Spitzer. "Because (the plans) were unlicensed, the extent of their actions is hard to determine, but we're still investigating," he said.

Florida, where 30,000 people have reported being bilked by bogus insurers since 2001, has gone even further.

On July 1, the state enacted a law that allows anyone who operates an unlicensed health plan to be charged with a first-, second- or third-degree felony depending on the amount of premium collected. The law also makes it a third-degree felony for anyone who has been banned from the industry to take part in any insurance transaction.

Because the courts are swamped with so many criminal cases, "in order for us to prosecute (illegal insurers), it really has to be a felony," said a spokeswoman for the Florida Department of Financial Services.

Over the past two years, the Florida department has shut down 16 unlicensed insurance companies and filed criminal charges against six.

Laura B. Benko is a reporter for *Modern Healthcare*, a sister publication of *Business Insurance*.

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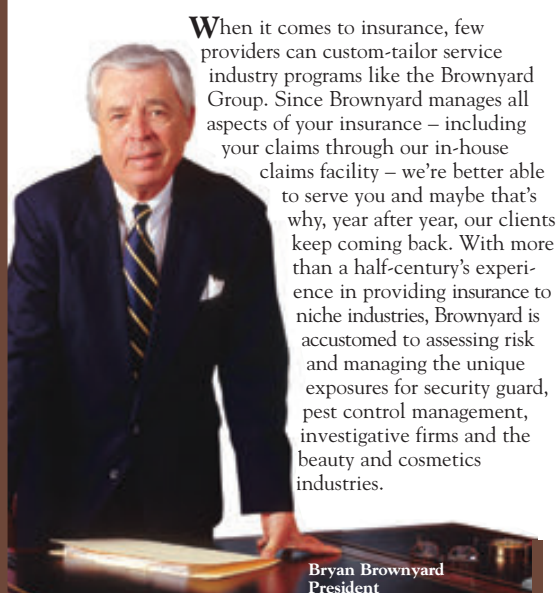


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Shootings likely to prompt more background checks

By **BOB TITA**

CHICAGO—Chicago-area employers likely will be less open to hiring ex-convicts and people with arrest records after a disgruntled former employee killed six at a South Side auto parts business last month.

Job-placement firms dedicated to helping ex-convicts find work are bracing for a backlash, predict-

ing that the incident will spur employers to launch more thorough background checks on job candidates.

Salvador Tapia, who died after a murderous rampage against his old bosses and co-workers at Windy City Core Supply Inc., had a lengthy arrest record for weapons offenses and domestic violence.

Background checks are being rec-

ommended as the most efficient way to identify candidates with violent criminal histories to reduce the risk of violence on shop floors and in offices. Some hiring managers at Chicago-area companies point out that the threat of lawsuits alleging discriminatory hiring practices causes them to tread carefully in investigating job candidates' lives.

And advocates for ex-offenders say that incidents of workplace violence only add to the stigma that people convicted of violent crimes face and make it more difficult for them to re-enter the mainstream.

"Those are already the hardest people to find jobs for," said Thomas Wetzel, director of business relations for the North Lawndale Employment Network in Chicago. "After an incident like this, it will be almost impossible."

About 300 people a year go through North Lawndale's worker-readiness program, but the non-profit agency is able to find jobs for only about one-third of them.

At the Chicago-based Safer Foundation, the state's largest employment advocacy service for ex-offenders, about 5,000 people a year complete job readiness and education programs. The foundation manages to find jobs for 1,200 to 1,500 of them.

Program managers say they don't anticipate a drop-off in hiring in the wake of last week's shootings at Windy City Core Supply, but they add that the job market is already dismal because of the sluggish economy.

Jerry Siegel, president of Midway Moving & Storage in Chicago, has

'We screen all our guys and do a lot of training before we ever put them out in the field. We hold these folks to a very high standard.'

*Jerry Siegel
Midway Moving & Storage*

hired many ex-offenders over the years and contends that potential problems with employees can be averted with good training and supervision.

"We screen all our guys and do a lot of training before we ever put them out in the field," he said. "We hold these folks to very high standards."

Gregory Bangs, a vp at Warren, N.J.-based Chubb Corp., which offers insurance coverage for work-

place violence, said businesses should be diligent in seeking ways to lessen the risk of violence on the job.

"If you have an individual who has a history of violent acts, you should be very, very careful about hiring that person," said Mr. Bangs, who recommends background investigations that search for arrest records.

"Would you rather spend \$150 (for a background check) or do you want to hire somebody who's going to kill three people in your shop?"

But Heather Egan, human resources director for Chicago-based binding company Rickard Circular Folding Co., said companies would face discrimination lawsuits if company policies precluded the hiring of ex-offenders. Moreover, employers can't arbitrarily conduct background investigations on job candidates they suspect of withholding information about criminal records.

"You have to tread a very fine line," she said. "You either do (background checks) for everybody or nobody."

Bob Tita is a reporter for Crain's Chicago Business, a sister publication of Business Insurance.



PHOTO: AP/WIDE WORLD

Crosses stand outside the Windy City Corp. warehouse in Chicago where seven people, including the gunman, were shot to death. Experts say the shooting will prompt more thorough background checks of potential employees.



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Commentary

Where will you be in the next outage?

The more blackouts change, the more they stay the same. Thirty-eight years separate the 1965 Northeast Blackout from the sequel of 2003, but the two have a lot more in common than, say, the Beatles and Eminem.

The 1965 outage doused the lights, phonographs and black-and-white TVs of 30 million people in New York, New England and Ontario; this year's equivalent added a few Midwestern states and afflicted 50 million.

Who in 1965 would have predicted the ordinary things that would fail in 2003—the Internet-connected cell phones, the microwave ovens, the laptops that make a 1960s-vintage supercomputer look like an abacus?

On the other hand, both blackouts started with one tiny glitch in a remote spot that spread through a huge and supposedly reliable power grid. Many people's first thoughts in both cases were of an enemy: in 1965, the Soviet Union; today, terrorists. Both jolted our happy assumption that electric power is as dependable as the sunrise.

Actually, it's blackouts we can probably depend on. After the Northeast Blackout, the nation's utilities banded together into the North American Electric Reliability Council to find and fix threats to the grid. It wasn't supposed to happen again, but it did. It was déjà vu all over again, except you couldn't see anything in the dark.

This means we can probably expect another blackout in 35 or 40 years, despite efforts to pinpoint the latest problems and fix them at a cost of tens of billions of dollars. And that makes me wonder if the next blackout will seem to us the way this year's outage would have seemed in 1965: both strange and eerily familiar.

As I see it, the next blackout sweeps across the entire continent, instantly cutting power in the United States and parts of Canada and Mexico.

Insurers fear this is a long-awaited attack by terrorists from the American Trial Lawyers Assn., who claim they've been driven to violence by decades of tort reform. In fact, the outage is triggered in California by the continual overuse of electronic voting machines. California voters blame former Gov. Gray Davis.

Amid the confusion of the blackout:

- The nation's millions of environmentally safe and efficient electric cars grind to a halt. President Arnold Schwarzenegger pledges federal funds to promote reliable internal combustion engines.

- Brown, Brown, Aon & Marsh, the world's only insurance broker, closes its offices, postponing its pending acquisition of Lloyd's of London.

- Risk managers shift operations to emergency back-up facilities, most outside the United States in locations with secure power supplies, like Iraq.

- Salad bar and yogurt smoothie chain McDonald's Corp. suffers large uninsured spoilage losses.

- American International Group Inc. Chairman Maurice R. Greenberg reminds jittery investors that AIG has a succession plan. Heir apparent Martin Sullivan retires.

- 105-year-old Sen. Orrin Hatch, the longest-serving member of the Senate, postpones hearings on a bill to create a \$500 billion fund to resolve asbestos liabilities. The measure has been stalled by disputes over how to handle claims of those frightened by stories of other

people's asbestos exposure.

- The Social Security Administration is unable to mail monthly checks to baby boomers who have reached the retirement age of 90.

- Utility industry directors and officers liability insurers step up plans to redomesticate to Vanuatu.

- The New York Stock Exchange suspends trading, delaying the historic split of Berkshire Hathaway Inc. common stock, which closes before the blackout at \$652,345 per share.

- Both of the nation's commercial airlines cancel or delay all scheduled flights. Few air travelers notice any disruption of normal service.
- The Environmental Protection Agency issues an emergency ozone alert amid nationwide barbecuing of everything left in the refrigerator.

Things will be different next time, but the same. We'll still have to light candles.

Senior Editor Douglas McLeod can be reached at dmcleod@crain.com.



Doug McLeod

Both blackouts started with one tiny glitch that spread through a huge and supposedly reliable power grid.

