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Business Insurance

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\$4

New class action reform proposed

Supporters of Senate legislation discount Breaux plan's chances of siphoning off support

By MARK A. HOFMANN

WASHINGTON—Advocates of reforming the nation's class action laws say that efforts to win Senate passage of bipartisan class action reform legislation will not be derailed by a new proposal being circulated by Democrats.

The original legislation—S. 274, the Class Action Fairness Act—would permit the relocation of certain interstate class action lawsuits to federal from state courts at the request of either plaintiffs or defendants, provided that at least \$5 million is at stake (*BI*, April 14). Class action reform

advocates have long held that removing class actions that involve defendants and plaintiffs from multiple states to federal court from state courts would provide more fairness than the current system of trying such cases in a single state court.

Proponents of S. 274 say that the full Senate could vote on the proposal in mid-October. The measure was supposed to go before the Senate for a final vote weeks ago but has been delayed as senators have grappled with appropriations bills. The House has already passed its own version of class action reform.

Now, though, Sen. John Breaux, D-La., is pro-

moting his own version of class action reform as a substitute for the bipartisan measure.

The Breaux substitute has yet to be put into legislative language, noted a spokesman for the senator. It currently exists only as a summary accompanied by a chart comparing its main components with those of S. 274.

Most significantly, unlike S. 274, the substitute proposal would not take the domicile of defendants into account when determining which cases could be shifted to federal from state courts.

Under the Breaux proposal, a federal court automatically would have jurisdiction only when one-third or fewer of the class members reside in the state in which the action was filed.

If two-thirds or more of the plaintiffs are from the state in which the class action was initially

See **CLASS ACTION**/page 26

Late News

Silverstein recovers proceeds, loses appeal

GMAC Commercial Mortgage Corp.



Mr. Silverstein

has agreed to release about \$20 million in business interruption insurance proceeds to World Trade Center leaseholder Silverstein Properties Inc. as the

parties seek agreement on a redevelopment plan for the WTC site. After consulting with the judge hearing the dispute over the redevelopment, the parties agreed that GMAC, which administers the mortgage on the property, would continue the business interruption payments and pay October rent. The agreement gives the parties until Oct. 22 to work out a redevelopment agreement. Meanwhile, one day after that agreement with GMAC, Silverstein encountered a setback in its insurance coverage litigation when the 2nd U.S. Circuit Court of Appeals affirmed a lower court ruling that a jury should decide whether the WTC attack was one occurrence or two.

More states consider Canadian drug programs

In what appears to be a growing trend, two state governors last week separately announced plans to study the possibility of importing drugs from Canada for their state workers and retirees. Gov. Tom Vilsack of Iowa and Gov. Tim Pawlenty of Minnesota both instructed their state officials to investigate the financial and legal implications of a drug importation program. The announcements are similar to an announcement made earlier this month by Gov. Rod Blagojevich of Illinois.

See **LATE NEWS**/page 27

RRGs challenge regulators' opposition to broader law

By JERRY GEISEL

WASHINGTON—State insurance regulators say they are willing to discuss possible changes to a draft resolution urging Congress to reject any legislation that would expand the coverages that risk retention groups can write.

That draft resolution was discussed by regulators at the National Assn. of Insurance Commissioners' fall meeting in Chicago earlier this month. The document, which contends that there is no "availability problem for property insurance coverage that has not been addressed by state-based solutions," has been criticized by risk retention groups as inaccurate.

"I believe there are points that are clearly erroneous. It is pretty clear there are capacity and pricing problems," said Wendy Fisher, corporate secretary-regulatory and business affairs for National Home Insurance Co. (A Risk Retention Group) in Aurora,

See **RRG**/page 27



PHOTO: AP/BOB JORDAN

Hurricane Isabel destroyed a motel in Hatteras, N.C.

Preparations, deductibles hold down Isabel claims

By DAVE LENKUS
and SALLY ROBERTS

Plenty of warning, a rapid deterioration in storm intensity and large property insurance deductibles combined to hold down insured losses from Hurricane Isabel.

As a result of those factors, insured damage is

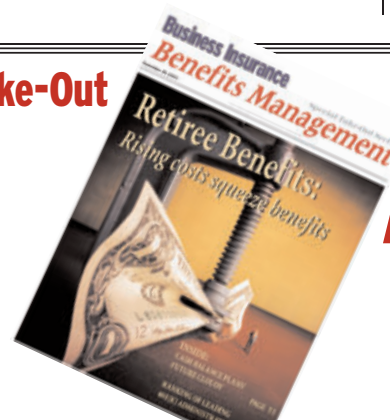
not expected to exceed the \$1 billion figure that the insurance industry estimated just 24 hours after the storm roared up the Eastern seaboard on Sept. 18.

But loss adjusters and risk managers point out that commercial policyholders will bear a much greater portion of their losses than they would

See **ISABEL**/page 26

Benefits Management Take-Out

RETIREE BENEFITS



LARGEST 401(k) PLAN ADMINISTRATORS

Ranking on page T4

Egan tapped to become new president of Marsh

By GAVIN SOUTER

NEW YORK—Roger E. Egan has been named president of Marsh Inc.

Mr. Egan, who was formerly vice chairman of the Marsh & McLennan Cos. Inc. insurance brokerage unit, will share executive responsibilities with Ray J. Groves, chairman of Marsh Inc.

In his previous position, Mr. Egan was responsible for Marsh's operations in North America as well as for global placement, consulting and client development.

In his new role, Mr. Egan will take on additional international responsibilities and work in "a collaborative partnership" with Mr. Groves, rather than have different Marsh units report to them individually, he said. "We'll use a team approach," he said.

Under the new executive team, Marsh will continue its current business strategy, Mr. Egan said. "I



Mr. Egan

believe that we have a well-developed and proven business model, and we'll continue to do things the same way while striving to improve, so any changes will be incremental," he said.

Changes might include exporting proven best practices in the United States to other Marsh operations, Mr. Egan said. However, he added that "we have strong operations in every part of the world, so it is not to suggest that good ideas only come from North America."

Mr. Egan, 53, has worked at Marsh for 31 years. He rose through the management ranks of the brokerage and was president and CEO of Marsh's North American business before being named vice chairman last year.

Mr. Groves was named chairman of Marsh in July on the retirement of John T. Sinnott.

Jeffrey W. Greenberg, chairman of Marsh & McLennan, said in a statement: "Ray and Roger have a unique combination of experience in professional and risk services. We are confident that, under their leadership, Marsh will continue its record of success."

NAIC working to determine fair capital requirements

How to ensure claims payment, avoid adding financial burden?

By MEG FLETCHER

CHICAGO—U.S. insurance regulators are considering proposals to change the amount of money that international and domestic insurers must maintain to satisfy capital adequacy standards and to meet future liabilities.

During the National Assn. of Insurance Commissioners' recent quarterly meeting in Chicago, two different groups of state regulators were discussing the issue at opposite ends of the spectrum. One NAIC panel was reviewing proposals for lowering current capital requirements for mostly non-U.S. reinsurers, while another was considering raising a set of risk-based

capital requirements for U.S.-based insurers.

At the meeting, the Reinsurance Task Force continued to review a longstanding request from European reinsurers to reduce the amount of collateral that they must post as security for their U.S. underwriting liabilities (*BI*, Sept. 1).

Meanwhile, an Ad Hoc Subgroup of the NAIC's Property/Casualty Risk Based Capital Task Force was considering its own proposal for a 50% increase in one of the risk-based capital requirements that apply to U.S. insurers. The proposal met with strong objections from several U.S. insurer trade associations.

The contrast between the two

proposals underscores regulators' continuing struggle to achieve an appropriate balance in requiring a level of capital adequate to pay all claims without creating an excessive financial burden.

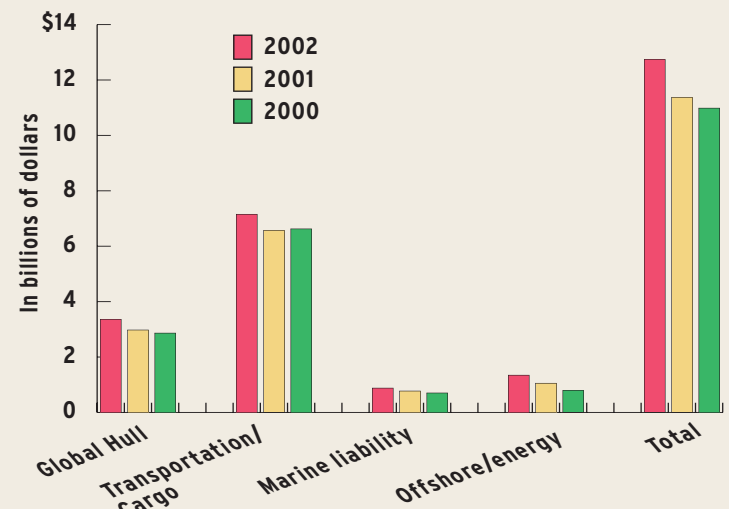
During the Reinsurance Task Force discussions, John Oxendine, chairman of the task force and Georgia's insurance commissioner, noted that "the feelings are pretty strong on both sides."

Currently, "nonauthorized" reinsurers—which are mostly non-U.S. companies—must post collateral in U.S. trust accounts equal to 100% of the gross liabilities they assume for U.S. cedents. The reinsurers have proposed that U.S. regulators

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MARINE INSURANCE PREMIUMS

Global premiums 2000-2002, as reported at the end of Aug. 2002



Source: IUMI

IUMI Conference 2003

Marine insurers chart course for rate hikes

By NEIL HODGE

SEVILLE, Spain—Marine insurers were told last week at the International Union of Marine Insurance conference in Seville, Spain, that the current state of the market is dire and that shipowners can afford to pay higher rates.

One solution put forward to correct the poor state of the insurance market is to simply extract more money from shipowners, knowing that they need the coverage and have the capital to pay for it.

Simon Beale, chairman of IUMI's ocean hull committee, said that increasing premium rates is the "last chance" to correct the "loss-making" market. He said that shipowners are making significant profits and so underwriters can seek rate rises with very little impact on the bottom line of companies.

"We are very close to being too late to correct our course," said Mr. Beale. "We must not worry

about losing business. This is usually only lost in the short term, but we shall have to lose business which we consider is underpriced. Clearly, we need more money in the sector, and the good news is that shipowners can afford to pay for the strong and healthy market we all deserve."

Mr. Beale said that, without increasing premium rates, hull insurance would collapse, reducing the market to just a few operators. He added that current rating levels are wholly inadequate and that "capital is bound to withdraw unless we take serious action now. The marine market is losing huge amounts of money."

Tore Forsmo, managing director of CEFOR, the Norwegian marine insurance association that annually compiles statistics on the state of the marine insurance industry, said that a collapse in the global hull and machinery insurance market may be the only solution to improve

See IUMI/page 15

Inside Business Insurance

A look at a decade under the FMLA

The Family and Medical Leave Act, now 10 years old, has not proved to be as burdensome as employers had feared. **Page 4**

California recall election not just a free show

Paul Winston notes that the California recall, for all its silliness, could mean serious changes. **Page 6**

Here's how not to reform pension plan funding

Waiving accelerated contributions for some underfunded pension plans is a bad idea, one of this week's editorials says. **Page 8**

There's no guarantee that guaranty funds will pay

In Perspectives, Sheila Small warns against relying on guaranty funds to cover bankrupt insurers. **Page 10**



Business interruption losses mount in Bermuda

Local insurers in Bermuda estimate that their losses from Hurricane Fabian will amount to no more than \$125 million. **Page 21**

Online

- The **Datebook** calendar lists upcoming industry seminars and meetings and allows you to add info on your own event.
- Searchable **directories** of all the listings of industry vendors found in *BI's* Market Sourcebook.
- New **Opinion Poll** for readers: Should employers that do not offer medical benefits to their workers be required to pay into a government-administered fund to cover the uninsured?

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REPORTING ON CORPORATE RISK AND EMPLOYEE BENEFIT MANAGEMENT NEWS.

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Family and Medical Leave Act has introduced some administrative problems

FMLA hasn't been big burden for employers

By MICHAEL PRINCE

In the 10 years since it became law, the Family and Medical Leave Act has proved to be a double-edged sword for employers.

On the one hand, the law has not proved to be the terrible burden that employers had predicted before its passage. On the other hand, it has introduced new headaches and administrative hassles for employers.

The law is credited with increasing employer awareness of work/life issues in general and dependent care needs in particular. Providing

employees with unpaid, job-protected leave after the birth of a child, or to take care of a serious medical issue has also engendered greater employee loyalty, employers and benefit observers say.

But, they add, managing FMLA programs and accommodating the small percentage of employees who stretch the boundaries of permissible leave has not been trouble-free for employers.

"It has changed the way American business has looked at their workers and their families, but the complexity has just snowballed," said Ophelia Galindo, a principal

with Mercer Human Resource Consulting in Newport Beach, Calif.

The FMLA, which took effect in August 1993, requires employers with 50 or more workers to provide employees up to 12 weeks of unpaid leave within a 12-month period for certain family or medical reasons. It also requires health insurance coverage to be continued on the same basis as before the leave.

FMLA supporters cite the law as a landmark in the effort to create a more family-friendly workplace.

"It has engendered an attitude change, both from the employer's and employee's perspective, that

these are important life issues and concerns," said Peter Burki, chief executive officer of Lifecare Inc., a work/life benefits consultant in Westport, Conn.

"It was a turning point in how workers looked at the workplace," said Deven McGraw, policy counsel at the National Partnership for Women & Families, an advocacy group in Washington.

Employers say the law has achieved its primary goal of providing a structure in which employees feel comfortable taking time off without fear of losing their job.

"Employees feel confident they

can take the leave they need and not worry about their job," said Ash Kilada, vp of risk management and benefits at restaurateur Sbarro Inc. in Commack, N.Y.

Before the law's adoption, people would be reluctant to take time off out of concern for losing their job or having the leave held against them, said Bill Falvey, benefits manager at law firm Morrison & Foerster L.L.P. in San Francisco. About 1% of the firm's 2,500 workers are out on FMLA leave at any one time, he said.

Employers say the law also en-

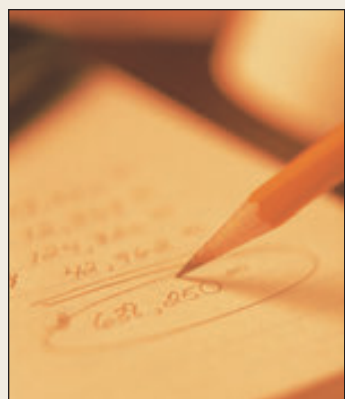
See FMLA/page 18

Crain offers employees a new retirement plan

By JERRY GEISEL

DETROIT—Building on the popularity of its decades-old profit sharing plan, the parent company of *Business Insurance* magazine is adding a second defined contribution plan.

The new plan offered by Detroit-based Crain Communications Inc. will, like the company's existing profit sharing plan, give participants the opportunity to direct company contributions into a wide range of investment options.



Unlike the profit sharing plan, in which annual contributions are based on company profitability, Crain's contributions to the new plan will be based on employees' length of service. Employees with fewer than six years of service will receive an annual contribution of 2% of pay; those with between six and 10 years of service will receive a contribution of 4%; and those with between 11 and 15 years of service will receive 6%. Employees with 16 or more years of service will be entitled to an annual contribution of 8% of pay.

Benefit experts say it is unusual and generous for an employer to offer two employer-funded defined contribution plans, one of which bases company contri-

butions on profits and the other in which contributions are fixed and are linked to service.

And the 8% of pay contribution for longer-service employees is especially generous and should encourage those employees to stay, said Sheldon Gamzon, a principal with PricewaterhouseCoopers' HR Services unit in New York.

All U.S. employees hired after Jan. 1, 2004, automatically will be enrolled in the new plan—which Crain is calling the Service Reward Plan—when they become eligible. Current employees will be given a one-time choice to enroll in the new plan or remain in the company's traditional final-average-pay defined benefit pension plan.

Those employees who switch to the new plan will have their accrued benefits in their old plan frozen. Company executives estimate that about half of the defined benefit plan's roughly 800 enrollees will remain in the plan. Company officials began exploring alternatives to the traditional defined benefit plan amid widespread recognition that the plan no longer was meeting its objectives.

While the plan was designed to provide a lifetime monthly annuity to employees when they retired at age 65, an ever-more-mobile workforce has resulted in few employees staying that long.

In all, only about 6% of employees remain at the company until 65. In addition, instead of taking a monthly annuity, most—about 95%—of employees take a lump sum payment from the defined benefit plan when they leave.

As a result, with most employees not staying until retirement and taking a lump sum, the original premise of the plan—pro-

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Scholar targets punitive abuse

Says three reforms could guarantee balance

By MARK A. HOFMANN

WASHINGTON—Three reforms could help reduce abuse in the awarding of punitive damages, according to a legal scholar who has spent three decades studying the issue.

Punitive damages are, "on balance," a good thing, David G. Owen, Carolina distinguished professor of law at the University of South Carolina in Columbia, told the House Judiciary Committee's Subcommittee on the Constitution last week. But "federal reforms appear to be a desirable path" to rid the state-based punitive damage system of some of its problems, Mr. Owen said.

Another witness questioned, though, whether Congress could interfere with how states deal with punitive damages, while a third witness held that Congress must get involved because some lower courts

are ignoring the Supreme Court's most recent ruling regarding punitive damages.

'Federal reforms appear to be a desired path' to rid the state-based punitive damage system of some of its problems.

David G. Owen
University of South Carolina

The high court's ruling in *State Farm Mutual Automobile Insurance Co. vs. Curtis B. Campbell et ux.*, handed down last April, held that under most circumstances, punitive damage awards that were in excess of single-digit multiples of underlying compensatory damages violated defendants' constitutional guarantee of due process (*BI*, April 14). The court also held that a Utah court

had erred when it allowed State Farm's conduct in other states to be taken into account in determining the amount of punitive damages that could be awarded to a Utah couple in a case involving allegations of bad faith in insurance claims handling. In that case, the Utah Supreme Court had reinstated a punitive damage award 145 times greater than underlying compensatory damages.

The House subcommittee convened to deal with the specific question of how Congress should respond to the ruling. The panel's chairman—Rep. Steve Chabot, R-Ohio—listed a number of possible reforms. These included prohibiting the multiple imposition of punitive damages by courts in different states for the same conduct, requiring that punitive damages be paid to the state rather than the plaintiff, giving special protections to small

See PUNITIVE/page 25

Self-Insurance Institute of America's 23rd National Educational Conference and Expo

Employers may see rise in suits related to HIPAA privacy rules

By MICHAEL BRADFORD

DALLAS—Employers may see an increase in privacy lawsuits filed by vengeful workers who believe they were improperly fired or refused a job, warns an expert on the federal Health Insurance Portability and Accountability Act.

While the law provides for civil and criminal penalties for violations, "the bigger evil here" is from lawsuits in which disgruntled plaintiffs cite HIPAA privacy violations, contends Paul Zigler, vp of HIPAA consulting with Strategic Health Care Initiatives in Dallas.

Speaking at the Self-Insurance Institute of America's 23rd National Educational Conference and Expo in Dallas earlier this month, Mr.



Continued coverage of the SIIA annual conference in Dallas begins on page 13

Zigler pointed out that HIPAA "sets a new standard—a standard of care," which employers can be accused of not meeting.

"HIPAA sets a federal floor for what the standards are in privacy, and I, and most folks out there, believe there will be a number of suits" in which workers claim wrongful termination or denial of employment that was based on information that should have been kept private, he said.

The HIPAA privacy requirements can become a "tool people can use if they want" to exact some retribution, Mr. Zigler said.

Lawsuits aside, penalties can be stiff for employers that violate the privacy rules.

See HIPAA/page 12

BI workers comp conference highlights new info, strategies

BOSTON—Bringing employers up-to-date information and innovative ideas to better manage their workers compensation and disability claims is the focus of the upcoming *Business Insurance* Workers Compensation and Disability Management Conference.

The 11th annual conference will be held Oct. 20-22 at the Fairmont Copley Plaza in Boston. While the conference has relocated to the East Coast from the West Coast, it remains, as always, geared to employers nationwide.

At the event, 30 conference speakers—a diverse group of risk and disability benefits managers, loss control specialists, medical specialists, attorneys, consultants and insurer executives—will share their insights and suggestions about how employers can lower their costs while improving workplace safety.

The conference also will present an extensive update on current legislative and legal trends that affect employer programs and the workers compensation insurance market.

Conference topics were chosen and developed with the help of a 17-member national advisory board, chaired by Jeffrey W. Pettegrew, vp-insurance and risk management at Westaff in Walnut Creek, Calif.

The conference program, which is being presented with the assistance of The Harrington Co. of Minneapolis, follows.

Monday, Oct. 20:

On Monday afternoon, preceding the formal conference agenda, will be the conference's annual Employers' Private Roundtable, a popular event at which employer representatives candidly discuss pressing problems and seek advice from their colleagues. Moderating the off-the-record roundtable will be Mr. Pettegrew and Paul D. Winston, editor of *Business Insurance*. Mr. Winston co-chairs the conference along with Senior Editor Meg Fletcher.

Concurrently, a Service Providers' Roundtable will be held for vendors to exchange ideas about meeting clients' needs and concerns. Martin J. Ross III, publisher of *Business Insurance*, and Sharon A. Falkenburg, a managing director of Aon Risk Consultants Inc., will moderate the roundtable.