Comings & Goings



Ms. Galer



Mr. Cornish



Mr. Bartlett

Insurers:

Zurich North America has named **Donna Galer** executive vp, Office of the CEO. Based in Schaumburg, Ill., she will lead Zurich's corporate responsibility and compliance program, working closely with the internal strategy, finance and risk management teams to coordinate the company's governance and compliance activities. She will also be responsible for strategic planning activities. Ms. Galer previously was executive vp and acting head of investor relations for Zurich Financial Services Group in Zurich.

Also at Zurich North America: **David Young** has been named first vp of strategy for Zurich North America's Middle Markets business unit. Before joining Zurich, Mr. Young was division underwriting manager for Liberty Mutual Insurance Co.

Hamilton, Bermuda-based ACE Ltd. has appointed **Frank Lattal** as chief claims officer. Before his promotion, Mr. Lattal was general counsel for ACE Bermuda.

Brokers:

Seitlin, an Assurex Global Partner, has appointed **Thomas M. Cornish** as president and chief executive officer. Before joining Mia-

mi-based Seitlin, Mr. Cornish was city president of Miami for Sun-Trust Bank.

David M. Glantz has joined Savannah, Ga.-based Palmer & Cay Inc. as executive vp and manager of the firm's new Chicago operations. Before joining Palmer & Cay, Mr. Glantz was resident managing director for Aon Corp.

Reinsurance:

New York-based reinsurance intermediary Gill & Roeser Inc. has made two senior-level appointments.

Charles T. Black and **Vik Jain** have joined the firm as senior vps and will form a new office in Dallas. Before joining Gill & Roeser, Mr. Black was president and chief executive officer for EWI Re Inc., and Mr. Jain was a principal with JMS Associates.

New York-based Willis Re has made two senior-level appointments.

• **John Novak** has been named senior vp in the Los Angeles office. Before joining Willis Re, Mr. Novak was branch manager and property/casualty treaty broker for JLT Re Solutions.

• **Scott Burgess** has been named senior vp in the Philadel-

phia office. Previously, Mr. Burgess was senior vp at American Re-Insurance Co.

Surplus lines:

International Catastrophe Insurance Managers L.L.C. has made two senior-level appointments.

• **John Beck** has been appointed senior vp and regional executive officer, with responsibility for leading the company's expansion on the Eastern seaboard. Before joining Boulder, Colo.-based ICAT, Mr. Beck was assistant vp and profit center manager for Empire Fire & Marine Insurance Co.

• **John Johnson** also has been appointed senior vp and regional executive officer, with responsibility building ICAT's presence in the Gulf region. Previously, Mr. Johnson was vp and product manager for Bank of America.

Managed care:

Mark Bartlett has been appointed executive vp and chief financial officer of Blue Cross & Blue Shield of Michigan. Before his promotion, Mr. Bartlett was senior vp and CFO of the Detroit-based managed care company.

Other suppliers:

New York-based law firm Chadbourne & Parke L.L.P. has named new partners.

• **Philip J. Goodman**, who specializes in reinsurance arbitration and litigation, practices in the Washington office.

• **Joy L. Langford** also practices in the Washington office. Ms. Langford concentrates on insurance and reinsurance litigation and arbitration.

• **Phoebe A. Wilkinson**, who focuses on complex products liability and general commercial litigation, practices in the New York office.

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Cedents log on for online reinsurance

Eight large reinsurance buyers sign up with ri3k for Jan. 1 renewals

By SARAH VEYSEY

LONDON—Eight large cedents have signed up to conduct business on ri3k, the London-based online reinsurance exchange, for the upcoming Jan. 1 renewals.

The group includes ACE Overseas General, a unit of Bermuda-based ACE Ltd.; London-based Aviva P.L.C., formerly known as CGNU P.L.C.; German insurance group Talanx/HDI; and London-based insurer Royal & SunAlliance Insurance Group P.L.C.

Brit Insurance Holdings P.L.C. and Hiscox P.L.C., both of which have large Lloyd's of London operations, have also signed up to use the online exchange during the upcoming renewal season.

The other two participating reinsurance buyers asked not to be

named, although industry sources said both are major players in the marketplace.

The ri3k exchange in London, which was formed in 2000, allows insurers, reinsurers and brokers to negotiate, exchange and bind contracts online. The company operates a similar exchange in Singapore for the Asian market. Gross premiums transacted across the platform so far total about \$100 million, a spokesman for ri3k said.

The eight cedents that have decided to participate in the ri3k system will use it for their treaty renewals, said Alex Letts, chief executive of ri3k.

Mr. Letts noted that although reinsurance trading platforms had previously focused on facultative business, ri3k decided after meeting

See R13K/next page



World Updates

New syndicate forms at Lloyd's

A new liability syndicate will launch at Lloyd's of London next year. Newly formed managing agency Illium Insurance will manage syndicate 4040, which will have capacity of £100 million (\$157.6 million) for 2004. The syndicate's active underwriter will be Denis Burniston, a former director of Limit Underwriting Ltd.'s syndicate 386. About 53% of the business written by the syndicate will be third-party liability, Mr. Burniston said, while employers liability will account for 41% and contractors all-risk business will make up 6%.

Benfield revenues rise in first half

Reinsurance broker Benfield Group Ltd. recorded gross revenues of £153.7 million (\$254.1 million) for the first six months of 2003, an 8.3% increase over the comparable period in 2002. Revenues from international business totaled £89.3 million (\$147.6 million), up 6.9%. Pretax profits were £1.5 million (\$2.5 million), compared with a loss of £2.7 million (\$4.1 million) in the prior-year period, Benfield said.

XL Capital completes Le Mans Re purchase

XL Capital Ltd. has completed its acquisition of the 33% of Le Mans Re owned by French insurer Les Mutuelles du Mans Assurances Group. Le Mans Re was formed in 1999 as a joint venture between XL and MMA. Le Mans Re will now be known as XL Re Europe.

Lloyd's to reduce Central Fund levy

Lloyd's of London next year will reduce syndicates' contributions to the market's Central Fund. In 2004, Lloyd's syndicates will have to pay 1.25% of their capacity—down from 2.0% this year—to the fund, which is intended to meet the liabilities of insolvent syndicates. The reduced rate reflects the financial strength of the market and of the Central Fund, a Lloyd's spokeswoman said.

Liberty Syndicates adds Paris office

Lloyd's of London managing agency Liberty Syndicates has opened an office in Paris to write reinsurance business at Lloyd's. The Paris office, which opened in August, operates as part of Liberty's syndicate 190, underwriting global property reinsurance with a focus on catastrophe and per-risk business. The Paris-based team is headed by Jean-Pierre Benoit, formerly general manager and chief operating officer worldwide at AXA Re.



PHOTO: REUTERS

Disasters such as the 1995 Kobe earthquake, which killed 6,300 and resulted in nearly \$6 billion in insured losses, have prompted interest in studying Japanese earthquake risks.

Researchers study Tokyo quake risks

TOKYO—Swiss Reinsurance Co. is sponsoring new research into the earthquake risk in the greater Tokyo area.

The Zurich, Switzerland-based reinsurer announced last week that the sponsored study aims to establish the probability of future earthquakes in Tokyo. The city, which has a high density of population and development, is located in one of the world's most seismically active regions.

A team of U.S. and Japanese scientists—including representatives of the United States Geological Survey and Japan's Active Fault Research Center—will carry out the research. Initial work began in May, and Swiss Re said the study should be completed by the end of 2004.

"We hope not only to improve the global knowledge base

on Japanese earthquake risks, but also to provide greater impetus for cutting-edge products such as catastrophe bonds—a large number of which have originated from Japan," Bruno Porro, Swiss Re's chief risk officer, said in a statement.

Swiss Re said that the study will complement another effort under way by the Japanese government and seismologists to create a seismic hazard map of Japan.

Such research was accelerated by the 1995 Kobe earthquake, which killed more than 6,300 people and caused an estimated \$100 billion in damages, of which nearly \$6 billion was insured. In 1923, an earthquake centered in Yokohama, just south of Tokyo, killed 143,000 people and caused an estimated \$2.8 billion in damages.

—By Neil Hodge

Australian insurers questioned about continued high rates

Insurers say pricing in line with risks

By ELIZABETH FRY

CANBERRA, Australia—Given insurers' hefty profits and continued high rates, Australian regulators are beginning to question whether insurers are charging too much, especially in light of tort reforms designed to end the country's public liability insurance crisis.

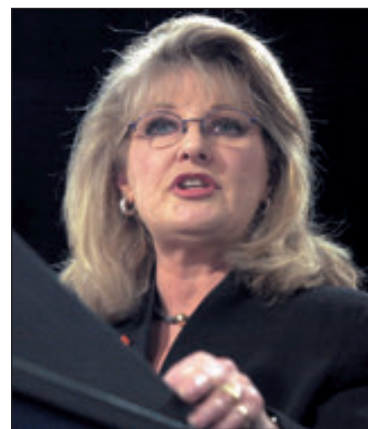


PHOTO: NEWSPIX

Helen Coonan, Australia's minister for revenue and assistant federal treasurer, says federal tort reforms should reduce insurance prices.

Australian insurers counter, though, that rates must remain high because of the long-term nature of the liability risks they underwrite and the sizable losses incurred in recent years. But according to Michael Wilkins, chief executive officer and managing director of Sydney, Australia-based Promina Group Ltd., premium rates will in-

crease at a much slower rate than previously, as pricing comes in line with risks and as the effects of legislative reforms are realized over the next 18 months.

And risk managers generally agree that despite high rates, competitive market forces—not government intervention—should guide insurance pricing.

In recent weeks, strong earnings reports by several publicly held insurers—Sydney-based Insurance Australia Group Ltd.; Promina; QBE Insurance Group Ltd.; and Brisbane, Australia-based Suncorp-Metway Ltd.—appear to support the arguments of Australia's antitrust regulator, the Australian Competition and Consumer Commission, that insurers have more than recovered from past losses.

Sydney-based QBE, which is Australia's largest property/casualty insurer, reported first-half net income of \$241 million Australian (\$161.6 million), up 110% compared with the first half of 2002. While earnings received a big boost from investment income, QBE also reported that rates had increased for most classes of business and that it had sustained "no large claims."

The first-half profits reported by QBE and other insurers prompted ACCC Chairman Graeme Samuels to warn the insurance industry that he would seek the authority to force insurers to pass on to policyholders some of the savings being generated by various state tort reforms.

State governments have adopted

See AUSTRALIA/page 51

ri3k: Cedents signing up for online reinsurance

Continued from previous page with insurers, reinsurers and brokers that treaty business was better suited to such electronic transactions, he said.

One of the benefits of using the system, Mr. Letts said, is that it lets insurers and their brokers access reinsurers online, allowing them to exchange data without time delays and the risk of human error. This also makes the process cheaper, he noted. When ri3k was founded, Mr. Letts said that the exchange hoped to cut back-office

costs associated with reinsurance transactions by 10%-20% (BI, Sept. 10, 2001).

The system also can enhance corporate governance, Mr. Letts said, as information and data exchanges can be more easily logged and tracked. Furthermore, it helps cedents track their worldwide reinsurance exposures and risk aggregation, he noted.

"We have been transacting our group and international treaty renewals over this hub since Jan. 1, 2003, and have been delighted with

the enhanced governance, compliance and discipline that ri3k brings, enabling us to co-ordinate and simplify the management of all our reinsurance and risk management activities," Craig Patterson, director of group reinsurance at Aviva, said in a statement.

Reinsurance brokerage Guy Carpenter & Co. Inc. and global reinsurers PartnerRe Ltd. and Hannover Re Group also have been closely involved in the development and use of the system, ri3k said.

"The reinsurance market still lags

behind other industries in exploiting technology for efficiency gains," Bruno Meyenhofer, chief executive officer of PartnerRe Global in Bermuda, said in a statement. "We all want and need these gains," he said, noting that electronic data exchange was one way of making the process of placing reinsurance risk more efficient for buyers.

Earlier this year, online reinsurance trading platform inreon Ltd. closed to new business, saying that the number of transactions completed using the platform fell short

of expectations (BI, May 12).

London-based inreon was launched in December 2000 by the world's two largest reinsurers—Zurich-based Swiss Reinsurance Co. and Munich, Germany-based Munich Reinsurance Co.—as well as consulting firm Accenture and capital provider Internet Capital Group.

inreon said that despite 130 companies across the world signing agreements to trade online via the platform, "the total number of risks transacted remained low compared with total market volumes."

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Proposals shall be made in the format included in the Invitation For Bid package containing instructions, specifications and detailed submission requirements. Packets may be obtained by contacting NYCHA's Workers Compensation Broker: Aon Risk Services, 55 East 52nd Street, 35th Floor, New York, N.Y. 10055 at (212) 441-1604. In order to be eligible, completed bid proposals must be received by 4:30 P.M. on October 24, 2003.

All inquires for additional information regarding the Invitation For Bid are to be directed, in writing, to George Goettelman, Broker, Aon Risk Services at the aforementioned address/phone.



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Michael R. Bloomberg, Mayor, City of New York
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REQUEST FOR PROPOSALS

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BATTEN, AS PROVISIONAL LIQUIDATORS OF
INDEPENDENT INSURANCE
COMPANY LIMITED,
DEBTOR IN A FOREIGN PROCEEDING
CASE NO. 01-13899 (SMB)

NOTICE IS HEREBY GIVEN THAT ON AUGUST 28, 2003, THE BANKRUPTCY COURT ENTERED AN ORDER (THE "ORDER") CONTINUING THE PRELIMINARY INJUNCTION ORDER PURSUANT TO 11 U.S.C. §304 ORIGINALLY ENTERED IN THIS CASE ON JULY 31, 2001. THE ORDER SHALL REMAIN IN EFFECT PENDING A HEARING SCHEDULED TO BE HELD ON FEBRUARY 26, 2004 AT 10:00 A.M. (THE "RETURN DATE") BEFORE THE HONORABLE STUART M. BERNSTEIN, CHIEF UNITED STATES BANKRUPTCY JUDGE, IN THE UNITED STATES BANKRUPTCY COURT LOCATED AT ONE BOWLING GREEN, NEW YORK, NEW YORK. ALL PAPERS SUBMITTED FOR THE PURPOSE OF OPPOSING THE CONTINUATION OF THE ORDER AFTER THE RETURN DATE SHALL BE FILED WITH THE COURT, WITH A COPY TO THE CHAMBERS OF THE HONORABLE STUART M. BERNSTEIN AND SERVED ON COUNSEL FOR THE PETITIONERS LISTED BELOW, SO AS TO BE RECEIVED AT LEAST FOURTEEN (14) DAYS PRIOR TO THE RETURN DATE. ANY PERSON WISHING TO OBTAIN A COPY OF THE ORDER SHOULD CONTACT COUNSEL TO THE PETITIONERS.

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ADVISORY NOTICE

ADVISORY NOTICE

To All Creditors of Pan Atlantic Insurance Company Limited in Provisional Liquidation: As of January 13, 2000, all of Pan Atlantic's title to reinsurance recoverables, with the exception of claims against Lloyds Syndicates/Equitas Limited (the "Assigned Recoverables") were assigned to PAICO Receivables, LLC ("PRLLC"). All amounts due from reinsurers to Pan Atlantic in respect of the Assigned Recoverables are the property of PRLLC.

If you have claims against the Pan Atlantic estate, please note that the Scheme of Arrangement that was sanctioned by the High Court on July 22, 2003 calls for filing of claims on a gross basis (no netting of offsets). All claims must be submitted with the Scheme Officers on or before September 18, 2003 as provided for in the Scheme. The obligation, if any, of PRLLC to accept offset of amounts due a reinsurer by PAICO against amounts due on the Assigned Recoverables, may depend on various facts and circumstances. **Please be advised that PRLLC does not intend to accept offset of any amount against any of the Assigned Recoverables for any claim not timely filed and accepted by the Pan Atlantic Scheme Officers.**

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Australia: Government questions rating practices

Continued from page 49

legislation to cap court awards and bar certain kinds of claims in the areas of public and professional liability. Those reforms were made in response to a crisis in insurance affordability and availability in Australia, in which general market hardening was dramatically amplified by the 2001 collapse of HIH Insurance Ltd.

Helen Coonan, Australia's minister for revenue and assistant federal treasurer, is seeking to force the industry to price its products more fairly. She cited actuarial estimates that conclude that, as a result of these tort reforms, premiums should come down by 13.5% on average.

Ms. Coonan contends that insurers exploited the public uncertainty caused by the Sept. 11, 2001, terrorist attacks and the 2001 collapse of HIH, which alone had accounted for about 80% of the high-risk liability and indemnity classes in Australia.

She noted that QBE, for instance, reported losing \$252 million Australian (\$129.0 million) in the World Trade Center disaster, but has since more than made up for

this loss through higher premiums and profits.

In her view, HIH's disappearance from the market in 2001 and the reluctance of most of the remaining Australian insurers to take on these long-tail classes for anything less than exorbitant premiums are the main factors behind the public liability crisis in Australia.