The interactive spirit of the roundtable is encouraged throughout the conference, as attendees are urged to ask questions and seek advice on specific problems from the moderators and panelists at the end of each session, during social gatherings and at a closing networking luncheon.

Monday evening will feature an opening reception in the confer-

ence's exhibit hall, followed by an onsite dinner.

Tuesday, Oct. 21:

The conference formally commences Tuesday morning with a keynote speech by Edmund "Ted" Kelly, chief executive officer of Liberty Mutual Insurance Co. in Boston. Mr. Kelly will discuss current trends affecting workers comp costs and exposures, as well as review challenges in the current property/casualty insurance marketplace.

The conference sessions that follow are:

• **Winning in a Seller's Market: Making Your Program Shine**, which will be moderated by



Register for the conference at www.businessinsurance.com/wcc.

Barry E. Thompson, president of Risk Acuity L.L.C. Panelists are: Ann Barry, risk manager of Fidelity Investments; Lorraine R. DeWerd, senior vp-risk management practice for Willis; John T. Leonard, president and CEO of Maine Employers Mutual Insurance Co.; and Stan Long, chairman-workers compensation for Marsh Inc.

• **Turning Risk Financing Challenges into Opportunities**, which will be moderated by Mr. Pettegrew of Westaff. Panelists are: James C. Halbleib, area executive vp of Arthur J. Gallagher & Co.; Michael M. Kaddatz, managing director of ARM Tech; and Rami Suleiman, casualty manager for United Parcel Service of America Inc.

• **Keeping a Lid On Expanding Disability Exposures**, which will be moderated by Bernadette Melchionne, senior corporate insurance administrator for Mattel Inc. Panelists are: Alison Heller-Ono, president and CEO of Worksite International; Dr. Alexander R. Lamponne of Work Comp Solutions; and David A. North, president and CEO of Sedgwick Claims Management Services Inc.

• **Bad Actors: Putting a Stop to Comp Fraud**, moderated by Dan H. Kugler, director, corporate risk management for Snap-On Incorporated. Panelists are: Timothy E. Fargo, president of Omega Insurance Services Inc.; Dennis Jay, executive director of the Coalition Against Insurance Fraud; and Peter Rousmaniere, president of Pain Disability Management L.L.C.

Tuesday will also feature as its luncheon speaker Mark W. Hinkley, executive vp with Odyssey Reinsur-

ance Corp. of Stamford, Conn., who will provide his incisive and satirical commentary on the state of the insurance industry.

Wednesday, Oct. 22:

Following a breakfast buffet, Wednesday's sessions are:

• **Top Legislative Developments of the Year**, moderated by Wayne L. Salen, director of risk management for Home Quality Management Inc. Panelists are: Gregory W. Heidrich, senior vp, secretary and treasurer of the Alliance of American Insurers; Nancy M. Schroeder, assistant vp-workers compensation for the National Assn. of Independent Insurers; and Bruce C. Wood, assistant general counsel for the American Insurance Assn.

• **New Strategies to Improve Safety and Cut Lost-Time Injuries**, moderated by Maria A. Bayne, principal of Bayne Consulting Group Ltd. Panelists are: Pamela K. Burger, corporate director of risk management for Baystate Health System Inc.; Gary S. Mackey, director of management services for Baystate Health

System Inc.; and Elise Macinka, safety/vehicle/risk manager for Cox Communications Inc.

The day's agenda will conclude with a Networking Luncheon, hosted by *BI*'s Ms. Fletcher and Mr. Pettegrew of Westaff. The informal lunch will provide attendees with an opportunity to ask panelists, conference organizers and peers unanswered questions, to seek clarification or to obtain additional information.

The Web site for the conference, www.businessinsurance.com/wcc, offers the full conference program, including speakers and moderators; advisory board members; an online registration form; hotel details; and information on exhibit and sponsorship opportunities.

The conference registration fee for risk, employee benefit, claims or safety managers or other corporate executives is \$795, while the fee for service providers is \$1,095. A 10% group rate discount is available if two or more executives from the same organization register at the same time.

Registrations can be obtained and submitted online at www.businessinsurance.com/wcc, or registration forms can be mailed or faxed to Lisa Ferrier, conference coordinator, *Business Insurance* WORKERS COMP CONFERENCE, 4248 Park Glen Road, Minneapolis, Minn. 55416; phone: 952-928-4642; fax: 952-929-1318; or e-mail: biwcc-registrar@crain.com.

Conference attendees can obtain a special rate of \$229 standard or \$249 deluxe by calling the Fairmont Copley Plaza direct at 617-267-5300 or 800-441-1414 and mentioning the *Business Insurance* conference.

Paul Winston

Hollywood scripts a total recall race

In a state that is both the center of the entertainment industry and of radical politics, it's not surprising that the two sometimes intersect.

The current recall effort for California Gov. Gray Davis—as well as the slate of more than 125 candidates seeking to take his place in office—certainly offers more than a bit of both.

For those of us who live outside California, it's easy to shake our heads at the spectacle and thank our lucky stars that we won't be heading to the polls on Oct. 7 to cast this momentous ballot. Imagine the choices that are before Californians: stick with the current governor, who has lost the confidence of most voters to effectively run the state, or

Schwarzenegger says he would revamp the state's Uniform Commercial Code, which allows lawyers to sue companies on behalf of the public for violations of the law, to prevent abuse.

Mr. Schwarzenegger also calls for limits on the state's employment liability laws, especially on the awarding of damages for "front pay" and on the state's "lawyer friendly" age-bias rules.

On the workers comp front, Mr. Schwarzenegger says he would seek to adopt new restrictions on medical utilization, introduce American Medical Assn. impairment ratings for permanent disability awards and curb judicial involvement in the system, and impose new cost-

containment goals for the state Division of Workers' Compensation.

No other front runner has a well-articulated comp reform strategy. The only other candidate who appears to have a comprehensive platform for workers compensation reform is Richard J. Simmons—not the fitness guru but an attorney who is

running as an independent. "The system does not need a Band-Aid or simple tinkering. It requires an overhaul. It is driving businesses away and jobs along with them," Mr. Simmons states on his Web site, offering a 21-point plan for reform.

Many other candidates cited soaring workers compensation costs as a problem driving businesses from the state, but few offered well-defined solutions.

Even the comedian candidate Leo Gallagher, famous for his melon bashing, weighed in on the need for comp reform: "Because the well has run dry, mandate that all recipients of workmen's comp be re-examined to help eliminate fraudulent payments."

On the tort reform front, I was encouraged by Republican Carl Mehl's call for adopting the loser-pays rule as a way to stem excessive litigation. But, unfortunately, I think some voters might be turned off by photos on his Web site of Carl in full combat holding an M1 rifle to shoot tomatoes in his garden to make juice.

The price of admission to the California recall race might be as cheap as the cost of campaign promises, but you can't beat the price of watching this political entertainment from afar. For Californians, of course, it might prove far more costly.

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Paul Winston

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Editorial

Pension proposal won't help system

IF THERE EVER WAS a perfect example of what *not* to do to improve pension plan funding and better protect the federal pension insurance program from losses, a provision in a broad pension reform measure passed by a Senate panel this month is it.

As we reported, legislation passed by the Senate Finance Committee includes a provision that, for the next three years, would waive for many employers with underfunded pension plans the current requirement to accelerate plan contributions.

Employers whose pension plans were at least 90% funded in 2000, or at least 80% funded in 2000 and at least 90% funded in 1999 and 1998, would be exempt in 2004, 2005 or 2006 from accelerating contributions, regardless of how

low the funding levels of their plans were in any of those years.

Certainly, we can understand the likely motivation behind this provision, which was never publicly discussed by the committee before its adoption.

Pension plans have been battered, like never before, over the last couple of years. The value of plan assets has plummeted due to the broad-based declines in the equities market. At the same time, the value of liabilities has soared as interest rates have fallen.

As a result, plans that once were significantly overfunded now find themselves underfunded, and with that adverse change in status comes the requirement for employers to speed up contributions to the plans.

No doubt some would argue that

the financial burden imposed by the acceleration in plan contributions would be too much for some employers and they would instead terminate the plans.

While that is certainly possible, the approach taken by the Finance Committee would, we think, do even greater damage. Waived from making extra contributions, plans will become even more underfunded. If the employers sponsoring those plans go out of business, as some certainly would, at the end of those three years, the liabilities assumed by the Pension Benefit Guaranty Corp. would be even greater than without a funding waiver.

Is this something Congress would like to see, given the PBGC already has a large and growing deficit and may eventually need

more funds—either an increase in premiums paid by employers with defined benefit plans or direct federal subsidies? We can't believe that.

To be sure, providing a much more limited waiver—no more than a year—from an acceleration in contributions—could, in a handful of situations, buy time for a financially troubled company to get back on its feet and then be in a better position to make contributions to its pension plans.

But a three-year waiver is just too long, and the risks posed to the nation's pension insurance program are too high. If a company can't afford to make pension plan contributions this year or next, it likely isn't going to be in a better position to make them three or four years from now.

Stick with original class action bill

SOMETIMES, TRYING to improve something actually makes it worse.

That's certainly the case with a proposed substitute to the class-action reform bill that's been languishing in the Senate for nearly six months. The bill hasn't been stalled because it's fatally flawed, but rather because more pressing business relating to the war in Iraq and contentious appropriations bills has sidetracked it. In fact, backers of the Class Action Fairness Act say they have the firm support of at least 57 senators—only three fewer than the number needed to cut off any filibuster on the bill and move it to a final vote.

That's a pretty strong hand, but that hasn't stopped Sen. John Breaux, D-La., from circulating a substitute version of the bill, a substitute he considers necessary to get to the 60 votes needed to pass class-action reform legislation.

The problem is, the Breaux substitute takes the reform out of the reform bill.

One of the most frequent complaints about current class action practice is that it allows plaintiffs to file national class actions in state courts known for their antipathy toward corporate defendants from other states. That's true even if only a single member of the class lives in the state where the action is filed.

That leads to so-called "forum-shopping" by plaintiffs' attorneys seeking the most-plaintiff friendly venue possible to hear their case.

As a result, defendants in interstate class actions complain—with justification—that they're being tried in a court where they can't get a fair shake and can't do anything about it.

The Class Action Fairness Act would address that complaint by allowing either plaintiffs or defendants to seek removal of a national class action to federal court from state court, under certain circumstances, when the parties are from different states. There would be some exceptions. For example,

there would have to be at least \$5 million at stake before a case could be moved. That's reasonable enough—we don't want the federal courts jammed with relatively minor class actions.

What isn't reasonable in the Breaux substitute is that, while it would permit the removal of certain national class actions to federal court, the formula for doing so would totally ignore the residency of the defendant.

Instead, it would focus on the proportion of a given class that happens to live in a given state. Even there, judges would have an awful lot of leeway in deciding which cases go to federal courts. We agree with opponents that the deck would remain stacked against defendants if the Breaux substitute replaced the original bill.

Right now, the Breaux substitute is little more than an outline—it has yet to be translated into legislative language. But even in draft form, there's no way this can be considered an improvement on the original bill. In a case like this, accept no substitutes. Stick with the real thing.

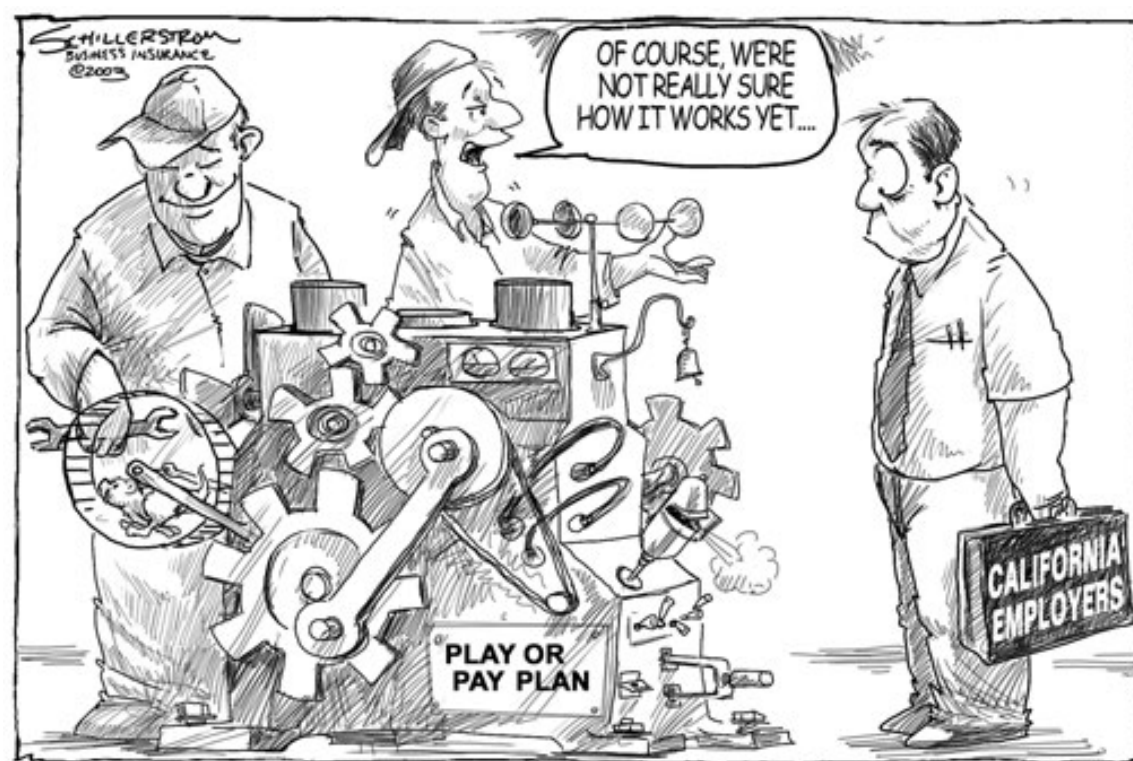
Letters to the Editor

Regulators often too quick to shut down insurers

To the editor: Your call in the Sept. 22 issue for a review of insolvency regulations in response to the Stewart Economics Report prepared for the Council of Insurance Agents & Brokers is a valuable push toward a necessary dialogue on an important topic. However, your focus and that of Stewart Economics is primarily on the front end of the process—

See **LETTERS**/page 24

Schillerstrom



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There's no guarantee guaranty funds will pay

By Sheila Small

Relying on guaranty funds to pick up the tab on claims for an insolvent insurer is reckless risk management. Sure, these state-regulated funds are supposed to do just that—cover the claims of bankrupt insurers and protect commercial policyholders from absorbing the loss. But given the magnitude of today's losses, these funds are often unsuited for the task.



Consider the difficult situation that the management of American Airlines faces as it tries to recoup more than \$100 million in losses from the Sept. 11, 2001, terrorist attacks and the November 2001 crash in Queens, New York. The airline has \$100 million in reinsurance from Lloyd's. But it has not been able to touch a penny of it, since Legion Insurance Co.—the once A+ rated carrier fronting this reinsurance program—was ordered into rehabilitation last year. Even

though Legion will probably be declared insolvent in all states and American Airlines has been granted access to Lloyd's, the court decision is being appealed. American Airlines still faces the uncertainty of whether they will ever be able to trigger the guaranty funds, and, if so, to what extent.

Commercial policyholders take note: There is no substitute for the credit quality of an insurer. A guaranty fund may respond, but its response will not be anywhere near the caliber needed to protect a policyholder facing a large liability. Clearly, fund creators assumed that large commercial insureds should be able to evaluate the financial condition of insurance companies and avoid falling victim to insurer insolvency. They designed guaranty funds to give the little guys a little something to ease the burden when the local Main Street carrier goes belly up. And, to be fair to these funds and their creators, a swift analysis of the funds makes their true—and limited—intention apparent:

- Most funds limit coverage for nonworkers compensation claims to \$300,000 per claim, or even less—an inadequate sum considering how litigious today's environment has become.

- In approximately half of the states, a net worth provision excludes large policyholders

from the class of eligible guaranty fund claimants. Typically an insured with a net worth over \$25 million in the year preceding its insurer's insolvency cannot collect any first- or third-party claim payments from the guaranty fund. In 22 states, guaranty funds will pay certain claims on behalf of large commercial policyholders—but then seek to recoup costs from these insureds on third-party claims paid.

- An insurer must be determined to be insolvent before a guaranty fund can be triggered. This determination often may come only after a lengthy legal process that creates tremendous uncertainty for the policyholder, its balance sheet and shareholders.

- Many guaranty funds bypass certain types of damages altogether. Among those not covered are noneconomic losses and punitive and exemplary damages—which are often the lion's share of claim dollars.

In addition, the breakneck pace of insolvencies—a historic high of 38 last year, according to A.M. Best Co.—coming on the heels of the collapse of Reliance Insurance Co., America's largest-ever insurance liquidation, has left many states' funds financially strained. Funds vary greatly state by state, and it is nearly impossible to predict which fund's door you'll be knocking on. No state, though,

is likely to provide the reception your company—or its shareholders—is hoping for.

Given the current state of the economy and of the property/casualty insurance industry, there is every reason to expect more insolvencies, even of currently high-rated carriers. Guaranty funds will not be the ultimate panacea to provide adequate recourse.

For real security, do your homework and choose carriers that have been identified by the industry rating agencies as being the best both in financial strength and claims paying ability. Considering the long-tail nature of many of today's largest claims, it is critical that the sustainable financial viability of the insurer be the primary driver of every insurance purchase decision, even if it means paying a premium. Every risk manager should adopt a prudent recipe for choosing the right insurance partner. A pinch of due diligence, sprinkled with strong financials, blended with long-term viability will ensure the most practical risk management strategy.

Sheila Small is assistant treasurer-risk management and insurance for Verizon Communications in New York. She is also 2003 Risk Manager of the Year.

Ask A Benefit Actuary

Pension plan sponsors facing rule changes

Q: Are the accounting rules threatening the viability of defined benefit plans?

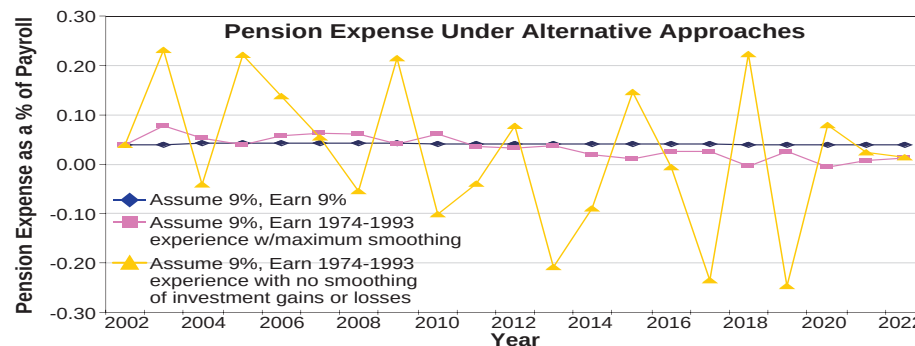
A: Defined benefit pension plans are under the microscope these days. Stock analysts dissect pension income to understand what impact it has on a company's income statement. And in the aftermath of Enron and the heightened focus on corporate governance, the Financial Accounting Standards Board is reviewing its pension accounting standards and disclosure requirements. Over the last six months, FASB has made some pronouncements



that may make analysts and the Security Exchange Commission happy. But pension plan practitioners are concerned about current and future FASB actions and the implications these could have for defined benefit pension plan participants.

First, a little background. In the mid-1980s, FASB adopted Financial Accounting Standard 87, which required plan sponsors to recognize the annual expense (or income) generated by their pension plans on their income statements. Plan sponsors must also prepare a balance sheet analysis disclosed in the footnotes at the end of the sponsor's fiscal year. These disclosure requirements were updated in the mid-1990s with FAS 132.

Annual expense is generally the cost of benefits accrued annually offset by expected returns on assets. In addition, plan changes and gains or losses (from plan experience or investments) are reflected but smoothed over several years.



Source: Watson Wyatt Worldwide

Analysts have long complained that the complex rules that govern smoothing boost earnings artificially, especially during down markets. The outcry is especially pronounced today because the current down market combines poor returns with low discount rates (resulting in high pension liabilities). If liabilities are high and asset values low, the smoothing mechanisms that plan sponsors are permitted to use allow plan sponsors to delay recognition of losses and lessen the impact of such market conditions.

Globally, there is a trend toward removing smoothing mechanisms. The U.K. accounting board recently eliminated smoothing for both assets and gains and losses. The outcome? Since the changes were adopted, plan sponsors are terminating their pension plans in record numbers. The International Accounting Standard Board is following suit. Its standard, IAS 19, doesn't allow smoothing of assets, and the IASB has tentatively ruled that, starting in 2005, gains/losses be recognized immediately. The FASB has, for now, decided it will not adopt similar measures, though a recent Financial Times article asserted that FASB is flirting with the idea.

Smoothing pension assets does not hide losses (or gains)—it simply defers recognition of losses (or gains). The asset smoothing mechanism itself is permitted under generally accepted accounting principles and is subject to review and approval by auditors. So there

are measures in place to prevent abuse of the accounting principles.

Pension expense can be highly volatile without asset smoothing. The above graph illustrates this volatility. It assumes that the asset returns from 1974 through 1993 (which averaged about 9% per year) are repeated.

Add to that the volatility of immediately recognizing gains and losses and we can understand why plan sponsors in the United Kingdom are terminating their pension plans.

For me, this chart vividly illustrates the risk to the defined benefit system. For a chief financial officer at an organization sponsoring a defined benefit plan, such a level of volatility is typically not acceptable. To reduce the level, the CFO can invest more of the plan's assets in bonds. But that effectively increases the cost of the company's plan. The other principal option is to change the design of the plan or freeze the benefits at current levels.

At its May meeting, the FASB tentatively amended its FAS 132 disclosure requirements. Sponsors can expect to devote more space in their annual reports to pension plans. An exposure draft of the new disclosure requirements has been released, with requirements effective for fiscal years ending after Dec. 15, 2003. Comments in writing regarding the exposure draft will be accepted by the FASB until Oct. 27, 2003. The proposed disclosure requirements include target allocation, actual allocation, expected return,

and maturity description of each asset class; accumulated pension obligations; benefit payments from the plan; and expected contributions to the plan.

Along with reviewing its FAS 87 and FAS 132 standards, the FASB is scrutinizing cash balance plans.

The FASB recently ratified a change in the actuarial cost method used to measure the obligations of cash balance plans, measuring the obligations as the sum of all account balances. The change will likely reduce a plan's pension obligations and annual expense because current methods reflect future pay increases, whereas account balances do not.

Plan sponsors should not celebrate yet. Another proposal, which would affect many cash balance plans, recommends measuring the obligations using the same discount rate as the interest crediting rate used to credit the cash balance account for participants. This would significantly increase the expense for some cash balance plan sponsors. Regardless of the net result, it is clear that the cash balance debate is not yet over.

There is a whirlwind of activity in the pension accounting world. The best course of action is to vigilantly monitor FASB proposals and decisions. Companies will continue to ask if plan sponsorship is worth the volatility, disclosure and angst. These questions do not bode well for the participants who are accruing benefits under the plan.

Ask A Benefit Actuary answers written questions from readers on benefits actuarial problems.

This month's column on actuarial questions in the benefits field is written by William J. Miner, an actuary with Watson Wyatt Worldwide in Chicago. Valerie M. Lopez, a consultant with Watson Wyatt Worldwide's Chicago office, assisted Mr. Miner with the preparation of this column.

Address your questions to ASK, Business Insurance, 360 N. Michigan Ave., Chicago, Ill. 60601. Please give your name, title and employer; however, Business Insurance will consider unsigned letters.

HIPAA: Privacy rules set a new standard of care

Continued from page 4

Unlike most other health care-related legislation, "this actually carries criminal penalties," Mr. Zigler told his audience. "On the civil side, you could pay up to \$100 per violation" to a maximum of \$25,000 per year for multiple violations of the same standard, he said.

On the criminal side, an employer that releases private information with malicious intent or attempts to profit from such information could be subject to penalties of up to \$250,000 and 10 years in jail.

"It really goes without saying," Mr. Zigler said, that "there is some concern in mainstream America and, certainly, among legislators about the privacy of this information. So they've put enough teeth into the law" to encourage employers to be watchful about guarding private records and mindful of mitigating any damage that might result from its release.

Alison W. Archer, a health and welfare consultant with Towers Perrin in Dallas and a panelist in the discussion, reminded conference attendees that many states also have their own privacy laws. Some states may have tougher rules than HIPAA, she said, "and you may have to meet those more-stringent requirements."

She pointed out, though, that self-funded health plans would appear to fall under federal rules because the Employee Retirement Income Security Act pre-empts state regulation of those plans.

SIIA 2004 conference slated for Miami Beach

DALLAS—Around 1,400 attendees, exhibitors and speakers gathered at the Adam's Mark Hotel in Dallas for the Self-Insurance Institute of America Inc.'s 23rd Annual National Educational Conference and Expo, held Sept. 16-19.

The event featured scores of educational sessions for employers, third-party administrators, senior managers and others. Topics ranged from the basics of self-insurance to more advanced discussions of stop-loss underwriting, technology issues and general self-insurance and insurance topics.

The association will hold next year's conference at the Fontainebleau Hilton Resort in Miami Beach, Fla., Sept. 28-Oct. 1. More information about the 2004 conference is available from the SIIA by phone at 800-851-7789, or by e-mail at www.siiia.org.

The privacy rules, though effective last April, still cause a lot of confusion, according to Ms. Archer.

The regulations cover protected health information, or PHI, as it has become known. "It is both past information as well as present information," she explained, and is health information that contains an identifier, such as a name or Social Security number, that links it to an individual.

PHI is defined as information held by a "covered entity," which is an organization such as a health plan, health care clearinghouse or

health care provider. Those entities must abide by strict regulations under the law as to how they handle and exchange that private information among themselves.

Mr. Zigler pointed out that an employer-sponsored health plan becomes a covered entity through amendments to its plan document, and language in contracts between health care organizations and vendors can establish the business partners as covered entities.

Under the act's complex rules, there should be no exchange of PHI between an employer and its group

health plan, Mr. Zigler advised. "The water gets a little muddy here because the employer and the plan sponsor may be the same," he said. "But there needs to be firewalls or some sort of separation between the folks that hold this protected health information and the people that are involved in hiring and firing to make sure that this information isn't inappropriately used."

Mr. Zigler said his company recommends to clients that they take a close look at which areas of their organizations handle PHI. "There are a lot of ways that you may be get-

ting PHI that you're not aware of. So, one of the first things you want to do is to inventory that."

For those areas that do handle PHI, they should be advised on how private data is to be treated, shared and disposed of, he advised. "Make sure that you either have PHI or you don't have PHI, because that is a very important distinction that needs to be made."

Also on the panel was Herbert G. Gleitz, a partner in the Dallas law firm of Godwin Gruber. The session was moderated by Steven T. Polino, also a partner with Godwin Gruber.



Gary Bridgeford, Director—Corporate Risk Management Johnson Controls, Inc.

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SIIA 23rd Annual National Educational Conference and Expo

Stop-loss assessments raise costs for self-insurers

By MICHAEL BRADFORD

DALLAS—States that want to impose assessments on stop-loss reinsurers are keeping the Self-Insurance Institute of America Inc. busy. "As far as SIIA is concerned, this issue has attracted more of our time and energy than federal issues," said George Pantos, the SIIA's Washington-based general counsel. "This is a very, very serious issue."

"It really is important," he stressed, "because I see it as a newly emerging trend" in which states op-

erating high-risk pools for the uninsured are looking to stop-loss reinsurers to help make up deficits in the pools.

"There's no money in the state budget to make up those deficits, so they are looking around for other sources of revenue, and one of the sources they seem to have come upon is stop-loss," Mr. Pantos said.

"The way this plays out may have a significant impact on your businesses," Mr. Pantos told an audience at the SIIA's 23rd Annual National Educational Conference and

Expo held earlier this month in Dallas. "It adds tremendous cost onto the self-insured health plan, and it also restricts" the ability of stop-loss reinsurers to operate, he said.

Assessments could drive up stop-loss premiums as much as 15% to 25%, according to Mr. Pantos.

He listed the states that are most aggressive in seeking the levies, and those that are the target of SIIA efforts to stop the charges, as Colorado, Indiana, Mississippi, South Dakota and Wisconsin. Though the issue has been clouded by legal

questions, the assessment in Colorado appears to seek annual fees of \$25 per covered employee from stop-loss reinsurers, Mr. Pantos said. "They don't have covered lives; they're a stop-loss carrier. So we have a legal issue."

The assessments aside, legislative concerns also occupy much of the association's time.

As the presidential election nears, debate will heat up over health care issues that affect self-insured employers, Mr. Pantos predicted.

Presidential primaries "are only a

few months away," he said, and the election is just over a year from now. Health issues will be at the "very top of the dialogue in this country over the next 12 months as people begin to make suggestions and proposals for change."

Mr. Pantos said he believes President Bush will try to "pre-empt the health care issue and get it off the plate of the nation" as a way to neutralize the debate during the election year. "So I think we are going to see some initiatives coming from the White House that are going to be very interesting over the balance of this year and next year as they try and crystallize some of the administration's policy goals on health issues."

A stop-loss assessment 'adds tremendous cost onto the self-insured health plan, and it also restricts' reinsurers' ability to operate.

George Pantos
Self-Insurance Institute
of America

While the SIIA has its work cut out in lobbying and monitoring legislation, it isn't battling anything as potentially onerous as the health care plan that was put forth by President Clinton's administration, Mr. Pantos pointed out. The SIIA considers defeat of that proposal one of its victories, he said, because the Clinton proposals "would have eliminated self-insurance."

On the SIIA's radar screen is the Medicare Prescription Drug Modernization Act of 2003, proposed legislation that has implications for employers, Mr. Pantos said. Flexible spending accounts and employer-provided retiree health benefits could be affected by the legislation, for example, he said.

And, a lot of SIIA members are vendors that provide prescription drug services to the self-insurance market and they could be affected by the legislation as well, Mr. Pantos remarked.

He acknowledged, though, that there remains a "lot of heavy lifting" before a final bill can be written. Two versions yet to be reconciled contain big philosophical differences that need to be overcome, Mr. Pantos explained.

In the House of Representatives, there is a "significant push for privatization," he said, so that insurers can provide coverage for drugs under Medicare. "Whereas in the Senate, there is tremendous opposition to that concept....The issue is, will there be more private-sector involvement in Medicare or will there be less? We don't know."

Mental health parity legislation is also being watched by the SIIA. "This legislation has been on our radar screen a long time," Mr. Pantos said.

It is important for self-insurers to understand that "mental health parity could take a turn for the

See **STOP LOSS**/next page

Mr. Anonsen complained that there is no clear definition of the core role of each of the professions in the chain. He said that in some cases reinsurers are offering coverage that shipowners find more favorable, bypassing the traditional marine market.

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IUMI Conference 2003

70% of container cargo losses are avoidable: GDV

By NEIL HODGE

SEVILLE, Spain—Loss prevention efforts must be “greatly improved” by the shipping industry and its insurers to control the fast-growing exposures within the container market, according to a leading German marine insurer.

Edwin Mast, nautical technical consultant at Munich-based Munich Reinsurance Co. and a member of the cargo loss prevention committee of the Gesamtverband der Deutschen Versicherungswirtschaft e.V., the German insurance association, said that some 70% of all losses in the container cargo market could be avoided, but that economic pressures are making it increasingly difficult for carriers to keep on top of rapidly rising exposures.

Mr. Mast told attendees of the International Union of Marine Insurers conference in Seville, Spain, last week that fierce competition among freight carriers has led to low freight rates, reduced crew levels, inadequate training and lax safety standards over the past 20 years.

He said that one of the most popular ways for vessel operators to influence operating costs is to cut their investment in crewing. But he warned that this has had catastrophic consequences for safety.

“Such attempts at cost-cutting have led to ever-decreasing crew numbers on the ships, mixed nationalities and a general lack in training and know-how, with the result that the risks for the marine

insurance industry have changed—usually not for the better,” Mr. Mast said.

He added that “the result of all this is that technical know-how and in-depth knowledge are no longer available as a matter of course and the conclusion of the GDV is that 70% of all cargo losses are deemed avoidable even in our containerized world of today.”

The GDV has issued an in-depth Web-based container handbook, which can be found at [www.container-](http://www.container-handbook.de)

[erhandbook.de](http://www.container-handbook.de), on how to improve loss prevention for containerized cargoes.

Other speakers also said that improved safety checks, both on vessels and at ports, should improve the bottom line of marine underwriters.

Richard Soja, senior vp and global marine and energy manager of Chubb & Son in Chicago, said that new legislation passed in the United States last November and due to come into force in November of

this year should promote better security at ports and push liability onto port operators rather than insurers, thereby reducing the amount paid out by insurers in claims.

Mr. Soja said that because the Maritime Transportation Security Act 2002 requires vessels and port operators to conduct security self-assessments and develop and submit security plans, underwriters should benefit from reduced terrorism risk, cargo damage and theft, as

well as a reduction in marine general liability claims.

“Increased security procedures and screening within ports and vessels should benefit underwriters as it reduces the risk of cargoes or ships being destroyed through terrorism,” said Mr. Soja.

But he added that “there is also the possibility that insurers could receive an increase in claims because of cargoes being damaged through increased handling and inspection.”

IUMI Conference 2003

Need for TRIA likely to extend beyond '05 expiration

By NEIL HODGE

SEVILLE, Spain—The U.S. government should extend the Terrorism Risk Insurance Act beyond its 2005 expiration because of reinsurers’ reluctance to cover primary terrorism policies, an attorney says.

Speaking at the International Union of Marine Insurers conference in Seville, Spain, last week, Joseph Grasso, a partner at New York-based law firm Thatcher Proffitt & Wood L.L.P., said that he

thinks that the U.S. government won’t extend TRIA because it believes that “terrorism coverage is now generally available.”

But he added that TRIA should be extended because the low level of interest in buying terrorism coverage has slowed the development of products in the commercial market. This, he said, stems in part from “reinsurers being unwilling to cover terrorism risk,” which curbs insurers’ ability to offer affordable primary coverage.

“Clearly, a factor is whether coverage is generally available on the commercial market and, if it is, it will end the Act. Terrorism coverage is generally available now, but how comprehensive it is could be subject to debate,” he said.

TRIA, which was passed in November 2002, created a backstop that ensures that the government will share in future terrorism losses. The program includes a deductible that increases each year until the law expires, and the coverage pro-

vided by the government is capped at \$100 billion.

The law requires insurers to offer terrorism coverage, but reinsurers are not subject to its provisions.

“TRIA was always intended as a short-term measure to provide insurance companies with sufficient time to come up with suitable commercial solutions. Technically, that is happening, but there is no provision within the act to compel reinsurers to take on the risk, whereas direct insurers have to provide ter-

rorism cover,” said Mr. Grasso.

Richard Decker, senior vp-ocean marine at ACE USA in New York, agreed that some progress had been made in the commercial market, but he said that the law likely would need to be extended.

“TRIA is very narrow, and you still need specific coverage to replace that. There is still one-and-a-half years to go, but if sufficient alternatives do not emerge, it will have to be extended,” Mr. Decker said.

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Technology

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SEVILLE, Spain—This year’s International Union of Marine Insurers conference in Seville, Spain, attracted 408 attendees, and organizers hope that there will be even more at next year’s event.

IUMI 2004 will be held in Singapore at the Raffles City Convention Centre, Sept. 12-15. The conference will be hosted by the General Insurance Assn. of Singapore.

Further information about the event and accommodations is available by mail at the Organizing Committee for IUMI 2004 Conference, c/o Professional Conference Organizer, The Event Company Pte. Ltd., 15 Jalan Kilang Barat, Frontech Centre Level 8, Singapore 159357; or by e-mail at iumi2004@eventco.com.

Registration forms will be available starting in February.

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FMLA: Not causing major problems for employers

Continued from page 4

ables employees to take care of personal issues and then return to work without those issues hanging over them.

"When they do come back they are a better employee and can concentrate on their work," Mr. Falvey said. "You have a better workforce."

The law also especially helped new mothers, said Donna Frisch, manager of corporate health benefits at H.J. Heinz Co. in Pittsburgh.

Expectant mothers can plan in advance their leave period and their return date, which allows their employer time to develop a plan to fill in for the absent worker, she said. Also, by holding the person's job open, as required under the law, it's more likely the worker will return, she said.

"We, as the employer, don't lose that experience," Ms. Frisch said.

The law's biggest impact has been on companies that didn't already have leave policies, said Mary Masal, senior specialist, FMLA, ADA and rehabilitation programs at Southwest Airlines Co. in Dallas.

In addition, many of the law's opponents' concerns have not become reality, Ms. McGraw said. Specifically, the FMLA has not in-

creased costs or forced employers to cut other types of benefits, she said.

About 16.5% of all workers took some form of FMLA leave between Jan. 1, 1999 and July 1, 2000 according to a 2000 Department of Labor survey, the most recent one conducted. Overall, 23.8 million

'Our big problem has been the unclear definition of "serious health condition" for the employees themselves.'

*Dixie Dugan
Cardinal Service Management Inc.*

workers took FMLA leave during that period.

The most common reason for taking a leave is caring for the employee's own health, the survey found, with 52.4% of leaves taken for that purpose. Caring for a new child places second, accounting for 18.5% of leaves.

Most leaves are for a short term, the survey found, with 54.1% of leaves lasting 10 or fewer work days. Only 9.2% of leaves were for the full 60 work days, the survey found.

Problems with the law

But the successes have not come without problems for employers.

"It started off with very good intentions," said Victoria Schweitzer, senior vp at Aon Workforce Strategies, a unit of Aon Corp. in San Francisco. "But a few issues have surfaced that have spun it in a different direction."

The most common problems with the law involve employees taking leave for their own medical conditions, observers said.

Many employees "have found it very easy to abuse the regulation," said Michael Eastman, director of labor law policy at the U.S. Chamber of Commerce in Washington.

Labor Department regulations and court rulings have broadened the definition of serious medical condition to encompass many illnesses not originally intended to be part of the law, critics say.

The definition of FMLA medical leave has been stretched to include a situation where a person has three or more days of absence with two or more doctor visits, Ms. Schweitzer said. Once this threshold is reached, a person can qualify for FMLA and take up to 12 weeks off.

"It was not supposed to be a national sick leave policy," said Dean-

na Gelak, executive director of the FMLA Technical Corrections Coalition, a Springfield, Va., lobbying group founded by the Society for Human Resources Management to support changes in the law.

"Our big problem has been the unclear definition of 'serious health condition' for the employees themselves," said Dixie Dugan, residential operations coordinator for Cardinal Service Management Inc. in New Castle Ind., who has testified before Congress on ways to improve the law. Cardinal Service Management provides assisted living services for the disabled.

To correct some problems, Ms. Gelak's group is lobbying to change the regulations. Two bills are pending in Congress and the Department of Labor is looking into the issue of the definition of "serious health condition" as well, she said.

Jesse Montano, benefits administrator at lingerie retailer Frederick's of Hollywood Inc. in Hollywood, Calif., however, said the definition should stay as it is because it's easy for employees to understand.

Since the law is vague on the issue, employees get leave when they present a letter from a physician stating time off is necessary.

"We don't feel we have anything

in writing to back up the questioning of the letter," Ms. Dugan said.

Intermittent leaves

Additionally, the leave does not have to be taken in one chunk. Employees can take their leave intermittently, in periods as small as one hour. In addition, once a person has qualified for FMLA leave, he or she does not have to notify the employer in advance when that leave will be taken if it is not foreseeable.

The DOL survey found that 27.8% of leaves taken are intermittent, rather than continuous.

"It's a small population of the workforce, but they can be huge headaches," Ms. Schweitzer said.

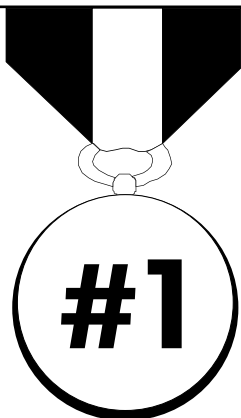
Mr. Montano cited intermittent leave as the biggest administrative problem the company has had with the law.

"I would like to do away with intermittent leave, as it's hard to track," he said.

He did note, however, that the impact is limited to administrative requirements.

Another problem has been employees taking leave and never returning, Sbarro's Mr. Kilada said. During the person's leave the com-

See FMLA/page 20



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Between the Lines

Compiled by Joanne Wojcik



Heavy duty

In recognition of America's growing obesity problem, American Medical Response is super-sizing its ambulance stretchers and gurneys to transport patients that weigh more than 300 pounds.

Greenwood Village, Colo.-based AMR's new "bariatric unit," designed for people weighing up to 1,000 pounds, is a reinforced stretcher and gurney connected to a motorized wench that smoothly pulls the patient into the ambulance. Its name is derived from the Greek word "baros," which means weight, according to Lauren Sides, AMR's director of corporate communications.

AMR's Portland, Ore., location first developed the unit to reduce the risks associated with transporting obese patients, Ms. Sides explained. After some adjustments, it was introduced in the Denver market last month.

"We haven't had any serious injuries, but we certainly didn't want to wait until we did," she said, adding that employees have suffered strains and muscle pulls from handling heavy patients.

"Paramedics push and lift patients, and it puts our people and the patient at risk," she said. "This allows any of our (emergency medical technicians) and paramedics to work with these patients. We don't have to find the biggest and the strongest of our people."

Furthermore, the device can eliminate some of the shame obese patients feel when they are transported by ambulance to a health care facility, Ms. Sides added.

"It's not pleasant to be transported by ambulance when you weigh 500 pounds. It can be embarrassing. It can be awkward. This decreases any embarrassment. And it really does make it more comfortable for the patient and safer for the EMTs and paramedics."

Cav-eat emptor

A fed-up Seattle restaurateur is waging a food fight against so-called "fat suits."

Diners who order the decadent dessert called "The Bulge" at the 5 Spot in Seattle's Queen Anne neighborhood must first sign a liability waiver that states:

"I (insert name) release the 5 Spot from all liability of any weight gain that may result from ordering and devouring this sinfully fattening treat. I will not impose any sort of 'Obesity-Related' lawsuit against the 5 Spot or consider any similar type of frivolous legislation created by a hungry trial lawyer."

Surprisingly, no one—not even lawyers—has declined to sign the release, according to Jeremy Hardy, co-owner of Chow Foods, which operates four restaurants in the Seattle area. "In fact, people love it," he said.