Yet, insurance companies are not about to respond to threats by the government to reduce rates for what they see as a long-long tail business with many unpredictable market variables.

An Insurance Council of Australia spokesperson said future rates will be affected by the significant increase in claims costs. A recent ACCC report revealed a 75% increase in claims between 1997 and 2002.

As such, all indications from the industry are that insurance rates will continue to rise.

Brad Greer, president of the Assn. of Risk & Insurance Managers of Australasia Ltd., said he accepts that the market has hardened and that public liability rates would not be cut for at least another nine months.

"The dynamics of the market have changed. This market is tougher for longer than we expected," said Mr. Greer, who also is the insurance and risk management officer at Griffith University in Brisbane.

'I don't think that (government) intervention is justified. I think there is enough competition in the marketplace and rates have to come down.'

Ashley Selwood
Australian Rugby Union

Kevin Mutch, group risk manager of the Melbourne, Australia-based global mining and resources company Rio Tinto Ltd., said underwriting is not a perfect science. He said that insurers will need to become more discerning, more technical, better at analyzing corporate risk and then price accordingly.

"So what you're going to find is rather than be a level playing field

where pricing might be flatter across the industries, you might find high risk industries pay a higher premium," he said.

Ashley Selwood, the chief financial officer and risk manager of the Australian Rugby Union, has encountered "nightmarish" problems securing affordable liability insurance premiums in connection with the Rugby World Cup 2003, which is being held at several venues in Australia starting Oct. 10.

"I think there has been a polarization in the insurance market, and that has caused some problems," he said. "But I don't think that ACCC intervention is justified. I think there is enough competition in the marketplace and rates have to come down."

Mr. Greer and Mr. Mutch also said they do not support ACCC intervention in insurance pricing.

In general, risk managers believe liability insurance premiums will rise another 30% this year. An analysis by the ACCC shows public liability premiums rose 44% last year, with professional indemnity premiums up 36%. In a recent industry report on the Australia's insurance market, Standard & Poor's Corp.

said this period of unprecedented rate increases will continue for the next two years.

In its report, S&P says: "The ultimate moderation in premium rates as opportunistic capital floods the market is likely to be less pronounced than for previous soft markets because of elevated shareholder focus on profitability and less investment market leverage with which to support reported profitability.

"Nonlife insurers have emerged stronger and more profitable following Sept. 11 and the HIH Insurance collapse and as material premium rises for the second and third year of renewals are successfully achieved, and with claims experience remaining manageable in most lines. Through the mid-1990s, nonlife insurers benefited from investment market gains, taking the pressure off ordinary underwriting performance.

"The playing field has now changed, with owners actively demanding and monitoring underwriting profits and having less tolerance for material investment income volatility," the S&P report states.

FIFA taps capital markets to cover cancellation risks for 2006 World Cup event

By SARAH VEYSEY

ZURICH, Switzerland—The Federation Internationale de Football Assn. plans to turn to the capital markets—rather than traditional insurance companies—to cover the risk of cancellation of the 2006 World Cup tournament.

Zurich-based FIFA announced that it will issue bonds worth 350 million Swiss francs (\$250 million) to investors this month. Funds raised in the bond issue would be used only to protect against any losses stemming from the cancellation of the next World Cup, which kicks off in Germany in June 2006, FIFA said in a statement.

Once the tournament has been completed, funds will be repaid to investors, noted the governing body of world soccer. FIFA declined to provide additional detail on the structure of the bonds.

FIFA said it decided to tap the capital markets after evaluating the traditional insurance market for event cancellation coverage and concluding that it "no longer covers FIFA's needs as required."

In the wake of the Sept. 11, 2001, terrorist attacks, FIFA's insurers, led by AXA S.A., withdrew cancellation coverage for the 2002 World Cup (BI, Oct. 15, 2001). AXA Colonia Versicherung A.G., a unit of Paris-based insurance giant AXA, which

led a consortium providing the 944 million euros (\$861.4 million) of coverage, said the termination in November was prompted by the "uncertain international climate."

FIFA was able to find alternative cancellation coverage for the 2002 tournament, provided by National Indemnity Co. Ltd., a unit of Berkshire Hathaway Inc.

But FIFA said it "requires any future insurance arrangements to be immune from such risk" of coverage being withdrawn.

"The proposed transaction meets FIFA's requirements in this respect and provides certainty as to the continuity of insurance cover," FIFA said.

The bond issue was structured by Credit Suisse First Boston.

Earlier this year, FIFA was uninsured for the cost of relocating the 2003 Women's World Cup to the United States from China, due to concerns about SARS outbreaks. The tournament runs from Sept. 23 to Oct. 11.

FIFA at the time said it could afford to buy event cancellation coverage only for the men's World Cup tournament.

"Due to various economic factors including the current global economy and steadily rising insurance premiums, FIFA will not carry cancellation insurance for additional FIFA events," a spokesman said.



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Results: Most reinsurers post gains

Continued from page 3

ficer of Overland Park, Kan.-based ERC Property & Casualty Reinsurance Corp., said it is positive to see the industry combined ratio below 100%. "Our view is that the industry in general, especially in this era of lower investment yields, needs to be pricing to a combined ratio in the low 90s to be profitable. It's nice to see, compared with previous years, that some of the pricing benefits and the terms and conditions benefits we've seen along with the industry may be starting to take hold," said Mr. Wright.

"Obviously, we're seeing the impact of price increases on companies," said Brian Meredith, senior property/casualty insurance analyst with Banc of America Securities in New York. But, he added, "there are still a number of companies with combined ratios well above 100," which indicates the continued need for price hikes to achieve adequate return on capital.

Furthermore, the broker market reinsurers "continue to benefit from what's called the re-underwriting, or the conservatism, that you're finding" among the big direct reinsurers, said Mr. Meredith. "Given the heavy losses (direct reinsurers have) had over the last three years, the reserve developments, they have taken a pretty hard line on underwriting, and therefore have shed accounts and shed business, and that business, when it leaves the Gen Re or the Munich Re will go visit the broker market reinsurers," said Mr. Meredith.

The low interest rates remain a factor in reinsurers' results, say observers. "On the one hand, it is incrementally positive to maintaining the hard market conditions and the strong pricing environment," said Moody's Mr. Bartie. "But on the other hand, it has the negative effect of subduing earnings and capital generation."

Low interest rates and the reserve developments of the late 1990s lends people "more resolve to get to adequate rates and stay there," said Steve Tirney, president of Philadelphia-based reinsurer PMA Capital Corp.

Gary Ransom, senior vp at Hartford, Conn.-based Conning Research & Consulting Inc., said, however, "I was more worried about it when the 10-year Treasury (note) was down under 3.5%." Now, though, the rate is back up to about 4.5%. "The companies have already dealt with the interest rates over almost the whole past 12 months."

The investment side of the equation is a "wild card," said Chris Winans, senior property/casualty analyst with Lehman Brothers in New York. "We're going into an economic recovery, and therefore a stock market recovery, and therefore higher interest rates. The question is, will we get compounding on the underwriting profit that offsets the negative impact on the balance sheet of bond portfolios declining in value?"

Most observers are generally optimistic, though, about the reinsurance industry's outlook and expect rates to remain hard.

"I think the casualty rates still have some momentum to them," said Mr. Tirney. "The property rates have been leveling off, but they're leveling off at an adequate level," said Mr. Tirney, who noted property rates have been increasing now for three years.

The January renewals "will kind of look like things right now. You'll still see casualty rates still inching up and property rates level," Mr. Tirney said.

"I would expect to see possibly some moderation in rates, but still strong rates and a hard market for the next 12 to 18 months," said Mr. Ward. "The post-9/11 era has really moved towards a broad-based hardening across a lot of different lines of business, and I just would expect that for the foreseeable future there's going to be strong pricing discipline in most lines."

"The fundamental framework that drives the hard market has not changed," said Thomas Holzheu, a senior economist with Swiss Reinsurance America in New York. The industry's capital position worldwide is still tight, and interest rates remain low, even though they are now increasing, he said. "Things are still set on underwriting discipline, and that's what we expect to continue, absent any major national catastrophes," said Mr. Holzheu.

However, Moody's Mr. Bartie said, "our outlook for the industry remains negative." The industry certainly continues to see the potential need for "reinsurers to continue to strengthen loss reserves," he said.

The terrorism risks being assumed

by reinsurers also are a potential concern, say some observers.

"I've been hearing anecdotally that some reinsurers are really going after this business, not because they could price it adequately, but because they could put any price they wanted on it," said Mr. Winans.