While unsure of the precise calorie count of the \$5.75 batter-fried banana topped with vanilla bean ice cream, caramel and chocolate sauces and fresh whipped cream, Mr. Hardy acknowledged "we know it's a lot, but it's dessert. It's supposed to have a lot of calories."

No rest for the worked

More than 70% of workers between the ages of 50 and 70 who have not yet retired say they plan to continue working past age 65 because of inadequate pensions or lack of health care coverage, reports a new survey by the AARP, the senior citizen group formerly known as the American Assn. of Retired Persons.

Although the age of 65 has customarily been associated with retirement, the AARP found that one in five 50-to-70-year-old workers had postponed retirement as a result of stock market losses, and many of them indicated that they would probably continue working until the age of 70.

The complete study, "Staying Ahead of the Curve 2003: The AARP Working in Retirement Story," is available on the organization's Web site, www.aarp.org.

Tips and feedback from readers are welcomed. Please send information to jwojcik@crain.com.



PHOTO: TIAH OAKFORD, COURTESY CHOW FOODS

FMLA: Not causing problems

Continued from page 18

pany is required to hold open the job and continue supplying all benefits, with the expectation that the person would return.

Administrative challenges

In addition, administering the law has been a challenge for employers. It's "a little bigger than expected," admits Lifecare's Mr. Burki.

"It definitely creates some administrative challenges," said Ms. Masal of Southwest.

To address this problem, more and more employers are turning to outside vendors to track FMLA leave. FMLA record keeping can be tedious and time consuming, in particular with intermittent leave, said Dr. Presley Reed, chief executive officer of The Reed Group, an FMLA administrator in Boulder, Colo. "They are clearly the problem child right now with the FMLA," he said.

A Society for Human Resources Management survey this year found that 62% of human resource executives say it's difficult to comply with the FMLA's regulations to track intermittent leave.

For some employers, however, the administration is just part of life.

"It's an administrative issue that we've learned to work with," Heinz's Ms. Frisch said.

With FMLA a decade old, the law's supporters have turned their attention to a new area: paid leave.

"Paid leave is definitely the next level of debate," Ms. McGraw said.

Spearheading the way is California, which will launch a six-week paid leave program starting Jan. 1, 2004.

Under the California leave law, employees will be entitled to take up to six weeks of paid leave per year to care for a newly born or

adopted child or to take care of a seriously ill child, spouse, parent or domestic partner. While on leave, employees will receive payments from a state fund to replace 55% of wages, up to a maximum of \$728 a week. The state will fund the program through a payroll tax on employees.

Paid leave will create a great incentive for abuse, its opponents contend.

"A paid leave mandate would be very problematic," Mr. Eastman said.

Mr. Falvey supports the idea, however, even though most of the

law firm's employees are in California.

"It adds one more level of capabilities for an employee to deal with a difficult situation," he said.

Despite the problems that have emerged in a decade under the FMLA, employers generally say the law has had a positive impact on the workplace.

"I don't see any problems with the FMLA. It runs very smooth. Nobody abuses it," Mr. Montano said.

Even Ms. Dugan, who advocates changes in the law, has praise for it.

"It's a good law. It just needs to be tightened up a bit," she said.

FASB to review the need for cash balance rule

NORWALK, Conn.—The Financial Accounting Standards Board will review whether special rules are needed to govern the way employers with cash balance pension plans may value plan liabilities.

FASB officials said a review is necessary due to the prevalence of the plans. The move comes several months after the accounting board hastily withdrew a proposal that would have required many employers with cash balance plans to use more conservative interest rate assumptions to value plan liabilities than they now use.

Under the withdrawn proposal, employers with cash balance plans that use a market rate—such as the yield on one-year Treasury bills—to credit interest on participants' account balances would have had to use that rate in valuing liabilities.

That, in many cases, would

have resulted in inflated liabilities, consultants and actuaries said. Plans that used a fixed rate for calculating interest could have continued to use the yields on long-term corporate bonds to value plan liabilities.

FASB withdrew the proposal amid intense criticism from employers that plans paying very similar benefits would have reported very different levels of liability.

While benefit experts question whether separate accounting rules are needed for cash balance plans, they welcome FASB's decision to study the issue further before ruling.

"They are allowing enough time for consideration, with a very open process. That is the way to do it," said Eric Lofgren, global director of benefits consulting at Watson Wyatt Worldwide in Philadelphia.

—Jerry Geisel

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Losses, hard market causing market to contract

Credit risk insurance capacity falling

By CAROLYN ALDRED

A hard market, changes in accounting regulations, rating concerns, legal disputes and some large losses have prompted the insurance industry to sharply reduce its financial and credit enhancement underwriting.

"For a variety of reasons, the market for credit enhancement has contracted very, very substantially," said Mark Drummond-Brady, London-based partner of JLT Risk Solutions Ltd., and head of alternative risk transfer and credit and political risk business for Jardine Lloyd Thompson Group P.L.C.

Many insurers and reinsurers viewed capital market and financial risks—including credit derivatives, asset performance and business risks, collateralized bond obligations, residual value and credit enhancement transactions and film financing—as profitable underwriting areas in the late 1990s and a way to boost returns in a soft property/casualty market.

However, many companies have exited the market during the last year or so, while others, such as Swiss Reinsurance Co., have reduced their credit risk underwriting.

"There are extremely few underwriters who are looking to write

those types of deals and those that are have substantially reduced their capacity and stiffened up their underwriting criteria," said Mr. Drummond-Brady.

Credit enhancement, residual value and financial guarantee markets have "definitely tightened, making it a much bigger challenge for brokers to put together a corporate program," said Phillip Bolt, executive director of structured financial risks at Willis Global Markets in London, a unit of Willis Group Holdings Ltd.

An executive at an international bank that uses credit enhancement programs, who asked not to be

identified, said insurers' withdrawal is forcing buyers to be "more creative and imaginative in putting structures together to offset their credit risks." The executive said credit risk capacity is likely to grow when the property/casualty market softens again.

Zurich Financial Services Group recently announced that its Bermuda-based subsidiary, Centre Solutions, which previously was a leading market of credit enhancement insurance, has boosted its reserves by nearly \$500 million, partly due to losses on its now discontinued credit enhancement business.

See CREDIT/page 23

World Updates

E.C. to consider report on Lloyd's regulation

The European Commission has been asked to consider a report that questions the adequacy of the U.K. government's regulation of Lloyd's of London dating back to the 1970s. The report, which the European Parliament approved, stemmed from complaints by names who charge their losses were caused by a U.K. failure to adopt E.U. regulations governing the adequacy of reserves. The Commission has until Nov. 15 to deliver its opinion. Late last week, according to Reuters, a spokesman for the E.U. internal market commissioner said the Commission was satisfied with Lloyd's regulation. But a spokesman for the Commission said it was still considering the report.

Stock rally narrows U.K. pension deficits

The U.K. stock market's recent rally has reduced the deficits in the country's largest employer-sponsored pension funds, according to a recent study. Dresdner Kleinwort Wasserstein Securities Ltd. in London found that the total pensions deficit of the 100 biggest companies listed on the London Stock Exchange narrowed from £62.4 billion (\$98.29 billion) in March to £49 billion (\$77.13 billion) in September.

Report urges better rehab management

More than 7.5% of the United Kingdom's working-age population receives some form of disability or incapacity benefit, according to a report by the London-based Institute of Directors. Once a claimant has received a benefit for a year or more, the average duration of the claim is an additional seven years, the report states. Because the U.K. National Health Service is primarily concerned with medical care, employers and others must take the lead in rehabilitation management and return-to-work efforts, the report says.

Chaucer posts gains for half

Chaucer Holdings P.L.C. posted a pretax profit of £15.0 million (\$24.7 million) for the first half of 2003, compared with a restated £400,000 (\$609,720) loss a year earlier. Gross written premiums increased 31.8% in the first half to £201.2 million (\$332.0 million). Chaucer will also merge motor syndicate 587, marine syndicate 1084 and nonmarine syndicate 1096 for 2004. That enlarged syndicate will have capacity of £400.2 million (\$654.8 million).



PHOTO: AP/ANDRES LEIGHTON

Hurricane Fabian's widespread damage has created business interruption losses for businesses in Bermuda, including Mickey's Bistro, above, and several large hotels.

Business interruption losses mount in Bermuda

Fabian damage tally continuing

By MICHAEL BRADFORD

HAMILTON, Bermuda—Local insurers in Bermuda are sticking with their initial estimates that their losses from Hurricane Fabian will amount to no more than \$125 million, even though some industry estimates have been significantly greater.

Total insured losses will be somewhat higher, the insurers acknowledge, because some of the commercial damage from the hurricane that raked the island earlier this month is covered by insurers outside Bermuda. Fabian, which was blamed for four deaths, caused widespread losses on the island, ranging from significant structural damage to minor roof problems.

Larry Osborne, vp-property casualty at Argus Insurance Co. Ltd. in Bermuda, said the island's insurers are pretty confident that their losses will end up around \$100 million to \$125

million, which include estimated business interruption losses. If business interruption losses grow, he added, then the loss estimate could rise.

Not included in the estimate is what is likely the biggest business interruption loss from the storm: damage suffered by the Southampton Princess, a hotel owned by Toronto-based Fairmont Hotels & Resorts Inc., and its sister property, the Hamilton Princess. The damage to the Southampton Princess was so extensive that the hotel is closed until at least spring 2004.

Coverage for those facilities is written by non-Bermudian insurers.

Fairmont Hotels would not release total damage figures for the hotels but did say it expects its retained share of the properties' business interruption and property losses would amount to \$5 million to \$10 million after insurance recoveries.

See FABIAN/next page

Syndicates' losses prompt concerns

Rating agencies changing outlook

By SARAH VEYSEY

LONDON—Although rating agencies are predicting solid profits from Lloyd's of London for 2002 and 2003, concerns about losses in recent years have prompted one agency to lower its assessment of several syndicates.

Moody's Investors Service in London last week forecast a return to profit for Lloyd's, issuing marketwide profit estimates of £1.9 billion (\$3.06 billion) for the 2002 year of account and £1.7 billion (\$2.78 billion) for 2003.

For 2001—the next year to close under Lloyd's three-year accounting system—the rating agency forecast a marketwide loss of £2.1 billion (\$3.06 billion), due largely to claims from the Sept. 11, 2001, terrorist attacks.

"Lloyd's looks set to achieve a period of strong profitability for 2002

and 2003 in the current upturn, notwithstanding events such as Hurricane Isabel," said Mark Hewlett, managing director of Moody's European insurance division.

For the years 1997 through 2000, Lloyd's recorded marketwide losses. On a three-year accounting basis, Lloyd's posted a loss of £2.40 billion (\$3.58 billion) for the 2000 year.

Lloyd's is eliminating its three-year accounting system as part of a package of reforms designed to modernize the market.

Standard & Poor's Rating Services also expects the market will return a profit for the 2002 and 2003 years (BI, Feb. 17, 2003). But its outlook for certain syndicates has been worsened by the losses of the late 1990s and a poor return on capacity for 2001, according to the London-based unit of Standard & Poor's

See LLOYD'S/page 24

Study cites importance of risk quality

Risk management, return linked at public companies

By CAROLYN ALDRED

A strong correlation exists between risk management and the overall financial performance of companies, according to a study of 438 companies quoted on international stock markets.

The study, conducted by Oxford, England-based consultant Oxford Metrica, proves that risk management should be viewed as an investment rather than a cost, according to Deborah Pretty, author of the report and a principal of Oxford Metrica.

The study, "Improving Risk Quality to Drive Value," analyzed the

"risk quality" of companies using Factory Mutual Insurance Co.'s "Risk Mark" benchmarking system. Factory Mutual, which does business as FM Global, sponsored the study.

Under FM Global's system, risk quality is determined by the core operational activities of a business, its physical location, and how the activities are managed and protected.

The system utilizes a 100-point scale to evaluate the business vulnerability to physical damage.

"A clear, empirical connection was found between risk quality and

See OXFORD/page 24

Fabian: Bermuda coping with hurricane's aftermath

Continued from previous page

A rough estimate of the Southampton Princess' lost revenues, though, indicates the loss could be in the tens of millions of dollars. With 593 guest rooms out of operation, at the current rate of about \$300 per night, lost room



Bermuda continues to repair damage, such as this buckled road, from Hurricane Fabian.

PHOTO: EPA PHOTO/EFEE/DAVID SKINNER/ROYAL GAZETTE

revenue alone would be more than \$5 million a month. And that does not take into account the considerable revenue that such a facility would derive from meetings, meals and other guest services.

Kyle Beatty, manager of technical marketing with catastrophe modeler Risk Management Solutions Inc. in Newark, Calif., said business interruption losses will figure heavily in the final damage total. A resort such as the Southampton Princess that was heavily damaged and forced to close could see property and business interruption losses of \$25 million to \$50 million, he said.

Like the Princess hotels, Mr. Beatty said Bermuda's largest resorts typically buy coverage from non-Bermudian companies.

The Bermuda Department of Tourism reported several hotels still closed as of last week. Those hotels included the Pink Beach Club, closed until March, and the Sonesta Beach Resort, which is not expected to reopen before May.

The business interruption portion "will be the primary driver of the insured loss" for resorts forced to cancel bookings, Mr. Beatty said.

RMS does not produce a catastrophe model for Bermuda but did send personnel to the island to survey Fabian's damage.

Even with damage covered by

Business interruption 'will be the primary driver of the insured loss' for resorts forced to cancel bookings.

Kyle Beatty
Risk Management Solutions Inc.

off-island insurers, Mr. Osborne said he does not expect the covered loss to reach the \$300 million to \$350 million estimate of insurable property and business interruption values released by catastrophe modeler AIR Worldwide Corp.

AIR released its estimate soon after Fabian struck the island and a spokesman for the Boston-based company said last week that the figure remains valid. He pointed out, though, that take-up rates for commercial risks are around 90% in Bermuda and around 60% of personal lines policyholders buy cover-

age. The AIR figure is an estimate of the value of property and business interruption exposures that were affected by the storm that are insurable, but not necessarily covered.

As Bermuda's three local insurers have tallied claims, A.M. Best Co. has kept their financial strength ratings under review with negative implications. Argus, BF&M Ltd. and Colonial Group International Ltd. are the underwriters being scrutinized by the Oldwick, N.J.-based rating agency.

Mr. Osborne said accountants at Argus have spoken to Best and he does not expect a change in its rating once a clear picture of the losses has emerged. A spokesman for A.M. Best said talks are ongoing with the insurers.

Meanwhile, Bermudians are working to repair damage from the storm.

Repairs are ongoing to the Castle Harbour Causeway that connects the Bermuda airport with other parts of Bermuda. Only one lane of traffic was open as of last week on the causeway, which was heavily damaged by wind and water churned up by Fabian.

The causeway also remains closed at night, which meant airlines still were not operating evening schedules because arriving passengers would be unable to reach parts of the island, Mr. Osborne said.

"Obviously we still see pockets of difficulty," he said of Fabian's aftermath. Some large trees have yet to be cleared from roads and properties and repairs are ongoing to some damaged properties. Apart from the causeway though, traffic is flowing freely on main roads, he noted.

Damage at the Southampton Princess also has led to the cancellation of two insurance industry conferences scheduled to be held there. The Bermuda Angle, a meeting geared to insurance industry analysts and scheduled for Oct. 1, was called off. Organizers expect to reschedule the event for early December.

The World Insurance Forum, scheduled for Feb. 17-20, 2004, has been postponed and organizers expect the event to be rescheduled for late April or early May.

Still on is the 17th International Reinsurance Congress at the Hamilton Princess Oct. 8-10.

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The advertisement that appeared in this publication on 1 September 2003 concerning the Scheme of Arrangement under section 425 of the Companies Act 1985 in relation to each of the above companies dated 27 May 2003 should have appeared on 28 August 2003.

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Credit: Losses causing market to contract

Continued from page 21

Meanwhile, Swiss Re's latest sigma report, published this month, notes that insurers and reinsurers have significantly reduced their exposure in the credit default swap market.

Swiss Re itself has "streamlined" its credit business, reducing its credit exposure and shifting it from "capital-intensive, portfolio-based activities to transaction-based, tradable credit markets products," said a spokeswoman. However, "Swiss Re continues to be active in offering credit risk services and products, including traditional credit and surety underwriting and financial guarantee (re)insurance, as well as credit securitization" and other credit derivative products, the company said.

According to market participants, reasons for the contraction in financial enhancement insurance capacity include:

- Hardening property/casualty insurance rates, enabling insurers and reinsurers to make better returns on traditional business.

- Corporate credit concerns as more capital market transactions have been backed by insurance. However, many insurers have seen their own credit ratings reduced below AAA or AA in recent years.

- High-profile corporate failures, such as Enron Corp. and WorldCom Inc., both of which used credit enhancement mechanisms.

- Increasing accounting and regulatory concerns about credit derivatives (*BI*, Feb. 3).

- Accounting changes. For example, "new statutory accounting requirements require that credit default swaps be valued at market prices, which enhances the volatility of income statements. For this reason, insurers massively reduced" their participation this year, according to Swiss Re.

- Litigation. Differences in contract and insurance law and in the

culture of banking and insurance have landed some contracts in court or arbitration, observers say. A notable example is the mass of litigation against insurers that wrote coverage for film finance projects.

- Increasing losses. Centre Solutions reported a loss of \$463 million for the first half of 2003, following a \$474 million reserve strengthening for the company's discontinued credit enhancement business, as well as its structured reinsurance and life/health business.

Centre announced in December 2002 that it would cease writing credit enhancement business. Zurich has also said it is selling its more complex credit transactions portfolio, including credit derivative transactions, previously written through Zurich Capital Markets, said a Zurich spokesman.

Much of the business Centre wrote involved asset-backed transactions providing credit enhancement in leisure, transportation and health care, said the Zurich spokesman, who noted that "unfortunately all those segments suffered significantly in the economic downturn and have not benefited yet from an upturn in the economy."

"The size of reserves is a cause for concern, and it is upsetting to discover that credit enhancement business heralded by Centre in the 1990s has turned out to be a bad risk that is unhedged and unprotected," said Chris Hitchings, an analyst for UBS in London.

Paris-based SCOR S.A. also is counting the cost of its involvement in the credit enhancement area. SCOR stopped writing credit derivatives at the end of 2001 and has downscaled its involvement in U.S. credit business and alternative risk transfer during the past two years. Losses and uncertainty surrounding its credit enhancement underwriting was one of the rea-

sons behind its recent rating downgrade (*BI*, July 14).

Other insurers that have moved out of the market include Chubb Corp., which announced earlier this year that its subsidiary, Chubb Financial Services Inc., intended to run off its financial products portfolio and leave the credit derivatives business to focus on more traditional insurance. The company states in its latest SEC filings that it has "implemented a plan to exit the credit derivatives business."

As of June 30, Chubb Financial's aggregate exposure, or retained risk, from its credit default swaps was \$43 billion, though the "realistic loss exposure of CFS is a very small portion" of that, the SEC filings state.

Meanwhile, as SCOR and Centre have found out, exiting the market is not the end of the story.

London-based Royal & Sun Alliance Insurance Group P.L.C., which ceased underwriting all new business in its U.S. financial insurance unit last year, is embroiled in litigation over credit risk policies totaling more than \$500 million. The policies cover loans made by the Student Finance Corp., primarily for truck driver training, and has led to litigation with MBIA Insurance Corp., Wells Fargo Bank Minnesota N.A., Wilmington Trust Co. and PNC Bank.

RSA's 2002 annual report states the group has exposure in the United States, Korea and the United Kingdom to "financial enhancement products which provide surety to banks, lending institutions and credit facilities that insure principal and interest payment on debt securities. The group no longer writes such business; however, the nature of such contracts is normally that the group is on risk for more than one year and therefore liabilities remain for an extended period."

RSA has bought reinsurance from

Berkshire Hathaway Inc. for a premium of £124 million (\$202.9 million) to reduce its U.K. exposures, the report notes.

Within its U.S. financial enhancement portfolio, RSA has a variety of credit default product exposures. Losses on these totaled £36 million (\$58.9 million) during 2002, with the ultimate loss estimate of the products £116 million (\$189.8 million).

However, while capacity in the credit enhancement insurance market has reduced, insurers will likely remain involved, brokers and analysts say.

"The likelihood is that there will be more insurer involvement in credit enhancement as the traditional insurance market peaks and

companies wish to put their capital to more effective use," said Earl Lancaster, director of the financial service ratings group of Standard & Poor's Corp. in London.

"Significant fault lines" in the convergence between insurance and the capital markets have emerged, and "everybody has taken a step back" to reassess the situation, said Mr. Drummond-Brady.

Insurers, banks and brokers have all learned from the past five years, and future business likely will be written with greater understanding, he said.

Meanwhile, "demand is very much there," said Willis' Mr. Bolt, noting that "clients see this business as a very important tool in their treasury armory."

EAP directory deadline approaches

Business Insurance will publish its online Directory of Employee Assistance Programs and the Directory of Dependent Care Resource and Referral Services Providers on Oct. 27. That week's issue of *Business Insurance* will include a ranking of the EAP providers and dependent care resource and referral providers, as well as a Benefits Management Take-Out Section on work/life benefits.

The online directories will be available to subscribers on www.businessinsurance.com and will be included in *BI*'s 2003/2004 Market Sourcebook, a special printed compilation of all of *BI*'s directories and rankings that will be published in December.

The EAP directory lists companies that provide EAP services directly to employers on a stand-alone basis, i.e., independently of other services the organization offers. To be listed, a company must generate at least \$100,000 in gross

revenues from EAP services or provide such services in at least three states.

The dependent care directory lists companies that provide resource and referral services on a stand-alone basis. To be listed, a company must generate at least \$100,000 in gross revenues from resources and referral services or provide the services in at least three states.

Companies must report gross revenues to be listed. If your company meets the requirements for either directory and has not received a questionnaire, please request one by calling Assistant Directory Editor Carrie Brittain at 312-649-5313. There is no charge to be listed.

Copies of the questionnaire can also be printed from the *BI* Web site at www.businessinsurance.com. Completed questionnaires must be returned by the extended deadline of Oct. 10.

Products & Services

Philadelphia offers liability coverages

BALA CYNWYD, Pa.—

Philadelphia Insurance Cos. is offering a new liability coverage for private companies.

Under the Private Company Protection Plus product written by the Bala Cynwyd, Pa.-based company, policyholders can purchase limits of up to \$10 million each for directors and officers liability, employment practices liability and fiduciary liability risks.

The coverage "allows the policyholder to customize their management liability insurance needs by enabling them to purchase different limits and retentions based on their own business requirements," Sean Sweeney, executive vp and chief marketing officer of Philadelphia Insurance, said in a statement.

More information is available from the insurer at 877-438-7459 or at www.phly.com.



Cairnstone Re markets SmartFlex debit card

MIAMI—Cairnstone Re will serve as a managing general underwriter for SmartFlex, a provider of electronic debit cards for flexible spending and transportation accounts.

SmartFlex, a New York-based subsidiary of Motivano Inc., provides a card that allows workers

to pay for eligible expenses on a pretax basis without having to submit a claim for reimbursement.

SmartFlex said in a statement that it expects demand for the cards to surge due to the Internal Revenue Service's announcement that it may eliminate a proposed rule that threatens to derail use of the cards (*BI*, Sept. 1). The proposed rule calls for onerous reporting requirements related to use of the cards.

Cairnstone Re is a Miami-based managing general underwriter and medical management firm.

More information on the SmartFlex card is available at www.smartflex.com.

Chubb offers package for biotech companies

WARREN, N.J.—Chubb Corp.'s new Innovator product provides several property/casualty coverages in a single package for biotechnology and medical device research and development companies.

The Innovator package includes

property, general liability, crime, employee benefits liability, foreign voluntary workers compensation and foreign hired and nonowned automobile liability.

The coverage can be written to various limits for the different exposures.



Agents and brokers can put together programs for their life sciences policyholders by using an online application at Chubb's extranet site.

More information is available from Frank Goudsmit, fgoudsmit@chubb.com.

New St. Paul product covers insurer liability

ST. PAUL, Minn.—Insurers can cover their own exposures with a new product from The St. Paul Cos. Inc.

The product, St. Paul SelectOne for Insurance Companies, incorporates a variety of management liability and professional coverages. It also includes financial institution bond, kidnap and ransom, general liability, auto liability, workers comp, property and electronic business coverages.

Insurers can opt for one limit or separate limits under the coverage. St. Paul, Minn.-based St. Paul will write coverage to limits of \$15 million.

The product is available on an admitted basis in most states and is provided to risk-bearing organizations that include insurers, reinsurers, captives, risk retention groups and others.

More information is available from Robert Dominiak at 312-831-4065.

Lloyd's: Rating agencies alter outlook on syndicates

Continued from page 21
Corp.

A string of losses in the four most recently closed underwriting years and a poor return on capacity in the still-open 2001 underwriting year contributed to Standard & Poor's decision to lower its assessments of 10 syndicates, according to the rating agency.

S&P, which gives Lloyd's a marketwide rating of A, explained that syndicates receive individual assessments based upon their dependency on Lloyd's.

The assessment considers each syndicate's dependency on the

market's rating, the Lloyd's Central Fund, brand, international licensing agreements and infrastructure. Assessments are based on a five-point scale, with "5" indicating very low dependency on Lloyd's and "1" very high dependency. The "pi" annotation indicates the assessment is based on publicly available information.

While syndicate forecasts suggest that the 2002 year of account will be profitable for them, the persistent period of poor profitability since the late 1990s "continues to constrain assessments," said S&P credit analyst Kevin Willis in London.

Syndicates whose S&P assess-

ments were lowered are: Goshawk Syndicate Management Ltd. syndicate 102, to 2pi from 3pi; KGM Underwriting Agencies Ltd. syndicate 260, 1pi from 2pi; R.J. Kiln & Co. Ltd. syndicate 308, to 1pi from 2pi; Brit Syndicates Ltd. syndicate 389, to 2pi from 3pi; Faraday Underwriting Ltd. syndicate 435, to 2pi from 3pi; Munich Re Underwriting syndicate 457, to 2pi from 3pi; SVB Syndicates Ltd. syndicate 1007, to 2pi from 3pi; XL London Market Ltd. syndicate 1209, to 2pi from 3pi; Catlin Underwriting Agencies Ltd. syndicate 2003, to 3pi from 4pi; and ACE Underwriting Agencies Ltd. syndicate 2488, to 3pi from 4pi.

S&P also has raised its assessment of three syndicates, and one—Chaucer Syndicates Ltd. syndicate 1084—became the first to get an interactive assessment, or one not solely based on publicly available information.

Syndicate 1084, a composite syndicate that was boosted earlier this year by the merger of motor syndicate 587 and nonmarine syndicate 1984 into its general marine syndicate 1084, was given a 3- assessment, an improvement on the 2pi assessment that 1084 held previously.

Ewen Gilmour, managing director of Chaucer Holdings P.L.C., said that the assessment is useful for the

syndicate because it gives buyers another measure by which to judge its security. This is particularly important for lines such as political risk, he noted, as banks tend to require a fairly high level of security for such exposures.

The two other syndicates whose assessments were raised are Atrium Underwriters Ltd. syndicate 609, to 4pi from 3pi; and Wellington Underwriting Agencies Ltd. syndicate 2020, to 4pi from 3pi.

Copies of S&P's Lloyd's Syndicate Assessments can be ordered for £1,500 (\$2,454) by e-mailing elizabeth_mcgloglan@standardandpoors.com.

Oxford: Risk management, returns linked

Continued from page 21

shareholder value performance," according to the study.

The study found that companies with high-risk quality have low cash flow volatility. It concluded that risk quality is a strategic issue and a key characteristic of profitable companies, as well as an essential aspect of effective corporate governance procedures.

"These findings provide evidence for what is intuitively understood

by corporate executives but, to date, has not been demonstrated quantitatively—that improving risk quality is a key driver of sustained shareholder value," said Ms. Pretty.

There are many well-publicized examples of companies that have suffered significant share value decline due to physical damage and disruption to their business activities, but the premise of the study is that a company does not need to experience a disruption to its busi-

ness to demonstrate the value of investing in risk quality, the report states.

It also shows that diligently following property risk improvement procedures can improve the financial performance of companies, according to Ruud Bosman, executive vp of FM Global in Johnston, R.I.

"Investment in improving risk quality to minimize the probability and severity of losses is fundamental to good corporate governance,"

Mr. Bosman said. He pointed out that "to sustain shareholder confidence and value, it is critical to strike the optimal balance between risk and reward by fully understanding the underlying risks to one's business."

More information on the report "Improving Risk Quality to Drive Value" can be found at www.fmglobal.com and www.oxfordmetrica.com.

NAIC: Determining capital requirements

Continued from page 3

adopt a more-flexible approach, reviewing the financial condition and allowing "highly capitalized" companies to post collateral in an amount less than 100% of their liabilities.

Some opponents of reducing collateral requirements had been concerned that a draft model regulation supplied by the non-U.S. reinsurers would be rushed through the task force. But their fears were allayed by Mr. Oxendine's call for two additional working groups to research accounting-related matters and the issue of enforceability of U.S. court judgments in other countries.

In answer to a letter from NAIC President Mike Pickens on the topic

Insurance industry trade groups, which oppose a plan to tighten risk-based capital rules, say a higher authorized control level would raise the cost of already-scarce capital.

of enforceability, for example, U.S. State Department attorney Jeffrey D. Kovar wrote that "our best information is that law and practice in

most foreign countries is not generally favorable to the prompt, predictable enforcement of U.S. civil judgments."

In fact, "an unwary litigant" may face "a host of technical obstacles" because "the written law appears to be more favorable than the actual practice," said Mr. Kovar, who is the State department's assistant legal adviser for private international law.

The U.S. State Department has been seeking a treaty supporting the enforcement of U.S. judgments on and off for nearly 40 years, Mr. Kovar said. Currently, 60 members of the Hague Conference are attempting to negotiate a narrower international agreement on enforcing choice of forum agreements in commercial contracts, as well as resulting judgments.

Risk-based capital

Meanwhile, the Ad Hoc Subgroup of the Risk Based Capital Task Force is considering a proposal to tighten risk-based capital requirements so there is more of a financial cushion before a financially troubled insurer becomes insolvent.

The risk-based capital concept assesses the various risks that an insurer's capital would have to absorb, such as underwriting and credit risks. It is enforced through a four-step process of increasing regulatory intervention, beginning with an insurer filing a plan and ending with a regulator seizing the insolvent company.

The specific proposal under consideration would increase to 75% from 50% the factor for calculating the amount of capital that would trigger "the authorized control level," which is the third highest level of increasing regulatory intervention.

The idea of tightening risk-based capital requirements stemmed from the insolvency of Reliance Insurance Co., where the insurer's financial condition deteriorated so rapidly there was no time to react, explained Steve Johnson, deputy insurance commissioner with the Pennsylvania Insurance Department.

Representatives of six insurance industry trade associations were unanimous in their opposition to the proposal. They argued that RBC is a minimum capital system and that a higher "authorized control level" would raise the cost of already-scarce capital. Instead, they urged that regulators use "better" solvency monitoring tools, including targeted financial examinations as well as reviewing premium growth and other risk factors, such as extraordinary dividend requests from an insurer's parent organization or shareholders.

Opposing the proposal at the meeting were the Alliance of American Insurers, the American Insurance Assn., the National Assn. of Independent Insurers, the National Assn. of Mutual Insurance Cos., the Physician Insurers Assn. of America and the Reinsurance Assn. of America.

Letters to the Editor

Continued from page 8

the regulators' role in acting against a financially troubled insurer. The back end is equally, if not more, important.

I question the Stewart report's axiomatic holding that the traditional regulatory approach is to keep failing insurers operating as long as possible.

My experience is that regulators often act too quickly in taking down a company that could be restored to the marketplace as a viable entity and that much more creativity and cooperation with the industry and its customers could often prevent the needless destruction of a valuable market. The regulators'

actions are also complicated by the fact that, in most states, the regulator becomes the receiver, with all the issues of waste, conflicts and accountability inherent in the current receivership system.

These issues are too numerous to be detailed here. Suffice it to say that any review of the insolvency process would be incomplete and meaningless without including a review of the process after an insurer is "taken down" by the regulators.

Peter H. Bickford
New York

Editor's note: Mr. Bickford, an attorney whose practice included insurance regulation and insolvency, is an independent consultant and certified reinsurance arbitrator and umpire.

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Punitive: Abuses debated

Continued from page 4

businesses, and giving judges rather than juries the power to decide the size of punitive damage awards.

Mr. Owen spelled out three possible reforms that he said would help promote balance in the system:

- The first would be to raise the standard of proof that must be met before punitive damages can be awarded to "clear and convincing" from the less demanding "preponderance of evidence" standard used in most civil litigation.

- The second would be to require trial judges to issue written opinions explaining the rationale for the punitive damage awards.

- The third, which Mr. Owen said he considered the most important, would be to cap punitive damage awards. He suggested treble compensatory damages as a maximum punitive damage award, just as treble damages is the maximum in antitrust cases. The cap would not include attorneys' fees and litigation costs, which would still have to be paid by the defendant.

Mr. Owen took his argument a step further by suggesting that punitive damages in "mass disaster" cases, such as asbestos liability, should be capped at the amount of compensatory damages, with the addition of attorneys' fees and court costs. He said that lawmakers could determine what constituted a mass disaster. The more stringent limit on punitive damages in such cases would help ensure that more victims of the mass disaster would be compensated, he said.

Not surprisingly, Robert S. Peck, president of the Washington-based Center for Constitutional Litigation P.C. and senior director-legal affairs and policy administration for the Assn. of Trial Lawyers of America, did not agree that any major reforms were needed. In fact, Mr. Peck said, the only reform Congress should consider is changing the way that punitive damage awards are taxed, because successful plaintiffs can be required to pay taxes on the portion that goes to lawyer's fees and to the state, which can mean that a plaintiff ends up paying more in taxes than he or she receives in the judgment.

Otherwise, Congress should stay out of the matter, Mr. Peck said. "You cannot invade something that is of state concern," such as punitive damages, without violating the Constitution, he said. Congress' power over interstate commerce does not apply, said Mr. Peck. Instead, punitive damages are "quasi-criminal" in nature and have nothing to do with commerce or any other economic enterprise.

The last witness held that Congress has the right to intervene. Lower courts have ignored the Supreme Court's ruling in *State Farm vs. Campbell*, said Victor E. Schwartz, general counsel of the American Tort Reform Assn. and a partner in the Washington office of Shook, Hardy & Bacon L.L.P.

The 14th amendment allows Congress to act, said Mr. Schwartz in response to a question from Rep. Tom Feeney, R-Fla. "You can't have a system where you have no guidelines," said Mr. Schwartz. "Some guidance is needed."

Crain: New savings plan

Continued from page 4

viding a lifetime benefit at retirement, had become somewhat obsolete, Crain Chairman Keith Crain and Crain President Rance Crain wrote in an e-mail sent to the company's U.S. employees announcing the new plan.

At the same time, because a lump sum can vary significantly based on prevailing interest rates at the time it is taken, it was difficult for employees to calculate ahead of time with any precision the benefits they would receive.

With increasing numbers of shorter-service employees and an inability to accurately project benefits, it wasn't surprising that there was little employee satisfaction with or understanding of a pension plan geared to longer-service employees.

"There was virtually no employee appreciation or satisfaction," said Crain Executive Vp Bill Morrow in Detroit.

By contrast, the company's profit sharing plan is enormously popular and well understood, Mr. Morrow said. That is because the formula—contributions being a percentage of salary—is simple to understand, employees can direct how company contributions are invested and, at termination of employment, account balances can be taken as a lump sum, he explained.

In moving to a new design, the company wanted to replicate the features that have made the profit sharing plan so popular, including an easy-to-understand benefit formula, self-directed investments and employee knowledge of the value of their benefits at all times, Mr. Morrow said.

At the same time, like the defined benefit plan, the new plan will reward, through a higher contribution rate, employees with longer service. "We wanted a plan that would encourage longtime service, be easily understood and appreciated," Mr. Morrow said.

Many other employers seeking to make their pension plans more visible and understood have converted those plans to cash balance plans, which have elements of both defined benefit and defined contribution plans.

But Mr. Morrow said a cash balance plan was not appealing because of the negative publicity the plans have received, as well as the uncertain legal environment in which they operate. Recently, for example, a federal judge in Illinois ruled that IBM Corp.'s cash balance plan discriminates against older employees, while the Internal Revenue Service has yet to provide definitive guidance on how cash balance accounts are to be valued when employees terminate employment and want to take their accounts as a lump sum.

Crain's U.S. employees next month will receive by mail a packet that includes an overview brochure, answers to frequently asked questions and a personalized projection form to help employees estimate projected benefits under the two plan choices. In addition, a live Webcast is planned for early November to enable employees to ask questions of benefit experts.

Benefit consultant and actuary Deloitte & Touche L.L.P. assisted Crain in developing the new plan. The plan is administered by Detroit-based Comerica Bank.

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Class action: Substitute proposed

Continued from page 1

filed, the suit would automatically stay in that state court. If between one-third and two-thirds of the members of the class reside in the state of the initial filing, then a federal court would have to decide whether to assume jurisdiction over a class action, under the proposal.

Unlike S. 274, the Breaux substitute would impose a deadline for parties to seek removal of a case to federal court. They would have 30 days from being first notified of the action to seek removal of the case; otherwise, it would remain in state court. It is also silent on any dollar threshold.

Speaking last week at a conference on legal reform sponsored by the U.S. Chamber of Commerce's Institute for Legal Reform, one of S. 274's original sponsors—Sen. Charles Grassley, R-Iowa—condemned the Breaux substitute as a "poison pill" that could derail class-

action reform efforts. He urged his audience to oppose it.

Sen. Grassley also said the full Senate would probably take up S. 274 after it returns from a short recess in early October.

The challenge facing supporters of S. 274 is getting the 60 votes needed to cut off any filibuster directed against the bill and then bring it to a final vote in the Senate. Sen. Grassley and other backers of S. 274 have said several times over the past few weeks that the measure has the firm support of at least 57 senators.

Jeff Peck, a consultant to the Institute for Legal Reform, said he doubted that the Breaux substitute would peel off enough Democratic support from S. 274 to doom the bipartisan measure.

"I don't see it creating that dynamic at all. The first day or two when it was circulated, people are interested in seeing what's out

there," he said.

Upon closer examination, "this is clear that is not really reform at all," Mr. Peck said. "It's not really an alternative when it preserves the status quo or makes the system worse," he added.

"The worst thing about it is that its jurisdictional provisions would create a situation where, basically, you would have no cases removed to federal court," Mr. Peck. "For the first time in more than 200 years, the citizenship of the defendant becomes irrelevant. For more than 200 years, we've had a policy in this country relating to diversity jurisdiction. It would overturn literally 200 years of diversity jurisdiction in certain kinds of cases."

Risk managers also find the substitute unacceptable.

The Risk & Insurance Management Society Inc. "views the Breaux substitute as an attempt to address

the inherent wrongs of the current system" said Lance J. Ewing, president of New York-based RIMS.

"However, it is a step in the wrong direction in that it does not adequately address the threshold of dollar limits, it allows plaintiff counsel to still collect huge fees under the guise of redeemed coupons and it erodes the rights of the defendant," said Mr. Ewing, who is also executive director-risk management for Park Place Entertainment Corp. in Las Vegas.

"It also does not adequately address the need to move interstate class action lawsuits out of state courts and into the federal court system. While we applaud the authors for making an attempt, it clearly is not one worth considering by our membership," added Mr. Ewing. He stressed that RIMS believes that S. 274 "is the Senate's best chance of passing reasonable yet meaningful class action lawsuit reform" and urges the Senate to approve it.

"The insurance industry could not support the Breaux alternative.

It subverts the entire purpose of the bill," said Melissa Shelk, vp-federal affairs for the American Insurance Assn. in Washington.

Another insurance industry lobbyist agreed.

"NAII supports the current bipartisan compromise bill, S.274. The Breaux proposal appears unnecessary and won't achieve the objective that the business community is seeking such as permitting many national class action cases to be heard in federal court," said Charles Taylor, assistant vp-government relations for the National Assn. of Independent Insurers in Washington.

The Breaux substitute "will never garner 60 votes," added Ms. Shelk. "I think this is an attempt to prevent S. 274 from passing," she said.

Sen. Breaux's spokesman denied that the lawmaker's aim was to scuttle S. 274.

"The intent would be to get something that would reach the 60-vote threshold in the Senate. Sen. Breaux's goal has always been to get something that will pass," he said.

Isabel: Limited losses seen

Continued from page 1

have in the past because of the significant retentions they had to assume during recent coverage renewals.

A week after Isabel pummeled the East Coast, residents and businesses in the storm's path were still assessing damage, coping with power outages and facing more flooding as new rainstorms rolled through the area. Isabel hit North Carolina, Virginia, Delaware and Maryland the hardest with high winds and heavy rains.

But unlike with the past catastrophes, when initial claims estimates ballooned significantly after insurers and loss adjusters had a week or two to more fully assess affected areas, the industry late last week continued to stand by its initial \$1 billion estimate of Isabel losses.

The New York-based Insurance Information Institute and Boston-based modeling company AIR Worldwide Corp. late last week both affirmed their original \$1 billion estimates.

While homes, automobiles and boats account for the majority of the damage, commercial risks sustained significant wind-related property damage and some insured flood and business interruption losses, according to industry experts.

AIR estimates that commercial risks will account for 20% of total insured losses.

The absence of a significant variance in loss estimates is "an indication that forecasting abilities and technology are more accurate than you otherwise may have seen. We were able to track and anticipate the storm for a week, and our modeling continues to mature," said P.J. Crowley, vp of the Insurance Information Institute.

In addition, while Isabel was a huge and powerful Category 2 hurricane responsible for a couple dozen deaths, it was not as powerful as many other past storms after coming ashore.

As a result, insurers "were able to get their arms around it a little faster" in terms of estimating losses, Mr. Crowley said.

But, based on some clients' losses, at least one broker anticipates that insured damage will be significantly higher than has been estimated.

The insured damage estimate is "way off," asserted Steve Deal, regional director of the mid-Atlantic region for Richmond, Va.-based Hilb Rogal & Hobbs Co. "I think that \$1 billion will turn out to be more like \$1.5 billion to \$2 billion."