But even that might not be enough, he said. "Basically, we're in a market that's being priced based on a single event, at least in the U.S. That's not much of an actuarial sample."

The question is whether the reinsurers that have taken on this business are adequately capitalized to handle another World Trade Center-type event, said Mr. Winans.

"They might be better off now than they were then, but it depends on so many unknowable variables. I suppose there are ways to write this business and be careful about it, but companies should be able to explain how they did it," said Mr. Winans.

"How did they limit their exposures geographically? How did they limit their exposure in other ways relative to aircraft as well as properties, and how did they price it? What is the worst-case scenario that each company takes on, and how well capitalized are they for that? It seems to me that, with investment income so weak, the profitability that they're showing on underwriting is all they have to really support those kinds of risks," he said.

While heightened demand for U.S. terrorism reinsurance is likely, this "has a somewhat conflicting effect," said Mr. Bartie. "On the one

hand, it contributes to continued market firmness, while on the other hand, it results in greater exposure to difficult-to-quantify risk. It's a very tricky coverage, too. It's a very challenging coverage to try to underwrite and almost impossible to know how to price."

Others agree. "It's not really a normal property/casualty product because it's based on human elements that are deciding whether to cause a loss or not, not an act of God," said Mr. Ransom. "This makes it very difficult to predict the frequency as well as the severity, so they just pick a price and hope there's no loss."

"It's awfully tough actuarially to put a price" on terrorism coverage, ERC's Mr. Wright said. "I think we're struggling with the rest of the industry, really, trying to work with modeling companies to refine and improve those models."

PMA Re's Mr. Tirney added, "It's hard to price for terrorism because you don't know when they're going to strike, or where or how devastating a blow it's going to be, so we try to keep it out of our contracts or cap it in some way, so we know exactly what the worst-case scenario is."

Other observers note also it is still a relatively new market. "Terrorism is a fairly new risk that we're all dealing with, and it's just difficult to say how that's going to play out, so that remains a true uncertainty," said Mr. Ward.

"That's still a market that's finding its legs," agreed Cliff Gallant, an analyst with Keefe, Bruyette & Woods in New York. "We're better of than we were a year ago, and we're definitely moving towards creating that market, but it's still early days."

LARGEST U.S. REINSURERS' FIRST-HALF 2003 RESULTS

Ranked by net reinsurance premiums written. All amounts in thousands of dollars.

Reinsurer	Net reinsurance premiums written 2003	Net reinsurance premiums written 2002	Policyholder surplus (reinsurers only)	Net income (loss) 2003	Loss & loss adjustment expenses	Loss ratio	Underwriting expenses	Expense ratio	Combined ratio 2003	Combined ratio 2002
Employers Reinsurance Corp. Group ¹	\$2,266,668	\$2,100,598	\$5,663,048	\$279,735	\$1,618,372	75.3%	\$641,598	28.3%	103.6%	117.6%
National Indemnity Co.	1,667,345	1,248,248	15,732,073	675,785	620,690	45.8	198,997	11.9	57.7	52.5
General Re Group ²	1,610,034	1,982,663	5,033,789	728,466	1,223,685	69.0	521,728	32.4	101.4	107.3
Transatlantic/Putnam Reinsurance Co.	1,464,669	1,072,227	1,665,520	87,438	930,281	69.6	393,836	26.9	96.5	98.0
Everest Reinsurance Co.	1,338,271	993,347	1,614,624	83,283	817,950	71.3	317,234	23.7	95.0	97.2
Swiss Reinsurance America ³	955,201	512,314	2,504,972	25,183	755,789	89.6	293,375	30.7	120.3	114.6
Odyssey America Reinsurance Corp./Odyssey Reins Corp. ⁴	927,914	677,686	1,184,270	108,584	565,844	68.4	264,546	28.5	96.9	97.7
American Re Corp. ⁵	715,935	536,843	2,861,076	443,640	667,663	72.3	155,728	21.8	94.1	353.4
Berkley Insurance Co.	677,064	386,359	898,209	38,718	390,734	68.4	177,751	26.3	94.7	95.9
Partner Re U.S. ⁶	579,578	395,366	533,959	(12,614)	348,969	74.5	170,642	29.4	103.9	106.5
Converium Reinsurance (North America) Inc.	468,854	602,099	718,776	76,774	295,579	72.5	133,763	28.5	101.0	102.0
Platinum Underwriters Reinsurance Inc.	445,008	0	340,124	4,818	242,646	61.6	155,265	34.9	96.5	N/A
Folksamerica Reinsurance Co.	436,096	307,700	894,695	25,579	265,970	66.4	125,286	28.7	95.1	98.5
CNA Re	326,993	347,883	N/A	N/A	191,673	67.1	94,042	28.8	95.9	95.3
PMA Capital Insurance Co.	308,672	293,275	581,821	14,355	185,196	66.2	98,637	32.0	98.2	97.5
Endurance Reinsurance Corp. of America ⁷	301,762	0	332,021	(39,598)	67,287	68.1	99,740	33.1	101.2	N/A
American Agricultural Insurance Co.	241,279	184,007	293,835	9,758	182,258	76.7	51,618	21.4	98.1	106.1
SCOR U.S. Group/SCOR Reinsurance Co.	233,301	310,607	423,263	9,831	216,335	82.8	70,587	30.3	113.1	110.3
QBE Reinsurance Corp.	207,097	177,517	258,199	2,154	131,819	67.3	60,061	29.0	96.3	98.6
XL Reinsurance America Inc.	192,575	163,165	1,255,990	69,237	160,637	85.7	13,020	6.8	92.5	83.3
Total for Top 20	\$15,364,316	\$12,291,904	\$42,790,264	\$2,631,126	\$9,879,377	69.8%	\$4,037,454	26.3%	96.1%	117.6%
Total for all companies	\$16,070,341	\$13,453,075⁸	\$44,725,068	\$2,588,940	\$10,826,644	71.3%	\$4,281,892	26.6%	97.9%	117.4%

1. Includes the combined results of Employers Reinsurance Corp., Westport Insurance Corp., First Specialty Insurance Corp., The Medical Protective Co. and GE Reinsurance Corp. 2. All data presented for the North American Property/Casualty segment of the General Re Group. Includes certain intercompany and other adjustments. 3. Prior to cessions to its parent, Swiss Re Zurich, Swiss Re America's combined ratio was 107.4% and pretax profit was \$34 million. 4. Includes combined results of Odyssey America Reinsurance Corp., Odyssey Reinsurance Corp., and Hudson Insurance Co. 5. Includes the combined results of American Re-Insurance Co., American Alternative Insurance Corp., and The Princeton Excess & Surplus Lines Insurance Co. 6. Includes the combined results of Partner Reinsurance Co. of the US and its subsidiary PartnerRe Insurance Co. of New York. 7. On May 15, 2003, the company completed a transaction with The Hartford Fire Insurance Co. and HartRe Co. L.L.C. (collectively, HartRe) to assume the majority of the in-force reinsurance business of HartRe. The effective date of the arrangement was April 1, 2003. All business acquired has been treated as prospective in nature. 8. Total premiums written shown for June 2002 are those reported in the June 2002 Reinsurance Underwriting Report.

Source: Reinsurance Assn. of America

PBGC: Congressional committee pledges action

Continued from page 1

the long-term problems and do the hard work" of developing remedies for the PBGC, which insures employees' and retirees' pension benefits, he said.

Rep. Boehner's comments came as the PBGC released new numbers that show the continued deterioration of the agency's financial position and its exposure to huge future losses that could swamp the agency. Those losses could result in a hike in the premiums employers pay to help fund the agency's pension insurance programs or, if the situation grows more dire, a taxpayer bailout.

Between March 31 and July 31, the PBGC's deficit widened to \$5.7 billion from \$5.4 billion. As of Sept. 30, 2002, the deficit stood at \$3.6 billion. A year before that, the PBGC had a \$7.7 billion surplus, but several massive losses—including the agency's termination of pension plans sponsored by now-defunct steelmakers LTV Corp. and Bethlehem Steel Corp.—quickly

turned that surplus into a record deficit.

And, according to figures provided by the PBGC, the potential for far bigger losses is very real. By the



'In the worst case, PBGC's deficit could grow so large that the size of the premium increase necessary to close the gap would be unacceptable to responsible premium payers.'

Steve Kandarian
Pension Benefit Guaranty Corp.

end of the month, unfunded liabilities in pension plans sponsored by financially troubled companies could exceed \$80 billion, compared to \$35 billion a year ago, PBGC Executive Director Steve Kandarian said in testimony during the hearing. If those companies fail, much of the pension liabilities would be shifted onto the PBGC.