Business interruption claims could be relatively significant for commercial risks, because many have faced extended power outages, according to industry experts.

"We have a very large grocery store chain, and they're going to have a very large food spoilage loss in excess of a million dollars," Mr. Deal said.

Another grocer was more fortunate. Although 170 of the 198 Giant Food Inc. stores were in the storm's path, none was damaged, said Charlie Daniels, risk manager for the Landover, Md.-based grocery store chain. The grocer, however, did sustain a large spoilage loss, which it had not calculated late last week. Mr. Daniels said that Giant Food plans to file a claim with its insurer, Johnston, R.I.-based Factory Mutual Insurance Co., which does business as FM Global.

Among the individual insurers and reinsurers that have estimated their losses from the storm are:

- Munich Reinsurance Co., less than \$100 million.
 - Hannover Reinsurance Co., \$20 million.
 - Zurich Financial Services Group, \$10 million to \$50 million.
 - Midland Co., \$10 million to \$15 million.
 - Ohio Casualty Corp., \$9 million.
 - Converium Ltd., \$7 million.
- Among the insurers that have not yet issued claims estimates are

State Farm Group and Allstate Corp., which are likely to face a significant portion of the total personal lines claims.

Regardless of the industry's total loss, commercial risks will be retaining a greater portion of their losses than they would have in the past because of the much higher deductibles they assumed during recent coverage renewals, according to loss adjusters and commercial policyholders.

"I've heard from larger clients that they expect to make claims, but we have to see whether they're over their huge deductibles," said Robert J. Barnett, the national catastrophe coordinator for independent claims adjuster VeriClaim Inc. of Chicago.

Deductibles "are all over the board," but some are as high as \$10 million, Mr. Barnett noted.

While many of the losses that Parsippany, N.J.-based GAB Robins North America Inc. has adjusted will exceed commercial policyholders' deductibles, risks located close to the shoreline face higher wind and flood-loss deductibles than do other risks, noted Art Kirkner, senior vp-field operations.

At two Virginia paper mills owned by Chicago-based Smurfit-Stone Container Corp., flooding caused an estimated \$1 million of physical damage to boilers and turbine generators in the mills' basements, and the resulting forced shutdown in operations could lead to about \$4 million in lost business, according to Doug Bachman, the Clayton, Mo.-based director of risk management.

But, Smurfit-Stone's deductible is \$5 million, so the company was unsure late last week how much coverage it would have to respond to losses, Mr. Bachman said.

In addition, the company was able to shift some production from the mills, located in Hopewell and West Point, to other facilities, and paper industry supply currently is running over demand, Mr. Bachman noted. Those factors could greatly reduce the company's busi-

ness interruption recovery, he said.

At the Bethlehem Steel Corp. mill in Sparrows Point, Md., an "unprecedented" nine-foot rise in the Chesapeake Bay water level in that area flooded the facility's power plant, closing the plant for about a week, according to John D. Lefler, vp and general manager at the mill. The power plant produces all of the steam and 10% of the electricity that the facility needs to operate, Mr. Lefler explained.

Replacement costs alone "will be in the multimillions," he said, noting that he has been informed that the facility is covered for flood- as well as wind-related losses.

In addition, the plant, which was operating at near capacity, is expected to lose six days of production, or 1.5% of its annual production, Mr. Lefler said. While the company had an inventory exceeding the lost production, it still expects delays in meeting its orders over the next three months, he said.

"But our deductible levels are pretty high," Mr. Lefler said. "I'm not sure whether we'll have losses large enough to allow a recovery."

Another factor that likely will mitigate the amount of insured damage is that many of the small, independently owed businesses with significant losses caused by storm-related flooding either did not have flood coverage or purchased it through the federal National Flood Insurance Program, noted Allen C. Gross, president of Globe Midwest/Adjusters International of Southfield, Mich.

Typically, only certain large accounts can purchase flood coverage as an endorsement to their property policies, Mr. Gross and representatives for several insurers explained.

Insurance experts also are crediting loss prevention efforts that commercial risks took as the storm barreled toward the coast for helping limit damage.

At the Bethlehem Steel plant, for example, the advance warning gave plant officials time to arrange an orderly shutdown of equipment ahead of the storm, which was safer for employees and prevented damage to the equipment, Mr. Lefler

said. Workers also were able to set up water-pumping equipment that helped prevent a worse flooding problem than the plant did experience, he said.

The Newport News, Va., facility of defense contractor Northrop Grumman Corp. was closed for three days due to the storm but sustained "no major damage," according to a spokeswoman. She said the company spent a lot of time preparing for the storm, including tying down all the cranes and trailer offices in its shipyard.

A combination of long-term catastrophe planning and last-minute reminders from FM Global about moving products out of basements and off of first-story floors and maintaining skeleton crew to ensure that fire-protection systems worked as planned, mitigated losses, said a spokesman for the insurer.

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Late News

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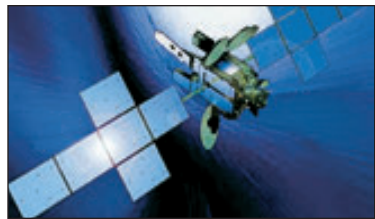
Farmers to quit medical malpractice coverage

Farmers Insurance Group, the country's fifth-largest medical malpractice underwriter, is exiting the market. The insurer said that in an effort to focus on its core business lines it will no longer write new medical malpractice coverage and will begin the process of nonrenewing existing business beginning Jan. 1, 2004. According to A.M. Best Co., Farmers represented 4.7% of the total U.S. medical liability market in 2002.



Travelers to buy rights to marine lines

Travelers Property Casualty Corp. is acquiring renewal rights to most of Atlantic Mutual Cos.' commercial lines inland marine and ocean cargo business. The deal gives Travelers the opportunity to acquire business worth up to \$110 million in net written premiums and the related unearned premium reserve on Atlantic Mutual's balance sheet. Terms of the deal were not released.



Coverage for satellite loss led by Munich Re

Munich Reinsurance Co. is the lead underwriter for the \$141 million communications space satellite that owner Loral Space &

Communications Ltd. has declared a total loss, sources say. Marsh Inc. placed the risk, but Loral switched to Willis Group Holdings Ltd. before the loss and has asked Willis to handle the claim, according to sources. The primary power plant for the Telstar 4 satellite, manufactured by Lockheed Martin Corp., short-circuited Sept. 19, and Lockheed and Loral were unable to correct the problem.

Claims commission sued by Holocaust survivors

Two Holocaust survivors are suing the international commission established to handle Nazi-era insurance claims, alleging that the entity's efforts to resolve those claims violates California's unfair trade practices law. The plaintiffs allege that the International Commission on Holocaust Era Insurance Claims helped Assicurazioni Generali S.p.A. reduce its exposure to claims from over \$1 billion to only \$100 million and that it has failed to publish on Web sites the names of all policyholders during that era, among other things. Generali dismissed the allegations as "baseless."

RICO suit against health plans to proceed

A suit filed under the Racketeer Influenced and Corrupt Organizations Act against Capital Blue Cross and its health maintenance organization, Keystone Health Plan Central, can go forward as a result of a ruling by a federal court judge in Pennsylvania. The judge ruled that a RICO claim by doctors against an HMO is not barred by either the McCarran-Ferguson Act or the U.S. Supreme Court's 2000 decision in *Pegram vs. Herdrich*. The suit, filed Oct. 5, 2001, alleges, among other things, that the managed care provider "shaves" capitation payments by purposefully underreporting the number of

patients enrolled in physicians' practice groups.

New Jersey orders cleanup of 18 watershed sites

As part of a large-scale effort to collect damages for the loss of use of polluted natural resources, New Jersey environmental regulators have identified and directed dozens of potentially responsible parties to begin assessing and restoring 18 contaminated sites within the Passaic River watershed. The river watershed recovery effort by the Department of Environmental Protection is part of the state's broader effort to pursue recoveries for more than 4,000 polluted natural resource sites statewide.

Court orders Honeywell to pay retiree benefits

A federal court has ordered Honeywell International Inc. to reinstate full health insurance benefits for 800 retirees that worked at an automotive parts manufacturer it formerly owned by Oct. 1, 2003. Bendix Corp., a brake manufacturer, was acquired in 1983 by Allied-Signal Inc., which later merged with Honeywell. The litigation against Honeywell began in August 2002, after Motor Components L.L.C., the current owner of the auto parts plant formerly owned by Bendix, cut retirees' health and life insurance coverage. The court said that Honeywell had to reinstate the benefits under an agreement between Bendix and Allied Signal at the time of the Bendix acquisition. The retirees were represented by the United Auto Workers union.

Employers get time to adopt COBRA rules

Employers will have six months to comply with the Department of Labor's proposed federal COBRA

notification rules once they become final some time early next year, the department's Employee Benefits Security Administration said. The notification requirements, which were proposed in May, would, among other things, set minimum standards for the timing and content of the notices required under health care continuation provisions of the Consolidated Omnibus Budget Reconciliation Act.

Briefly noted

Dallas-based **Summit Global Partners Inc.**, the 26th largest broker of U.S. business, has named Joseph R. Wiedemann as chairman. Mr. Wiedemann, a longtime insurance executive who retired from American International Group Inc. in 1996, replaces Gary R. Griffith. Mr. Griffith resigned as SGP's chairman and chief executive officer but will remain a director. Management of the brokerage will be led by a new office of the president, headed by Jeff Pan, who has been an executive at SPG since 1997....A.M. Best Co. downgraded its financial strength ratings of the **Royal & SunAlliance USA Insurance Pool** and the Royal Surplus Lines Insurance Co. to B+ from A-....John T. Sinnott, the former chairman and chief executive officer of Marsh Inc., has been named the **2003 Insurance Leader of the Year** by the School of Risk Management, Insurance and Actuarial Science at St. John's University. Mr. Sinnott will be given the award at a Jan. 22, 2004, dinner in New York.

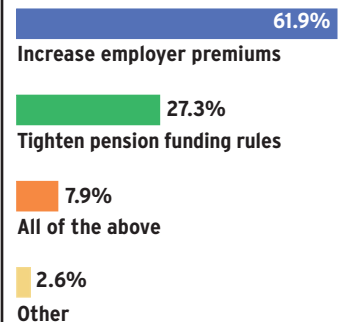
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Online Poll

[9/22 - 9/26]

What steps should the government take to shore up the Pension Benefit Guaranty Corp.?



BI Stock Index

[9/22 - 9/26]

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  **-0.05**
1940.45

Dow Jones  **-3.44**
9313.08

S&P 500  **-3.81**
996.85

Largest gains

Unico American Corp.	8.22%
John Hancock	7.62%
Penn-America Group Inc.	5.33%
Meadowbrook Ins. Group	4.26%
ACE Ltd.	1.72%

Largest losses

AEGON N.V.	-12.43%
EMC Insurance Group Inc.	-11.54%
ING Groep N.V.	-10.40%
Vesta Insurance Co.	-10.19%
Acceptance Insurance Co.	-10.00%

Weekly change by market segment

Brokers	-3.86%
Insurers/Reinsurers	-3.40%
Managed Care Organizations	-3.88%

Source: CNET Investor (investor.cnet.com)

RRG: Groups seek to broaden their role

Continued from page 1

Colo. "Coverage at reasonable rates continues to be a problem. The fact is, there are not enough quality insurers serving our members," said Janice Abraham, president and chief executive officer in Chevy Chase, Md., for Vermont-domiciled United Educators Insurance Risk Retention Group.

"There is a definite need for more competition and more options for buyers," Ms. Abraham added.

Texas Insurance Commissioner Jose Montemayor said the proposal to resist any broadening of RRG use was prompted by some "spectacular failures" of such entities. In addition, while RRGs may be appropriate for large, sophisticated buyers, there has been a "misapplication" of the groups, said Mr. Montemayor, who chairs the NAIC Property and Casualty Insurance Committee, which is considering the proposal.

Still, he says, regulators are open to changes in the resolution.

"We are willing to talk to advo-

cates" of broadening the coverages RRGs can write, Mr. Montemayor said, adding that negotiations are a part of regulation.

The draft resolution, which commissioners are expected to discuss during a conference call over the next couple of weeks, comes as risk retention group backers have been lobbying Congress to expand the federal law that gives the groups their special status.

Under the Risk Retention Act, risk retention groups, which are essentially multiple-owner captives, can write business in any state for policyholder-owners after meeting the licensing requirements of one state. That eliminates the need for groups to use a fronting carrier to issue policies in states where the groups are not licensed.

The federal law, though, limits RRGs to funding commercial liability risks. Advocates of expansion have asked Congress to broaden the groups' underwriting authority to include property risks. Just over 120 RRGs are currently operating.

Legislation has yet to be introduced to expand the Risk Retention Act, which was first enacted in 1981 following a capacity shortage and soaring rates for product liability insurance in the mid and late 1970s. The law originally limited the groups to writing product liability and completed-operations coverage, but Congress in 1986 expanded it to enable RRGs to fund all casualty coverages except workers compensation. However, backers of expanding the law say congressional oversight hearings are possible in the months ahead.

The NAIC resisted both the 1981 and 1986 legislative efforts as a usurpation of state insurance regulation, and it is clear from the draft resolution that at least some regulators still resent the law and consider it damaging to consumers.

The resolution, for example, says there have been a "disproportionate number of insolvencies of RRGs when compared to admitted insurers."

However, Robert H. "Skip" My-

ers, a partner with Morris, Manning & Martin L.L.P. in Washington and counsel for the National Risk Retention Assn., said that the annual failure of RRGs and licensed insurers has been about the same over the last 20 years.

The resolution also says "limitations on state authority, if adopted, would be detrimental to the interests of the nation's consumers."

Mr. Myers notes, though, that under the Risk Retention Act the insurance department of the state in which an RRG is domiciled is not restricted in its ability to regulate or, if necessary, shut down the entity.

The draft resolution says the requirement that RRGs be owned by its insureds is contrary to "sound risk management principles that demand a spreading rather than a concentration of risk in a similar business."

But United Educators' Ms. Abraham said that reasoning suggests that regulators also do not approve of mutual insurance companies.

Business Insurance

Special Take-Out Section

Benefits Management

September 29, 2003

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Retiree Benefits:

Rising costs squeeze benefits

INSIDE:
CASH BALANCE PLANS'
FUTURE CLOUDY **PAGE T3**

RANKING OF LEADING
401(K) ADMINISTRATORS **PAGE T4**

Business Insurance

Special Take-Out Section

Benefits Management

September 29, 2003

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Inside

PBGC's deficit sparks concern

A legislative solution is under consideration to reverse the PBGC's slide. **Page T8**

U.K. employers changing plans

More U.K. employers are moving away from defined benefit plans. **Page T10.**

Shifting costs to retired workers

Employers increasingly are looking at ways to reduce retiree costs. **Page T12.**

Interest growing in long-term care

As the workforce ages, both employers and workers are showing interest in participating in long-term health care plans. **Page T14.**

Largest 401(k) plan administrators

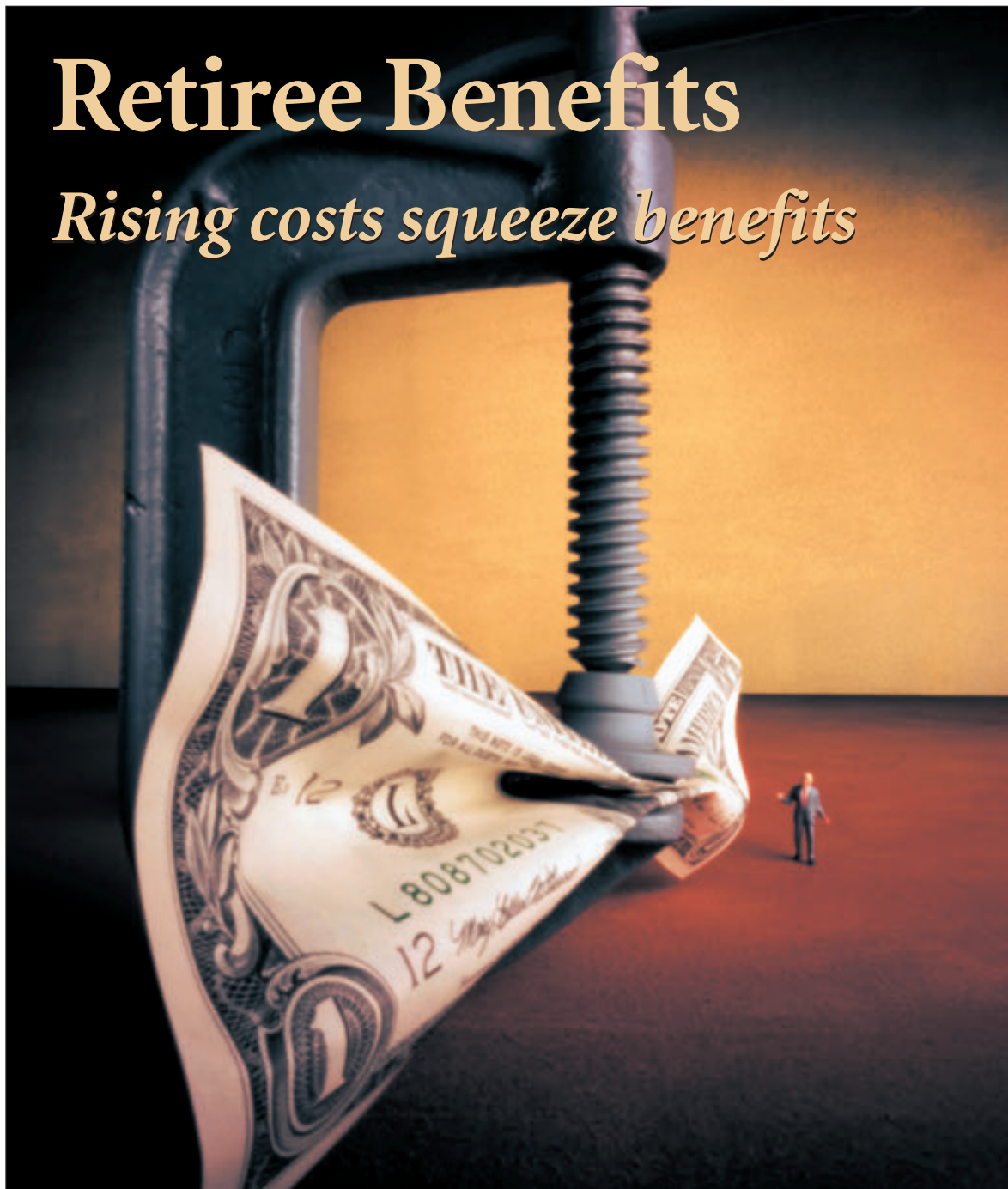
Based on number of plan participants receiving services on an unbundled basis. **page T4.**

- 1 **Hewitt Associates Inc.**
- 2 **BISYS Retirement Services Inc.**
- 3 **Mellon**
- 4 **Great-West Retirement Services**
- 5 **CNA Trust**
- 6 **Milliman USA**
- 7 **ADP Retirement Services**
- 8 **Invesmart Inc.**
- 9 **Administrative Management Group**
- 10 **DailyAccess.Com Inc.**

The full Directory of 401(k) Plan Administrators is available online in the directories area of www.businessinsurance.com. The searchable directory enables users to locate 401(k) plan administrators by company name, number of participants and clients, among other information. PDF copies of the directory are available by calling the Crain Information Center at 312-649-5476.

Retiree Benefits

Rising costs squeeze benefits



Cash balance pension plans seeing a shift in fortunes

By JERRY GEISEL

The future of cash balance pension plans, which at the beginning of this year had appeared brighter than it has been in some time, may have again turned cloudy.

Last December, the Treasury Department and the Internal Revenue Service—ending a 17-year regulatory vacuum—essentially gave their seal of approval to the plans (*BI*, Dec. 16, 2002).

Joint rules proposed by the two agencies made clear that the very core of cash balance design—crediting employees' accounts with a percentage of pay and crediting the accounts with interest—does not vio-

late the federal age discrimination law.

"Employers received great comfort from those regulations, as they made clear the plans were perfectly permissible," said Scott Macey, a senior vp with Aon Consulting in Somerset, N.J.

Those long-awaited and much welcomed proposed regulations from the government had come on top of earlier good news for cash balance plan sponsors: Congress, a few months before, had rejected legislation by persistent plan opponent Rep. Bernard Sanders, I-Vt., that would have tied the Treasury Department's hands in providing guidance in how employers are to

value account balances when employees terminate employment and take those balances as lump sums.

Now, though, in the wake of two recent developments, the plans' future once again is uncertain.

The first adverse development came at the end of July, when a federal judge in southern Illinois ruled that International Business Machines Corp.'s four-year-old cash balance plan discriminated against older employees (*BI*, Aug. 4).

That decision generated national publicity, not the least because it involves one of the nation's best-known companies.

But the decision also caused wor-

See CASH/page T6

401(k)s holding steady

Growth a hard sell

By JUDY GREENWALD

Getting employees to participate in 401(k) plans is an ongoing challenge for employers, and such efforts are growing in importance as the plans increasingly become the main retirement savings vehicle for employees.

Employee participation in 401(k) plans has remained steady in recent years, despite the economic downturn and the long bear stock market. In 2003, the average participation rate was 76% of eligible employees, roughly in the middle of the 72% to 79% range that has been reported since 1991, according to the latest survey by Lincolnshire, Ill.-based Hewitt Associates Inc.