Liabilities of that magnitude

would overwhelm the PBGC, which collects roughly \$800 million annually in income from premiums paid by employers with defined benefit plans.

agency has taken over, PBGC officials warn.

"In the worst case, PBGC's deficit could grow so large that the size of the premium increase necessary to close the gap would be unacceptable to responsible premium payers. If this were to occur, Congress could call upon U.S. taxpayers to pick up the cost of underfunded pension plans through a federal bailout of PBGC," Mr. Kandarian told the committee.

This isn't the first time such dire predictions have been made. They echo warnings frequently made in the early 1990s, the last time the PBGC's deficit ballooned. Ultimately, Congress in 1994 passed legislation that tightened corporate funding rules and aimed to put the PBGC on a sound financial footing over the long term.

But the funding rules, which Mr. Kandarian described as a "creature of past legislative compromises," have little relationship to the amount of money needed to pay

benefit liabilities if a plan terminates.

For example, Bethlehem Steel did not make contributions to its pension plan in the three years prior to the plan's termination, and under the funding rules, it was not required by law to do so.

In addition, Bethlehem, in its last filing prior to termination, reported that its plan was 84% funded, using a measure of liability permitted under the 1994 law.

However, when the PBGC moved to terminate the plan in December 2002, the agency found that the plan was only 45% funded, with total underfunding of \$4.3 billion. The PBGC was responsible for \$3.9 billion of those liabilities, making the termination the most costly in the agency's history.

The Bethlehem example illustrates how "employers can stop making contributions before a plan is sufficiently funded to protect participants, premium payers and taxpayers," Mr. Kandarian said.

Overtime: Dispute could create D&O risks

Continued from page 3

(BI, July 30, 2001). Employers also have sought coverage for such suits from their employment practices liability insurers, which have mostly rejected coverage and a duty to defend such claims (BI, Jan. 27).

The dispute arises from a controversial opinion handed down by California's Division of Labor Standards Enforcement in June 2002. In an opinion letter, the DLSE said that individual directors, officers, and managers can be personally liable for unpaid wages.

But a California trial court ruled that directors and officers are not personally liable for unpaid wages and overtime pay under California law. That ruling was upheld on appeal.

The California Supreme Court currently is reviewing briefs on the matter.

The plaintiffs in *Reynolds vs. Bement* insist, among other arguments, that the individual directors and officers of Sherman Oaks, Calif.-based Earl Sheib Inc. are their employer, not the corporate entity.

Earl Sheib is a paint and auto-body company. Christian Bement is the president of Earl Sheib and Steven Reynolds is a former Earl Sheib shop manager who filed a complaint against the company in March 2000, court records show.

A victory for the plaintiffs could be troubling for D&O insurers, particularly if the California Supreme Court agrees that Earl Sheib's directors and officers are the employer, said Dan A. Bailey, a partner with the Arter & Hadden L.L.P. law firm in Columbus, Ohio.

Mr. Bailey defends and advises insurers and is considered a leading expert in the D&O field.

"That would be very troubling and have widespread implications" for insurers, Mr. Bailey said. It could

mean that the directors and officers could face strict liability in such cases and D&O insurers potentially would be on the hook for their defense.

Earl Sheib's vp and general counsel, David I. Sunkin, agrees with that assessment. Mr. Sunkin is also named in the suit.

A victory for the plaintiffs in the Reynolds case 'would be very troubling and have widespread implications' for insurers.

Dan A. Bailey
Arter & Hadden L.L.P.

Mr. Sunkin argues that an adverse ruling would destroy long-established corporate law that shields individual directors and officers by limiting liability for corporate obligations to the corporate entity.

Mr. Sunkin said he does not want Earl Sheib's directors and officers to be found responsible and he hopes to prevail in *Reynolds vs. Bement*. But if the plaintiffs prevail then he will have to turn to his D&O insurer for coverage.

"It's good news, bad news," Mr. Sunkin said. "Obviously, I want the case dismissed because I'm the defendant. But the flip side is if they find any potential liability then my D&O carrier is going to have to respond."

Mr. Sunkin currently has been contacting D&O insurers hoping to convince them to file an amicus brief in the Reynolds case, he said. Numerous employer organizations and labor groups have already weighed in.

National Union Fire Insurance Co. of Pittsburgh, Pa., is providing

Earl Sheib's defense under an EPL policy, according to Mr. Sunkin. Earl Sheib early in 2002 won an arbitration award requiring National Union, a unit of American International Group Inc., to provide a defense in the case (BI, March 4, 2002).

Should the plaintiffs prevail in *Reynolds vs. Bement* then it will create a new category of D&O claims "with at least the possibility of coverage," and "arguments for coverage that otherwise may not have applied," said Kirk A. Pasich, a policyholder attorney at Pasich & Kornfeld L.L.P. in Los Angeles.

There could also be coverage for such claims under some EPL policies, Mr. Pasich argues.

Mr. Pasich represented Earl Sheib in the arbitration proceedings with National Union and currently represents more than a dozen other policyholders trying to obtain coverage for wage-and-hour claims under their EPL policies.

Most insurers argue that they exclude coverage for wage-and-hour claims under EPL and D&O policies, insurance law observers say.

The policies exclude coverage with wording that applies to existing "statutory laws," the observers said.

At least one insurer now specifically states that it will not cover "wage-and-hour" claims under a D&O form. National Union under a policy named D&O First specifically excludes claims for unpaid wages and overtime pay.

National Union made D&O First available about a year ago, an AIG spokesman said. If the plaintiffs in *Reynolds vs. Bement* prevail, other D&O insurers are likely to quickly follow AIG's lead by adding wording that specifically excludes wage-and-hour claims, said Michael A. Rossi, an attorney who advises policyholders for Insurance Law Group in Glendale, Calif.

"AIG just happens to be ahead of the game," Mr. Rossi said. "But you will see very quickly D&O endorsement exclusions slapped on so fast it will make your head spin."

D&O insurers typically offer their policies on claims-made forms, Mr. Rossi also noted. Therefore, should California's Supreme Court find di-

rectors and officers are liable in the Reynolds case, defendants in other similar cases may have only a small window of opportunity to tap current D&O policies, he added.

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RSA: Overhaul calls for U.S. exit

Continued from page 1

Proceeds also will go to other corporate uses, including severance costs stemming from job cuts and the withdrawal from the U.S. market. The rights issue, which is limited to U.K. shareholders, is fully underwritten by New York investment banks Merrill Lynch & Co. Inc. and Goldman Sachs Group Inc., and London-based Cazenove Group P.L.C.

"The rights issue allows us to address the past and to grow the business," Andy Haste, RSA's chief executive, said in a statement. "We have now dealt with the legacy issues and have put them behind us."

Shedding U.S. business

As part of its restructuring plan, RSA is selling the renewal rights to large parts of its U.S. commercial insurance business—whose portfolios accounted for net premiums of \$1.17 billion—to The Travelers Indemnity Co., a subsidiary of Hartford, Conn.-based Travelers Property Casualty Corp. Travelers will not assume any liabilities associated with previous RSA business.

"We're excited," said Doug Elliot, Travelers' chief operating officer. "It's a really good fit." The acquisition focuses on three core areas—commercial lines national accounts, middle market and marine, and standard and preferred personal lines—Mr. Elliot said, noting that those "are areas of strength for us." "We like the product breadth and we like the fits that we've been able to work out with them," the Travelers COO said.

Travelers said in a statement that the acquisition of the RSA renewal business is in keeping with the company's strategy of supplementing internal growth with acquisitions that complement its core businesses.

Travelers will pay RSA \$25 million immediately, followed by a further payment, estimated at \$35 million to \$40 million, contingent on policy renewal performance.

The Hartford-based insurance company described the purchase price as "attractive" and said the acquisition would let it acquire up to \$1.5 billion in new net written premiums.

Buyers' options narrow

"Coming at it from Travelers' perspective, this is a nice bump at a good valuation," said John W. Wicher, principal at John Wicher & Associates in San Francisco, an insurance industry investment bank. "Travelers really demonstrated again they know how to execute."

"From the consumer's perspective, I think it's a nonevent," Mr. Wicher said. "I think it's neutral from an insurance buyer's perspective."

But not all buyers agree.

William W. Johnson, risk financing manager for Hallmark Cards Inc. in Kansas City, Mo., said he thinks RSA's retreat from the U.S. market will be felt, perhaps driving many firms to move more toward an unbundled approach in their casualty programs.

"Very often you're not just buying risk transfer, you're buying services," Mr. Johnson said. "As fewer options exist on the bundled side, you've got to give more consideration to the unbundled route."

Royal & SunAlliance was already one of a limited number of insurers providing casualty insurance and services on a bundled basis, he said, and with the company's departure from the U.S. market, "that's a very good supplier in that area that's missing now."

For Hallmark, the situation has even greater immediacy in that the company had just negotiated an Oct. 1 renewal of its primary casualty program with RSA. "It's definitely going to have an impact on Hallmark because Royal has led our primary casualty program for the past 18 years," Mr. Johnson said. "So we're scrambling."

While RSA has committed to honoring existing quotes, Hallmark is currently studying its options, Mr. Johnson said. "This is just another case where there are fewer and fewer alternatives," he said. "Suppliers have thinned out dramatically in a lot of different areas and a lot of different lines, and this is just one more."

Renewing accounts

Travelers has indicated that the RSA business will be renewed "sub-

ject to Travelers' underwriting guidelines." Mr. Elliot said the company hasn't determined how much of the RSA business will be renewed but expects it will be a significant percentage of the overall book. "We really haven't had the data to do all the predictions," he said. "We're hopeful—we'd be disappointed if we didn't renew a significant chunk of it."

"They've had some strategies that we're going to have to work through and think about," Mr. Elliot said. "Particularly their workers comp strategy."

'Suppliers have thinned out dramatically in a lot of different areas and a lot of different lines, and this is just one more.'

William W. Johnson
Hallmark Cards Inc.

RSA's remaining U.S. business principally comprises its nonstandard personal auto line, as well as certain specialty commercial lines in the architects and engineers professional indemnity and wholesale agency program business sectors. These portfolios represented about \$935 million of 2002 net premiums written.

RSA said it is looking at ways of exiting the remainder of its U.S. operations, and that the cost of the full withdrawal would be about £300 million (\$474 million). RSA's U.S. business has posted an underwriting loss of £79 million (\$124 million) for the year to date, most of which came in the second quarter.

Mr. Haste said RSA also would eliminate another 1,000 jobs in the United Kingdom, in addition to 5,000 job cuts announced last year. He said an unspecified number of the cuts would involve outsourcing responsibilities to cheaper labor markets in Asia.

Mr. Elliot said some RSA employees would join Travelers, including some personal lines agents. "We pick up 500 new agents, which is terrific for us," he said. On a premium basis, about one-third of the

business Travelers is acquiring from RSA involves personal lines.

Travelers also will hire some of RSA's U.S. commercial lines employees, Mr. Elliot said, though the company hasn't indicated how many. "The intent, obviously, is to leverage the scale and the operation we've build here at the Travelers," he said. "But we're certainly going to need help to bring in this volume of new accounts."

To that end, the company hopes to hire "some quality underwriters," the chief operating officer said following the Thursday announcement. "That process begins this morning."

Change in focus

Duncan Boyle, chief executive of RSA's U.K. operations, said that the sale of its U.S. business confirmed that "the group has decided that it does not want to be a global player." Mr. Boyle said that RSA had made clear last November, during a shareholders' meeting, that it no longer thought it could compete globally.

"To succeed in the U.S., you either need to be a very big player or a small, niche operation, and we fell somewhere in the middle," said Mr. Boyle. He added that RSA's venture into the U.S. market had been "unlucky."

The news of the restructuring largely obscured RSA's results for the first six months of the year, for which it posted an operating profit of £351 million (\$554.6 million), up 16.6% from the same period last year. The insurer's combined ratio during the period was 99.3%, compared with 104.6% the year earlier.

Ratings agencies responded to RSA's announcement with downgrades and reviews of the group's ratings.

Moody's Investors Service Inc. of New York placed the group's rating under review and lowered the insurer financial strength ratings of Royal & SunAlliance USA intercompany pool members to Ba1 from Baa3. Nonpooled companies were downgraded to Ba2 from Ba1.

Fitch Ratings in London downgraded the insurer financial strength of Royal & SunAlliance to BBB from BBB+.

Oldwick, N.J.-based A.M. Best Co. placed its A- financial strength rating of RSA under review, noting that the insurer's U.S. units are un-

der review "with negative implications."

Standard & Poor's Corp. of New York downgraded its insurer financial strength rating of Royal & SunAlliance's U.S. units to BBB- from BBB+. S&P said Travelers' rating would not be affected by its acquisition of the RSA renewal rights.

Roman Cizdyn, an insurance analyst at German bank Commerzbank's London office, said he was unimpressed by RSA's announcement.

"If an insurer is going to the market to ask for £960 million with the intention of putting £800 million in reserves, then there is not a lot of room for profit growth," he said.

Mr. Cizdyn added that there is a still considerable uncertainty about the financial strength of RSA. "The fact that RSA still has £500 million tied up in the U.S. business that Travelers did not want, as well as a further £650 million to cover reserving shortfalls in the U.S., is a problem if RSA wants to continue to grow," he said. "It would not surprise me if RSA came back to the market asking for more money fairly soon."

He added, "Travelers must have certainly exercised great bargaining power if it was able to dictate to RSA the bits of business it wanted to take while RSA retains all the liability."

UBS Securities L.L.C. supported that view in its analysis of the deal, saying, "We believe Travelers acquired the renewal rights at attractive terms, while avoiding Royal's prior-period reserve deficiencies."

According to RSA's report, deterioration of prior-year claims has continued to be a problem in its workers compensation and general liability lines, and the latter has also been hit by the reclassification of some risks that had previously been booked in the commercial property line.

Mr. Wicher said he thinks Travelers' acquisition of RSA business at favorable terms is a scenario that might be repeated in the near future, with stronger companies buying business from middle-market companies that failed to correct balance-sheet problems during the hard market.

"I think it speaks volumes on how fragile many of the middle-market companies are," he said. "I think we'll see more of these transactions, frankly."

Tort reform: Senate likely to act on class-action reform

Continued from page 1

\$5 million; and the class involves more than 100 people (BI, April 14). Other provisions would ban proposed settlements where any class member would incur a net loss in paying attorneys fees and would require that all settlement notices be written in plain English. Another provision would ban settlements under which plaintiffs who live in the same geographic area as the court would receive larger awards than more remote plaintiffs.

Sen. Carper stressed that he is not interested in imposing caps on any types of awards, including punitive

damage awards, and opposes limiting the amount lawyers can receive for their services in a class settlement. Instead, he said he merely wants to return balance to the system, and is encouraged that an opportunity "to restore that balance is nigh."

Fifty-seven senators currently intend to vote for cloture—cutting off debate on the bill—if opponents launch a filibuster, he said. But ending a filibuster requires 60 votes, and "We cannot relax for a moment and assume the other three votes will materialize," he warned, urging his audience to continue

working to the last minute to forge that 60-vote majority.

Sen. Carper also noted that differ-

'We cannot relax for a moment and assume the other three votes will materialize' to prevent a filibuster.

Sen. Tom Carper
D-Delaware

ences exist between the Senate bill and a class-action reform measure

passed by the House in June (BI, June 23). But he said the differences "are not huge," he said.

The Senate also could take up an asbestos liability reform measure this fall, Sen. Carper said.

The Senate Judiciary Committee approved such a bill—S. 1125, the Fairness in Asbestos Injury Resolution Act—in July, but only after the inclusion of last-minute amendments that would impose new costs on companies involved in asbestos litigation and on their insurers (BI, July 14).

As a result of the changes, insurers and some employers withdrew

their support, while all but one of the committee's Democratic members voted against the amended version because they thought that the legislation would not adequately protect victims of asbestos-related diseases.

Sen. Carper said the bill would die if it were subject to repeated amendments on the floor. He suggested instead that Senate leaders from both parties craft a "major manager's" amendment to resolve remaining disagreements, and the senator pointed out that only a bipartisan team can get the bill moving again.

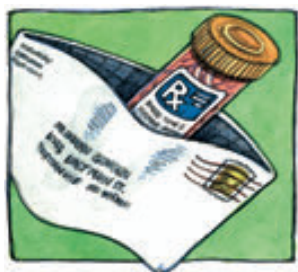
Late News

Continued from page 1

contribute to a statewide program to cover the uninsured. California's legislative session is set to end Sept. 12.

Caremark Rx deal would create big PBM

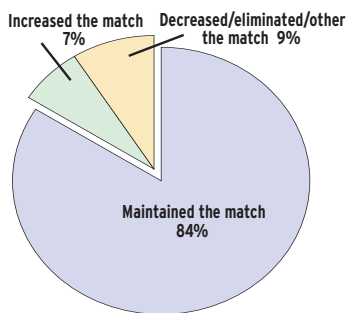
Caremark Rx Inc. of Northbrook, Ill., announced last week it has reached an agreement to purchase Irving, Texas-based AdvancePCS, a rival prescription benefit manager, in a cash and stock deal valued at \$6.0



billion. The combined entity would be the nation's second-largest PBM. Together, the two organizations' PBM operations generated \$19.9 billion in revenues in 2002. Under the terms of the deal, shareholders of Irving, Texas-based AdvancePCS stock will receive cash and 2.15 shares of Caremark stock for every share of AdvancePCS stock they own.