But greater participation is possible, observers say. "It's very difficult to get 100%, but clearly, getting participation in the 90%-and-up range is possible," said David Wray, president of the Profit Sharing/401(k) Council of America in Chicago.

The issue has become more important to employers, say observers. With 401(k) plans the primary retirement vehicle for many employees, "We're seeing a redoubling of efforts to get people into 401(k) plans," said Lori Lucas, manager of participant research at Hewitt. "It's becoming increasingly important that people participate in their plan." More than half of employers responding to the most recent Hewitt 401(k) survey reported that their 401(k) plan is the primary retirement vehicle.

Another impetus for communication and education efforts was the impact that Enron Corp.'s collapse had on its 401(k) plan participants. Many of Enron's employees had invested their 401(k) funds heavily in employee stock—due in part to the plan's rules—and such participants collectively lost more than \$1 billion after the company's accounting problems came to light and Enron stock became virtually worthless.

Indeed, although employers have been largely focused on health care costs, because of events like the Enron scandal they are "re-examining

See 401(k)/page T6

GROWTH OF 401(K)S

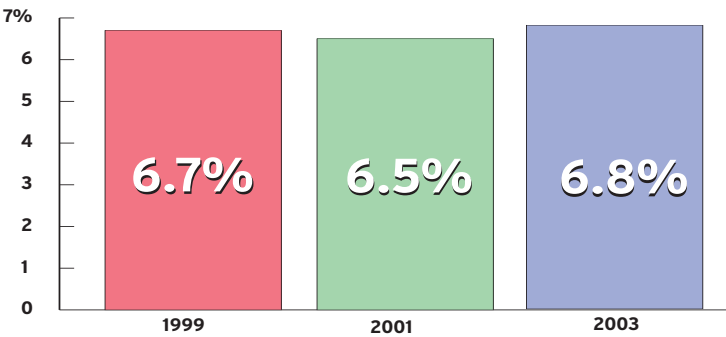
Eligible participants, assets and plans for the last 10 years

Year	Active participants	Assets	Number of plans
1993	23,138,000	\$616 billion	154,527
1994	25,206,000	\$675 billion	174,945
1995	28,061,000	\$864 billion	200,813
1996	30,843,000	\$1.1 trillion	230,808
1997	33,865,000	\$1.3 trillion	265,251
1998	37,114,000	\$1.5 trillion	300,593
1999*	39,500,000	\$1.7 trillion	340,000
2000*	41,000,000	\$1.7 trillion	370,000
2001*	42,000,000	\$1.6 trillion	390,000
2002*	42,000,000	\$1.5 trillion	400,000

*Estimated
Source: PSCA

SALARY DEFERRAL RATE

Average salary deferral rate by employees who are currently contributing to the plan



Source: Hewitt Associates Inc.

Largest 401(k) plan administrators

Based on number of plan participants receiving services on an unbundled basis†

Rank	Company/Address	Phone/Fax/Web site	Participants*	Clients*	Average participants per plan	401(k) staff**	Principal officer
1	Hewitt Associates Inc. 100 Half Day Road Lincolnshire, Ill. 60069	847-295-5000 Fax: 847-883-9019 www.hewitt.com	5,700,000	164	33,000	NA	Dale Gifford, chairman/CEO
2	BISYS Retirement Services Inc. 200 Dryden Road Dresher, Pa. 19025	215-648-8000 Fax: 215-648-1275 www.bisysretirement.com	1,700,000	18,000 ¹	88	550	Chris Guarino, president
3	Mellon 2100 N. Central Road Fort Lee, N.J. 07024	866-355-6647 Fax: 201-592-1168 www.mellonhrsolutions.com	932,386	51	5,149	764 ²	James Aramanda, president/CEO
4	Great-West Retirement Services 8515 E. Orchard Road Greenwood Village, Colo. 80111	303-737-5000 Fax: 303-737-3030 www.gwla.com	305,000	2,347	130	505	Charles Nelson, president
5	CNA Trust 3080 S. Bristol St., Second Floor Costa Mesa, Calif. 92626	714-437-1012 Fax: 714-437-4065 www.cnatrust.com	289,224	2,628	100	130	Renate Renfro, president
6	Milliman USA 1301 Fifth Ave., Suite 3800 Seattle, Wash. 98101	206-624-7940 Fax: 206-340-1380 www.milliman.com	275,000	709	500	400	Patrick J. Grannan, president/CEO
7	ADP Retirement Services 4 Becker Farm Road Roseland, N.J. 07068	973-974-2463 Fax: 973-974-3035 www.adp401k.com	207,353	13,880	NA	1,020	Mark Phillips, senior vp/general manager-retirement services
8	Invesmart Inc. Penn Center W. Six, Suite 211 Pittsburgh, Pa. 15276	412-249-3200 Fax: 412-249-3242 www.invesmart.com	200,000	3,500	75	200	Kent Buckles, CEO
9	Administrative Management Group 3800 N. Wilke Road, Suite 250 Arlington Heights, Ill. 60004	847-577-6000 Fax: 847-870-9200 www.amgusa.com	91,200	114	800	75	John Salajka, CEO
10	DailyAccess.Com Inc. 3101 International Drive, Building 6, Suite 600 Mobile, Ala. 36606	888-535-4322 Fax: 251-665-1802 www.dailyaccess.com	72,500	700	103	62	Tommy Thomasson, president/CEO

†Companies must offer 401(k) plan administration services, such as recordkeeping and handling of account activity, on an unbundled basis.

*Reflects unbundled business only **Reflects staff dedicated to 401(k) plan consulting, administration or consulting 1 Estimated 2 401(k) employees include call representatives trained for defined contribution plans 3 NA=not available

Source: BI survey

The full Directory of 401(k) Plan Administrators is available online in the directories area of www.businessinsurance.com. The searchable directory allows users to locate 401(k) plan administrators by company name, number of participants and clients, among other information. PDF copies of the directory can be purchased by calling the Crain Information Center at 312-649-5476.

401(k): Promoting enrollment

Continued from page T3

their entire retirement plan program and how employees are utilizing the 401(k) plans," said Patricia Pou, a principal with Mercer Human Resource Consulting in Tampa, Fla.

Boosting participation

New York-based AOL Time Warner recently embarked on a communications program designed to encourage participation in its 401(k) by lower-paid employees. The company launched the program because it feels "a responsibility to educate and inform employees of the benefit programs that are available to them," said Shirley Eng, director of the company's defined contribution plan. The program, which was developed by The Segal Co. in New York, has so far resulted in an additional 14% of AOL Time Warner's target population either enrolling in the program for the first time or increasing their salary deferrals.

"Employers are considering tinkering with virtually any element of the plan they can legally tinker with in order to get participation levels up, particularly among lower-compensated employees," who are less likely to participate, said Rick Barrett, principal and regional communications leader for Buck Consultants Inc. in New York.

"We try to make it as flexible and as easy for an employee to join and maintain their participation," said John Stamatiades, manager-pension and savings plan at Cleveland-based Alcan Corp. He said that about 96% of the company's employees participate in its 401(k) plan.

Targeted communication is one approach employers use to boost employee participation.

"When you look at a 401(k) plan, there's different levels of sophistication" among the participants, said Robert M. Mrazik, a consulting actuary with Harrisburg, Pa.-based Conrad Siegel Actuaries. As a result, employers are "trying to tailor their communications packages," he said.

Mr. Wray said that while communications programs were "pretty generic" five or six years ago, today employers are tailoring their programs more narrowly. Companies, for instance, issue quarterly statements to individual employees projecting how much the employee will collect at retirement, Mr. Wray said.

Employees want to know what their 401(k) plan means to them personally, "not as a member of some type of class, but me personally, based on my salary, my age, my aversion to risk," said Susan Alford, an Atlanta-based senior vp with Aon Consulting.

In addition, to encourage the participation among younger employees, many of whom do not get serious about retirement planning until their late 30s and early 40s, some employers are starting to think about promoting their 401(k) plans as a "financial plan for life, rather than a retirement vehicle," said Mr. Barrett. Such efforts stress the programs' loan, tax savings and hardship features, he said.

Importance of education

Employers are also focusing on education. "Every time we've done

the survey, we've tended to see an increase in the number of plans that offer education," said Ms. Lucas of Hewitt. "Now, 89% of plan sponsors do some kind of investment education."

"Employers, in general, are making sure that participants are receiving not just educational material but also workshops to help them understand asset allocation, so they understand that putting all your eggs in one basket is not the best thing to do," said Robert Liberto, a vp with Segal in New York.

At the Federal Home Mortgage Corp., where "98% plus" of the company's 4,500 employees participate in its 401(k) plan, Boston-based Fidelity Investments Corp. holds quarterly workshops, said Teri Herzog, director of benefits.

"There's a basic, 'What is a 401(k)?' workshop, and then there are also investment workshops because we offer 10 funds," said Ms. Herzog of McLean, Va.-based Freddie Mac. "It keeps it on the minds of employees."

As employers boost their educational efforts, there is less reliance on the Internet, say observers. More employers are offering one-on-one meetings, recognizing that "people still want someone to talk to," said Joe Hesselthaler, a principal with Towers Perrin in Philadelphia.

"Employers have, to some extent, been frustrated with the fairly low-cost but largely not very effective, Internet-based advice," agreed Michael Weddell, a retirement consultant in the Southfield, Mich., office of Watson Wyatt Worldwide.

As part of their educational offer-

ings, more employers are giving participants access to investment guidance. According to the Hewitt survey, 28% of plan sponsors in 2003 offer outside investment advisory services, up from just 18% in 2001, said Ms. Lucas.

"I think more and more companies are grappling" with the issue of whether they should cross the line and bring personalized investment advice to plan participants, said Harry Gross, a principal with PricewaterhouseCoopers HR Services in New York. "We're starting to see that kind of solution play a bigger role."

Design changes

Some employers also are changing their plan design to boost enrollment. One approach is to make new employees immediately eligible to participate in the 401(k) plan, said Ms. Lucas. In 2003, for example, Hewitt found that 43% of plan sponsors offered immediate eligibility in 2003, up from 35% in 2001, she said. "I think there's a lot of evidence that making eligibility immediate can have a big impact on participation," she said.

Alcan is one employer that has used such an approach, said Mr. Stamatiades. When a new worker is hired, "we try to get an election that day. We try not to let them procrastinate the decision, so they can get the company match right away." And if a new hire is somewhat reluctant to enroll, the human resources representative will try to convince him or her to set aside even just 1% of their salary in order to get the new employee started, said Mr. Stamatiades.

Another approach that is getting some attention is having the employee sign an agreement in ad-

vance to increase his or her rate of participation in the 401(k) plan as his or her salary increases. "It's an easier decision to say, 'I'll contribute down the line a little bit more,' to say go from 3% to 6%," Ms. Lucas said.

Meanwhile, most employers are keeping or even increasing their company match, despite the extensive publicity given to the relatively few who have made cuts. Unfortunately, though, some employers are increasing their matching contribution because they are either decreasing or freezing their pension benefits, said Ms. Pou.

More employers are also moving away from restrictions on the sale of company stock that employees receive as a match.

"We're definitely seeing an easing of those restrictions, allowing participants to diversify earlier or simply just putting in matching contributions in company stock, but not employee contributions," said Ms. Pou. "I think the primary concern is risk management in the post-Enron area, and the recognition that participants do need to be diversified, especially if the 401(k) is the primary retirement vehicle."

Another expert, though, said that such changes have not been so common.

"I think there was a brief spurt of loosening of such restrictions (but) I don't think it's been as widespread as one would have thought," said William J. Arnone, a member of the national leadership team of New York-based consulting firm Ernst & Young L.L.P.'s employee financial education and counseling practice. And, he added, "even where employers have loosened up restrictions, I'm not seeing widespread evidence that employees are diversifying."

Cash: Developments again make plans' future cloudy

Continued from page T3

ry on the part of employers because the ruling—unlike other, prior, narrow and fact-specific decisions—was sweeping in its findings. Indeed, the ERISA Industry Committee, a Washington-based benefits lobbying group representing large employers, said the decision, if affirmed by other courts, would outlaw hundreds of other cash balance pension plans.

"Potentially, the IBM ruling makes every plan fair game" for age discrimination charges, said Eric Lofgren, global director of benefits consulting at Watson Wyatt Worldwide in Philadelphia.

And the unfavorable developments didn't stop with the court ruling. Rep. Sanders, continuing his assault on the plans, proposed an amendment to a Treasury Department appropriations bill to effectively block Treasury from imposing rules that would have the effect of overturning the court ruling in the IBM case. The House then approved the Sanders amendment, with the amendment now facing an uncertain future in the Senate (BI, Sept. 15).

Clearly, these developments, especially the court ruling in the IBM case, have had an impact in the cash balance plan arena, benefit ex-

perts say. While employers who were close to implementing plans generally have proceeded, those in the consideration stage have been reluctant to move forward.

"Everything kind of screeched to a halt," said Ethan Kra, chief actuary with Mercer Human Resource Consulting in New York.

"If the ruling is upheld, you don't want Monday morning quarterbacking," Mr. Kra said, adding that many employers would be reluctant to move to a cash balance design until the dust settles from the IBM case.

Yet, amid all the concern about the IBM ruling and the efforts of Rep. Sanders and his anti-cash balance plan allies in Congress, there is optimism among employers and their advisers that the storm will be weathered and the plans will, once again, continue to grow.

As to the IBM decision itself, many believe it is so out of sync with what they believe to be the correct interpretation of age discrimination law and its application to cash balance plans that other courts will not adopt it.

"This is not the nail in the coffin of cash balance plans. It is just one district court decision, and it is likely to be overturned. I'm optimistic that, at the end of the day, the

plans will be found to be nondiscriminatory," said Sheldon Gamzon, a principal with the Human Resources Services unit of PricewaterhouseCoopers L.L.P. in New York.

"This has no chance of being affirmed by an appeals court," Watson Wyatt's Mr. Lofgren predicted.

At the same time, Rep. Sanders' amendment—which, even if adopted, would remain in effect for only one year—isn't going to stand indefinitely in the way of federal rules favorable to cash balance plans, some say.

"Treasury and the Labor Department have been very supportive of the design," Aon's Mr. Macey said.

"Employers had been getting very positive vibes from regulators," added Mercer's Mr. Kra.

Employers with cash balance plans are optimistic that Washington ultimately will give the plans clear approval.

"These are very attractive plans and are important to our employees. It may take some time, but I am hopeful Congress will do the right thing," said Bob Lawrence, senior vp-human resources and services for New York-based Empire Blue Cross & Blue Shield, which adopted a cash balance plan in 1999.

Others concur with that assess-

ment. "I'd like to think that reason and good policy will prevail," said Larry Sher, a principal and director of research at Buck Consultants Inc. in New York.

Indeed, the reasons that so many companies—roughly one-third of Fortune 100 companies, according to Watson Wyatt research—now have cash balance or other hybrid arrangements have not changed.

The most significant reason, employers and others say, is that cash balance plans are better suited to an ever-more-mobile workforce than the traditional final average pay plans they have replaced. In traditional plans, benefits accrue very heavily only after many years of service. In cash balance plans, the benefit accrual rate is much more even. That means employees terminating employment after a few years of service receive much greater benefits compared to traditional plans. At the same time, the benefits tend not to be as rich compared with traditional plans for very long service employees, especially those who, under the old plans, would have qualified for company-subsidized early retirement benefits.

"This is a plan that meets our needs, and our employees love it," said Shirley Grill, senior vp-human

resources at insurer Atlantic Mutual Cos., which adopted a cash balance plan in 1997.

If, though, the legal and regulatory environment were such that it no longer was possible for employers to offer cash balance plans, experts say there would be no return to traditional plans.

"Those plans did not work for employers and their employees. There was not enough bang for the buck. There will be no place for employers to go but exit the defined benefit plan system," said Janice Gregory, a vp with the ERISA Industry Committee.

"A few employers might go back. Most would not," said Ari Jacobs, a consultant with Hewitt Associates Inc. in Norwalk, Conn.

Most likely, experts say, employers would enrich their 401(k) plans. While those plans are valuable, they lack features that are unique to defined benefit plans such as cash balance plans.

Those features include protection from investment risk, basic benefits guaranteed by the federal Pension Benefit Guaranty Corp. in the event an employer fails and hasn't fully funded its pension plan, and the protection of benefits for spouses.

"Employees would be the losers," Mr. Sher said.

PBGC: Record deficits

U.K. employers moving away from defined benefit plans

Continued from page T8

increases, which ultimately could force some employers—resentful of having to subsidize benefits promised by employers that didn't adequately fund their plans—to terminate their own plans.

"At some point, these financially strong companies may exit the defined benefit plan system, leaving only those companies that pose the greatest risk of claims," said PBGC Executive Director Steve Kandarian.

While benefit experts say some changes in funding and other pension rules may indeed be necessary, they caution against hasty action or too great a change.

First, they say, the big rise in the PBGC's deficit over the last couple of years should not come as a surprise. That's because of an unusual convergence of financial events, including a weak economy, a plunge in the stock market that significantly eroded the value of assets held in pension plans and low interest rates that inflated the value of plan liabilities.

"It was an unprecedented perfect storm" of negative events, said Kevin Wagner, a consultant with Watson Wyatt Worldwide in Southfield, Mich.

Just as the PBGC quickly moved from a record surplus to a record deficit, there is no reason that its financial situation could not rebound to financial health as the economy improves, interest rates rise and the stock market recovers, Mr. Wagner said.

"I would caution against applying a tourniquet to what is a flesh wound," he said.

"Wholesale changes should not be made on the basis of a couple of years of experience," agreed Chris Bone, chief actuary with Aon Consulting in Somerset, N.J.

Indeed, what benefit experts most worry about is that Congress will overreact to the PBGC's current problems and stiffen funding rules to such an extent that it would trigger a new exodus of employers from the defined benefit plan system.

"You don't want to accelerate the decline in defined benefit plans. You don't want to discourage employers from offering the plans," Mr. Bone said.

Still, there is widespread recognition that certain changes in pension rules are necessary.

One widely supported change, included in a reform measure passed by the Senate Finance Committee this month, would allow employers to contribute to their pension plans even when the plans are fully funded. This additional funding, which is not allowed under current law, would give plans an extra funding cushion and reduce the likelihood of them slipping into deficit status during difficult economic conditions, when employers can least afford to make additional contributions.

"If more funding were allowed when times are good, their plans could more easily live through 'perfect storms,'" Mr. Wagner said.

Other potential reforms that may be in order, according to benefit consultants, include placing addi-

tional curbs on the ability of plan participants to take lump sum payments from underfunded plans, which can quickly drain plan assets; and putting limits on PBGC guarantees of so-called contingent benefits, such as plant shutdown benefits, that employers typically do not pre-fund.

Pension rules may be overdue for revision, Mr. Bone said, but the revisions need to be done with precision.

"What we may need is fine-tuning, not wholesale changes," he added.

By SARAH VEYSEY

More and more U.K. employers are closing their defined benefit pension plans to new employees and are offering defined contribution plans, or hybrid plans, instead. And while reports of the death of defined benefit plans may have been exaggerated, it is likely that this trend away from such plans will continue, experts say.

Ian Naismith, head of marketing,

technical and compliance at life insurer Scottish Widows P.L.C. in Edinburgh, Scotland, said that many employers have moved away from defined benefit plans—known in the United Kingdom as final salary schemes—because the plans represent an unlimited liability "and employers don't want unlimited liability."

"Many schemes have been closed to new entrants, and I think that over the next few years we could see

many of those wound up," he said. "We could come to a position where the only final salary schemes that are still open are those in the public sector which are underwritten by government."

Indeed, while employers will still be administering existing defined benefit pension plans for the next "20, 30 even 40 years," Simon Martin, a principal and actuary for Aon Consulting in London, said that he

Continued on next page



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was not aware of any new defined benefit pension plans being set up in the United Kingdom during the past decade.

There are several reasons that employers are moving away from defined benefit pension plans. "Final salary schemes have served employees very well for probably the last 30 years and have provided large numbers of people with very generous incomes in retirement," said Mr. Martin. "But unfortunately, a number of factors have hit them all at once, which probably makes them untenable in the long term."

The two biggest factors to have hit defined benefit plans, according to Mr. Martin, are the fall in stock

prices over the past several years and the increase in life expectancy. "One has significantly reduced the value of the assets that are in the schemes, and the other one has significantly increased the cost of the pension promise that has been made," said Mr. Martin.

Other factors contributing to the demise of some defined benefit plans include pension tax changes introduced in 1997 that have reduced the value of pension plans in the country by £3 million to £4 million a year, he said. In 1997, the government reimposed taxes on dividends for pension funds.

"Given the combination of performance of investments and extension of actuarial liabilities—because

people are expected to live longer—that combination has hurt companies quite a lot," said Peter O'Neill, a partner in the financial services division of Ernst & Young in London.

"But you also have a variable risk factor, in that you don't have to go too far back in the calendar to see a time when companies were taking (pension fund) contribution holidays because everything was hunky-dory in the schemes," he said. "You then move on a few years and you have got completely the opposite situation with enormous deficits."

Employers, particularly large and publicly traded companies, will always seek to avoid those kinds of uncertainties or volatilities, he said.

"Would anybody in their right mind leave themselves open to that kind of risk, those kind of swings? Particularly at a time when there is increased visibility of these kind of things through company accounts," he said.