401(k) matching little changed: Hewitt

Despite the economic slowdown, most employers are not decreasing or eliminating their 401(k) plan matching contributions, a new Hewitt Associates Inc. survey found. Eighty-four percent of employers last year maintained their 401(k) plan match, while 7% increased their match. Just 4% decreased their match and 1% eliminated matching contributions. These findings, based on a survey of about 500 large employers, challenge the perception that many



employers are cutting back matching contributions. Among other findings, 55% of employers said the 401(k) plan is the primary retirement plan they offer their employees.

Aon restructures reinsurance operations

Chicago-based Aon Corp. has combined its reinsurance operations under a new name, Aon Re Global, and made several executive changes. Aon Re Global will be headed by Aon Ltd. Chairman and Chief Executive Officer Dennis Mahoney as executive



chairman in London. Paul Davies, chairman of Aon Re Worldwide, will be senior chairman of Aon Re Global, while Michael Bungert will be president. Mr. Bungert is CEO of Aon Re Americas, based in Chicago. In addition, Clement Booth, formerly a member of the management board at Munich Reinsurance Co., will join Aon as CEO of Aon Re International and chief administrative officer of Aon Re Global.

Judge declines seconds on McDonald's lawsuit

A U.S. District Court judge has dismissed a suit alleging Oak Brook, Ill.-based McDonald's Corp.'s advertising and products cause obesity in children. Judge Robert Sweet found the plaintiffs failed to establish any connection between their alleged injuries and how McDonald's advertises its food. The



PHOTO: PHOTOGRAPHERS SHOWCASE

Last week, a judge threw out a suit alleging McDonald's Corp.'s advertising and products cause obesity in children.

suit, filed on behalf of two New York teen-agers, was initially dismissed in January, but the judge gave the plaintiffs a chance to submit further evidence of deceptive advertising. Last week, he ruled the plaintiffs still lacked evidence and barred them from bringing further suits against McDonald's.

Credit Lyonnais to settle ELIC probe

French bank Credit Lyonnais said it has reached an agreement to settle a federal investigation related to the 1991 acquisition of now-defunct Executive Life Insurance Co. of California. Late last month, Credit Lyonnais was indicted by a federal grand jury in Los Angeles on criminal charges relating to ELIC's sale. In a statement last week, Credit Lyonnais said terms of the settlement will remain confidential until the agreement is completed in the next few weeks.

Briefly noted

Standard & Poor's Corp. has downgraded its financial strength rating of Employers Reinsurance Corp. to A+ from AA-, with a negative outlook. S&P cited uncertainty in the General Electric Co. unit's reserves for prior accident years as well as potential deterioration in operating performance. In a statement, GE ERC noted it has strengthened reserves and has improved its underwriting performance, resulting in a current-

year combined ratio of less than 95% for property/casualty business....Benefits consultant Hewitt Bacon & Woodrow, a U.K. unit of Lincolnshire, Ill.-based Hewitt Associates Inc., has acquired Cork, Ireland-based pension fund administrator and consultancy Becketts. The newly merged entity will be headed by Kieran Barry, founder of Becketts. In 2002, Becketts' profits totaled 600,000 euros (\$569,000)....Bermuda-based XL Capital Ltd. has formed an Office of Corporate Relations. The office will be headed by XL Executive Vp Fiona E. Luck and Senior Vp Gavin R. Arton, who also will be director of global corporate social responsibility and philanthropy. Mr. Arton will remain head of XL's investor relations until a successor is named....The International Commission on Holocaust Era Insurance Claims approved what it says is a final extension—to Dec. 31, 2003—of the deadline for survivors and heirs to file insurance-related claims. Information on filing claims is available at www.icheic.org....AXIS Capital Holdings Ltd. of Bermuda has increased the capitalization of its Ireland-based European reinsurance unit, AXIS Re Ltd., to \$500 million. AXIS said the infusion is intended to help the reinsurer's planned expansion into Europe. AXIS Re writes both facultative and treaty reinsurance....Edison, N.J.-based insurance wholesaler NAPCO L.L.C. has opened three branch offices, in Connecticut, Ohio and Virginia, to develop customized property insurance programs. NAPCO has other branches in Bermuda and Texas.

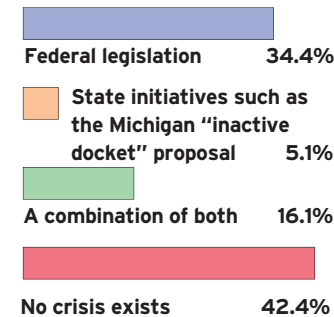
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Online Poll

[9/2 - 9/5]

What is the best way to deal with the asbestos litigation crisis?



BI Stock Index

[9/2 - 9/5]

Up-to-the-minute data for all 87 companies that comprise the BI Stock Index can be found at www.businessinsurance.com

Percentage change of BI Stock Index vs. key indicators

BI Stock Index 1.39
1997.41

Dow Jones 0.93
9503.34

S&P 500 1.33
1021.37

Largest gains

PXRE Corp.	7.28%
Harleysville Group	6.25%
Travelers P/C Corp.	6.04%
ING Groep N.V.	5.47%
Sierra Health Services	5.33%

Largest losses

Acceptance Insurance	-28.57%
Navigators Group	-6.32%
EMC Insurance Group	-5.39%
Axis Capital Holdings	-4.48%
Gainsco Inc.	-3.85%

Weekly change by market segment

Brokers	-0.11%
Insurers/Reinsurers	0.88%
Managed Care Organizations	1.77%

Source: FinancialContent Inc. (<http://financialcontent.com>)

CIGNA: Settlement reached in lawsuit

Continued from page 3

resolve claims disputes. The company estimates all the changes, including ones already undertaken, will cost \$400 million.

"Our processes will be transparent," said Dr. W. Allen Schaffer, CIGNA's chief medical officer in Hartford, Conn.

The approval came despite an objection letter submitted Tuesday by one of the lead plaintiffs, Dr. Timothy Kaiser. In the letter, Dr. Kaiser stated that he was unable to agree to the settlement because sections of it were "unintelligible" and it was rushed to completion.

"This CIGNA agreement was finalized in such a hurry, on such a 'last minute' basis, that I cannot sign the document or agree to its contents at this time," he wrote.

Dr. Kaiser, who filed his suit in Illinois in 2000, reached a settlement of his class-action lawsuit with CIGNA in late 2002. Judge

Moreno, who consolidated that action with others pending before his court, held up that settlement. This week's settlement essentially terminates that previous agreement.

CIGNA's settlement and the one reached between Aetna Inc. and physicians, 'are setting the standard' for other defendants to follow.

Edith Kallas
Milberg Weiss Bershad
Hynes & Lerach

This settlement "is a vast improvement" over the past one, said Edith Kallas, partner with Milberg Weiss Bershad Hynes & Lerach in New York, which represents plaintiffs in this case.

Judge Moreno has scheduled a hearing on Dec. 18 to grant final approval to the settlement.

The litigation is one of several suits that were consolidated in 2000 before Judge Moreno. The lawsuits, brought by more than 700,000 physicians against nearly every large managed care organization, charge that the companies systematically underpaid doctors for their services.

CIGNA'S settlement follows a similar one reached in May between Aetna Inc. and the physicians. Together with the CIGNA settlement, these two "are setting the standard" for the other defendants to follow, Ms. Kallas said. The two settlements "are very similar," she said.

Other managed care companies are still named as defendants in the suit, including Indianapolis-based Anthem Insurance Cos. Inc.; Bethesda, Md.-based Coventry

Health Care Inc.; Louisville, Ky.-based Humana Inc.; Cypress, Calif.-based PacifiCare Health Systems Inc.; Minneapolis-based United-Health Group; and Thousand Oaks, Calif.-based Wellpoint Health Networks Inc.

But these other defendants are in no hurry to settle the case, a spokesman for them said. These companies will continue to defend the suit and have no plans to settle at this time, he said.

An important moment in their defense is expected to come this Thursday, when oral arguments are scheduled before the 11th U.S. Circuit Court of Appeals in Atlanta to reverse Judge Moreno's certification of the plaintiffs as a class, the spokesman said.

While a decision is not expected for weeks, if the class is decertified, the suits against the nonsettling defendants could be seriously weakened, he said.