A new accounting standard, Financial Reporting Standard 17, which is being introduced in phases for full implementation in 2005, requires publicly traded companies to list their pension fund assets and liabilities on their balance sheets.

"Those two big factors, cost and risk, come together very strongly to say sensible companies operating sensible governance have to be concerned about this issue," Mr. O'Neill said.

Recent legislation introduced by the government will "I fear, make the final salary pension scheme too onerous," said Mr. Martin.

In the event of winding up a plan, companies now must guarantee to pay the pensions of employees still in work as well as those who have already retired, he explained. This, said Mr. Martin, may prompt some companies to view a defined benefit plan as "too big a burden" that may, in effect, risk the whole health of the company.

"While the final salary pension scheme has got a lot of life left in it...there aren't as many final salary schemes that now form a key part of the company's human resources strategy," Mr. Martin said. "When you are talking about recruiting new staff or retaining existing staff, the final salary scheme is becoming less and less important."

But there are still companies op-

'Many schemes have been closed to new entrants, and I think that over the next few years we could see many of those wound up.'

*Ian Naismith
Scottish Widows P.L.C.*

erating defined benefit plans that have a strong commitment to defined benefit systems, said Mr. O'Neill. "What they are doing is putting a lot of emphasis first and foremost on investment strategy, because that is one of the drivers behind making sure that schemes have sufficient financial health to meet the promise," he said.

And there is "middle ground," he said.

One option for employers that believe they cannot afford a full final salary pension plan but want to retain some form of similar employee benefit is to offer, for example, a career-average arrangement. "That is one way of retaining a (defined benefit) link but is a cheaper way of doing it," said Mr. O'Neill.

Under such an arrangement, the pension promise is based on a career average salary rather than an absolute final salary, he explained.

Another way for employers to keep defined benefit pension plans open is to ask plan members to make higher contributions, he said. In the United Kingdom, defined benefit plans are funded by employer and employee contributions.

But the proposed Pensions Protection Fund, similar to the U.S. Pension Benefit Guaranty Corp. model and slated for introduction in 2005, would cost employers a lot of money and might deter them still further from offering defined benefit plans, Mr. Martin noted.

The fund will be financed by employers operating pension plans. "So, therefore, as an employer, if you have a final salary pension scheme, not only do you have to pay for your own but you have to pay for everybody else's as well," he said. "That has the possibility of becoming a burden in the future, and employers are well aware of that."

The amount U.K. employers will have to contribute to the fund has not been determined.

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Employers looking to reduce retiree health costs

Methods include more cost shifting, using managed care techniques

By JOANNE WOJCIK

An increasing number of employers are attempting to stem rising retiree medical costs by applying defined contribution techniques like those used in the pension arena, capping their liabilities by shifting more of the cost burden to retirees.

In some cases, employers are carving out the administration of such benefits and using many of the managed care techniques that have worked successfully to cut costs for their active workers, such as pharmacy benefit management and disease management programs.

But while such strategies applied to retiree benefits may provide some temporary relief to employers, they are not a panacea, experts say.

In fact, they warn that if something is not done soon, workers may put off retiring to keep their health benefits.

"There is this looming crisis out there," warned Derek Guyton, principal at Mercer Human Resource Consulting in Chicago.

The situation is particularly acute for employers in blue-collar industries that today have more retirees than active employees, such as automakers, steelmakers and some utilities.

'It doesn't take a genius to figure out that if 70 cents of every dollar of steel is going to retiree legacy costs—pension and health care—it's going to be tough to compete globally. That's what's happening.'

*Samuel Fleet
Nation Employee Benefit Cos.*

"It doesn't take a genius to figure out that if 70 cents of every dollar of steel is going to retiree legacy costs—pension and health care—it's going to be tough to compete globally. That's what's happening," said Samuel Fleet, president and chief executive officer of National Employee Benefit Cos. in Warwick, R.I.

NEBCO, a retiree medical benefit plan administrator, handles a health care program for some of the retirees of Bethlehem Steel and LTV; the program was established when the two steelmakers went out of business. Bethlehem Steel has 12,000 active employees and 90,000 retirees, while LTV has 8,000 actives and 40,000 retirees, according to Mr. Fleet.

In an effort to cap their retiree health care liabilities, many employers have taken a defined contribution approach, providing a set monthly subsidy for retiree health care costs, with the retirees picking up the difference.

For example, in 1992, Northeast Utilities in Berlin, Conn., which provides health benefits to some

7,500 retirees and 6,500 active employees, capped its retiree health care liability by limiting its contribution to its self-funded health plan to \$2,100 per year for retirees 65 years of age and older and \$6,000 for retirees under the age of 65, according to Jean Claude Bazalais, human resource director-benefits.

In addition, retirees younger than 65 are required to contribute on a sliding scale depending on how old they are and how many years of service they have when they retire, ac-

cording to Mr. Bazalais.

But even with the increased retiree cost sharing, "we are over our cap for the post-65 retirees and getting close to the cap for the pre-65 retirees," Mr. Bazalais said.

Numerous employers implemented similar caps when Financial Accounting Standard 106 took effect, according to Mike Thompson, a principal in PricewaterhouseCoopers' Human Resource Services practice in New York. Under FAS 106, companies can no longer ac-

count for their retiree benefit costs on a pay-as-you-go basis; they must accrue the present value of all future retiree health care liability on their financial statements.

"When FAS 106 was adopted in the late '90s, many corporations were faced with very, very large liabilities based on the benefits they were offering. What they did to mitigate that was to recognize they wouldn't offer those benefits ad infinitum, so they put dollar caps on those benefits. When they

did the evaluations, it anticipated that the benefit would get increasingly costly but would cap out at some point," Mr. Thompson explained.

But what has happened is, "in the last few years, as health care costs have escalated, more and more companies are reaching those caps. The contributions for retirees are increasing almost exponentially," he said.

As a result, some employers are

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Continued from previous page

steadily reducing their annual subsidies to retiree medical benefits over time to reduce their future liabilities, according to Mr. Fleet of NEBCO.

"A proposal we just put together for an automotive parts manufacturer client with more than 4,000 retirees located all over the U.S. will gradually reduce the employer's contribution from \$11.8 million this fiscal year to \$6 million in 2006," he said.

"Each year, the company contributes less, to lessen the bite," Mr. Fleet described. "All the medical trend and the rate increases are passed on to the retirees."

But such an approach could

prove detrimental to retirees, many of whom are living on fixed incomes, such as their pensions, other industry experts point out.

"A recent study projected that, by 2031, the retirees, even the lucky ones who have retiree health benefits, would be paying 90% of the cost of anything not covered by Medicare," said Joe Martingale, national leader for health care strategy at Watson Wyatt Worldwide in New York.

As an alternative to capping their annual contributions to retiree health care costs, companies such as International Business Machines Corp. are using a cash-balance-type approach, providing a lump sum that employees can use for health

care costs after retirement.

Under IBM's plan, the company will provide, for up to 10 years, a \$2,500 annual credit, plus interest, to special accounts for employees age 40 and older. When employees leave—starting at age 55—they can draw on the accounts to pay premiums for IBM-provided retiree health care coverage.

"We've seen some other companies adopt this," said Mercer's Mr. Guyton.

In fact, a recent Mercer survey of employers with 500 or more employees found that 3% said they use such an approach, while 7% said they were considering it. By contrast, 16% said they are providing a fixed subsidy, or defined contribu-

tion, to the annual cost of retiree medical benefits, similar to what Northeast Utilities is doing.

There are advantages to both employers and employees in using such an approach, according to Mr. Thompson.

"By guaranteeing a certain amount of money toward retirees, you're not only providing a level of health security, you're also providing a flexible environment to provide a benefit when you get there. This is a middle ground, where they've made a commitment of a certain amount of money. They can design the benefit later based on what's affordable based on the amount of funding they have available," he said.

In the latest twist on defined contribution, some employers setting up consumer-driven health plans for their active employees are earmarking a portion of the funds in health reimbursement accounts for retiree medical care, according to Mr. Guyton of Mercer.

Others are creating 401(k)-type arrangements funded with both employer and employee contributions, reported Jonathan Nemeth, senior vp at Aon Consulting based in Somerset, N.J.

For example, one large industrial employer this year is combining a 401(k)-type funding mechanism with a VEBA, Mr. Nemeth said, though he declined to identify the employer.

Under the arrangement, the employer matches the employee contributions two for one up to a lifetime maximum of \$30,000. The employees' contributions are put into a trust, while the employer sets up a book reserve.

Mr. Nemeth acknowledged that the one drawback is that the employee contributions, unlike health premiums for active employees, are not made on a pretax basis.

But he pointed out that the interest on the money accumulates tax-free. Furthermore, he noted that while traditional retiree medical plans require a particular length of service and age at retirement for employees to qualify, the employees in the VEBA plan are always 100% vested in their own contributions.

In some cases, employers that wish to preserve existing retiree health benefits are carving out the administration of such benefits in an attempt to save money.

"Wausau Benefits is seeing growth in carve-outs for retiree medical. Usually medical management for retiree medical is nonexistent or combined with the active employee plan," said Brian Freiberg, product manager at Wausau Benefits Retiree Medical Administration in Wausau, Wis. "It's like a disease management program for retirees."

Wausau even added a gerontologist to conduct training for customer service staff "so they treat the retirees as if they were their parents," Mr. Freiberg said.

And because prescription drugs comprise up to 50% of the cost of retiree health benefits, Wausau helps employers reduce this expense through the use of its pharmacy benefit manager, Wausau Pharmacy Benefits.

Regardless of all the innovative strategies being tested, some employers are becoming so frustrated that they are reducing or dropping the benefit entirely for new or for future hires, industry experts say.

"Retiree medical is diminishing. Those that still offer it either charge more or have more-restrictive eligibility standards," said Mr. Martingale of Watson Wyatt.

But dropping the benefit altogether could have an unintended side effect, warned Mr. Guyton of Mercer.

"Employers that don't offer retiree medical need to be prepared to have those people working until age 63 and a half, and then taking COBRA until they qualify for Medicare," he said.

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More employers offering long-term care programs

By SALLY ROBERTS

After years of modest growth, interest in group long-term care insurance is increasing significantly.

Not only are more employers offering their employees group long-term care insurance as a benefit but the LTC product also is more attractive today, giving employees more benefit for their premium dollar, experts say.

At the same time, employee participation rates, which have traditionally been in the single-digit range, also are rising, as awareness of the coverage improves, experts note.

And while group LTC plans remain predominantly a voluntary benefit, LTC providers say more employer-paid LTC products are being offered today, especially in the smaller end of the employer market, where much of the growth in group LTC programs is being seen today.

According to the latest statistics compiled by the Health Insurance Assn. of America, 4,776 employers offered group long-term care insurance plans in 2001, a 20.7% increase over the prior year and a 46.8% increase over 1999.

"The number of employers offering long-term care insurance contin-

ues to grow, and even those not offering it are considering offering it in the near future," said Kathleen Harris, group health care consultant for Watson Wyatt Worldwide in Stamford, Conn.

Much of the interest and growth, experts say, is coming from the market of small- to medium-size employers, where group long-term care insurance plans have not been as widely adopted compared with larger employers.

In addition to an aging employee population demanding the coverage, much of this growth is being fueled by the federal government's

LTC program launched in March 2002, experts say.

Under the program, federal employees and members of the uniformed services, as well as retirees of both groups and certain family members, were able to apply for LTC coverage on a voluntary basis. In all, about 20 million people were eligible for coverage.

Although the open-enrollment period for the federal program ended last December, the U.S. Office of Personnel Management, which administers the program, does not have participation-rate figures yet, according to a spokesman. The fed-

eral LTC program is underwritten by John Hancock Life Insurance Co. of Boston and Metropolitan Life Insurance Co. of New York.

More employers are offering LTC programs, and "a lot of it has to do with the momentum created with the federal program," said Jodi Anatole, vp of Met Life in Westport, Conn.

"There is huge momentum in the marketplace. Clearly, the federal long-term care program has been a huge growth catalyst," agreed Janet Kennedy, head of long-term care products and marketing at Aetna Inc. in Hartford, Conn.

As interest in LTC insurance continues to grow, insurers are making their products more appealing for a broader base of consumers.

One of the biggest product trends is an automatic inflation feature,

'There is huge momentum in the marketplace. Clearly, the federal long-term care program has been a huge growth catalyst.'

*Janet Kennedy
Aetna Inc.*

which is an outgrowth of the federal program, providers say.

Historically, group LTC policies would offer inflation increases periodically and, if taken, employees' premiums would increase accordingly. The federal program, though, offered employees an automatic inflation feature, which automatically increased the benefits with no premium increase. The trade-off is that employees pay a much higher premium when they initially purchase the coverage, providers explain.

"We're absolutely seeing a tremendous increase in interest in the auto feature for employers," Ms. Anatole said.

In addition to offering this automatic inflation feature, LTC providers also are giving employees more choice in their LTC coverage and making the product more flexible, they say.

"We're starting to see recognition in the market that the boomer population is all about choice and flexibility," said Laura Moore, second vp in John Hancock Financial Services Inc.'s group insurance division in Boston. "What we tried to do is take some of the flexibility of retail products that enable people to have more choice but try to package them to allow people to make a benefits decision without having someone sit with them the way an agent would," she said.

The complexity of LTC products has been a deterrent for some employers.

After researching LTC coverage earlier this year, Jeffrey W. Pettegrew, vp-risk management and insurance for Westaff Inc. in Walnut Creek, Calif., decided not to offer a voluntary group LTC benefit.

Mr. Pettegrew determined that most employees under the age of 50 would not see a need for the cover-

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age, and that many of those over 50 would not want to pay the premium. In addition, he said, he could not decide which policy would be suitable for all of Westaff's employees across the country.

"It's like all the complex life products out there—there is no one model we felt comfortable with, even if there were enough people truly interested in buying a policy like that," he said.

LTC insurers have responded to such concerns.

"It's a complicated product, and you need to make it very simple," Met Life's Ms. Anatole said. "Our strategy is to provide...a prepackaged plan with the ability for people to customize it if the prepackage doesn't meet their needs. That allows people to look at something and ask, 'Is this right for me?' without having to weed through every single feature of the program," she said.

Some of the newer choices being offered to LTC buyers include "stay-at-home" benefits, which allow an individual in need of assistance to remain in his or her home and be reimbursed for costs associated with that home care; and "informal care" benefits, which reimburse costs associated with a care provider such as a family member.

The introduction of more attractive LTC policies is just one of the factors behind rising employee participation rates, experts say. Better communication and education about long-term care also is having a positive effect on LTC purchasing.

Historically, employee take-up rates hovered between 5% and 10%. Experts say that part of the reason for the low participation is that employees do not fully understand the product or the need for long-term care.

Southwest Airlines began offering employees a volunteer long-term care insurance benefit as part of an employer coalition about three years ago, but the employee participation rate is less than 1%, said Ralph Kimich, director of benefits and compensation for the Dallas-based airline. "We attribute that to our demographics and relatively young workforce," he said.

"We do think it is a valuable and useful benefit," Mr. Kimich said. "However, it's just not top of mind for our average employee."

Employees 40 years of age and under "don't see a need for it," said Barry Barnett, a principal with Price-waterhouseCoopers Human Resource Services in New York. "They look at long-term care as something they need at 65 or 70 years old and don't understand what they could use it for now."

"The younger employees don't realize they could get disabled in a car wreck and end up needing long-term care," he said. At the same time, many don't understand that if they have older parents who may one day need a nursing home or may need to move back home with them, they can buy LTC coverage for their parents or get their parents enrolled in their policy, he said.

"Everyone has wrestled with (the question of), how do you get more people interested in this? And the reality is, the biggest reason for people to enroll is because they've had a

personal experience," Ms. Anatole said. "The sad part is, as more people go through having personal experiences, the more likely they are to enroll."

Experts agree, though, that the better the education and communications about long-term care insurance, the better the participation rates.

"In our world, (participation rates) are most definitely increasing," Aetna's Ms. Kennedy said.

"More and more frequently, benefit managers are responding to employee requests for a long-term care insurance plan," she said. "The benefit managers really driven by what they are hearing from their employees are spending tremendous

amounts of time with us working on developing LTC plans, plan designs and communication programs to really meet employees' needs."

"Participation rates...are gradually increasing for a variety of reasons," including a growing awareness of the product and the aging of the U.S. population, John Hancock's Ms. Moore said. In addition, she said, "we've gotten better at communicating the (LTC) message and better at simplifying the enrollment process."

"Participation levels are still around 2% to 10%, depending on how well the benefit is communicated," Watson Wyatt's Ms. Harris said. "One communication method that seems to work is if you put it in

the context of financial planning rather than putting it out as just another voluntary benefit," she said.

"When you spend a lot of time communicating it as part of retiree planning in general, employers seem to have more success in employee-participation rates," Ms. Harris said.

Not only are some employers beginning to see higher participation rates but some are also beginning to subsidize some of the costs of LTC insurance, experts say.

While LTC insurance is predominantly a voluntary benefit, some smaller employers—those with 4,000 or fewer lives—are choosing an employer-paid route.

"The majority of plans are still

voluntary, but we are seeing what we call 'core plus,' plans where an employer will pay for a basic benefit and enable people to increase their coverage on a voluntary basis," said Ms. Moore of John Hancock.

She said she is seeing this trend more in cases of employers with 3,000 to 4,000 lives and in smaller professional firms.

"The larger the company, the more financial bit that is, and with smaller companies there might just be a culture of benefit subsidies," Ms. Moore said.

Aetna's Ms. Kennedy and Met Life's Ms. Anatole said they too are seeing increased interest among smaller employers in offering subsidized LTC insurance benefits.

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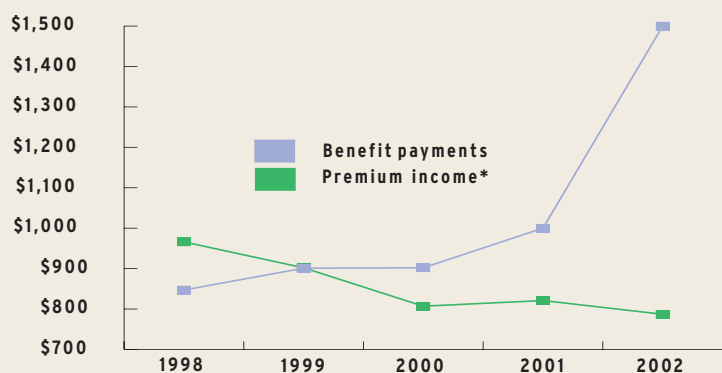
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PBGC INCOME DROPS AS PAYOUTS GROW

As the Pension Benefit Guaranty Corp. takes over more plans, payments to plan participants are rising. Dollar figures in millions.



* For single-employer insurance program
Source: PBGC

PBGC deficits have Congress considering legislative solution

By JERRY GEISEL

Is the Pension Benefit Guaranty Corp. experiencing a sense of déjà vu?

It wouldn't be an unreasonable question pertaining to the federal agency that guarantees employee and retiree pension benefits, which is again racking up massive losses as underfunded plans collapse.

A decade ago, the future of the

PBGC appeared so bleak that some federal pension officials and lawmakers warned that only a taxpayer-subsidized bailout could save the agency from insolvency.

Those fears led Congress in 1994 to pass legislation that was intended to put the agency on a sound financial footing that would last. Those reforms included accelerating pension plan contributions by employers with severely underfunded

plans, curbing lump sum distributions by underfunded plans and boosting premiums to the agency that employers with underfunded plans pay.

Whether by design or coincidence, the PBGC's financial health in the years following the enactment of that reform legislation—which was phased in—improved dramatically. From its low in 1993, when the agency's deficit in its single-employer insurance program hit nearly \$2.9 billion, the PBGC racked up a record surplus of nearly \$10 billion in 2000.

The PBGC's fortunes appeared to have grown so strong that business groups called for a reduction in the premiums that employers with defined benefit plans pay the agency. The PBGC's then-executive director also supported this recommendation.

Today, though, the agency's financial picture is much different from a few years ago and again resembles its situation in the early 1990s.

Driven by the biggest losses in its history over the past 18 months, the PBGC now has a record deficit—\$5.7 billion at the end of July. Also, members of Congress once again are gearing up to consider changes in the law to reduce the PBGC's exposure to big pension failures.

Rep. John Boehner, R-Ohio, who chairs the House Education and the Workforce Committee, said it would be "criminal neglect" on the part of legislators if they failed to act—while there is time—to address the PBGC's problems.

The outcome of a new round of pension rule changes is of direct concern and interest to employers with defined benefit plans.

Employers with defined benefit plans pay to the PBGC a basic annual premium of \$19 per participant. An additional premium of \$9 per \$1,000 of plan underfunding is assessed on employers with underfunded plans.

Those premiums and the interest they earn—as well as income the PBGC earns on assets it acquires from the underfunded pension plans it takes over—are used to pay benefits to participants in terminated plans.

To the extent the PBGC's income can't cover the liabilities it has assumed from terminated plans, it would have to ask Congress to raise the premiums paid by employers, a course of action it has taken several times in the past but one that its officials now say would be only a last resort.

Instead, the PBGC and other agencies are preparing proposals that they say would ensure that pension plans are better funded, especially those with the greatest likelihood of not being able to meet their obligations.

The alternative to these funding and other reforms, PBGC officials say, would be yet more premium

See PBGC/page T10

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