

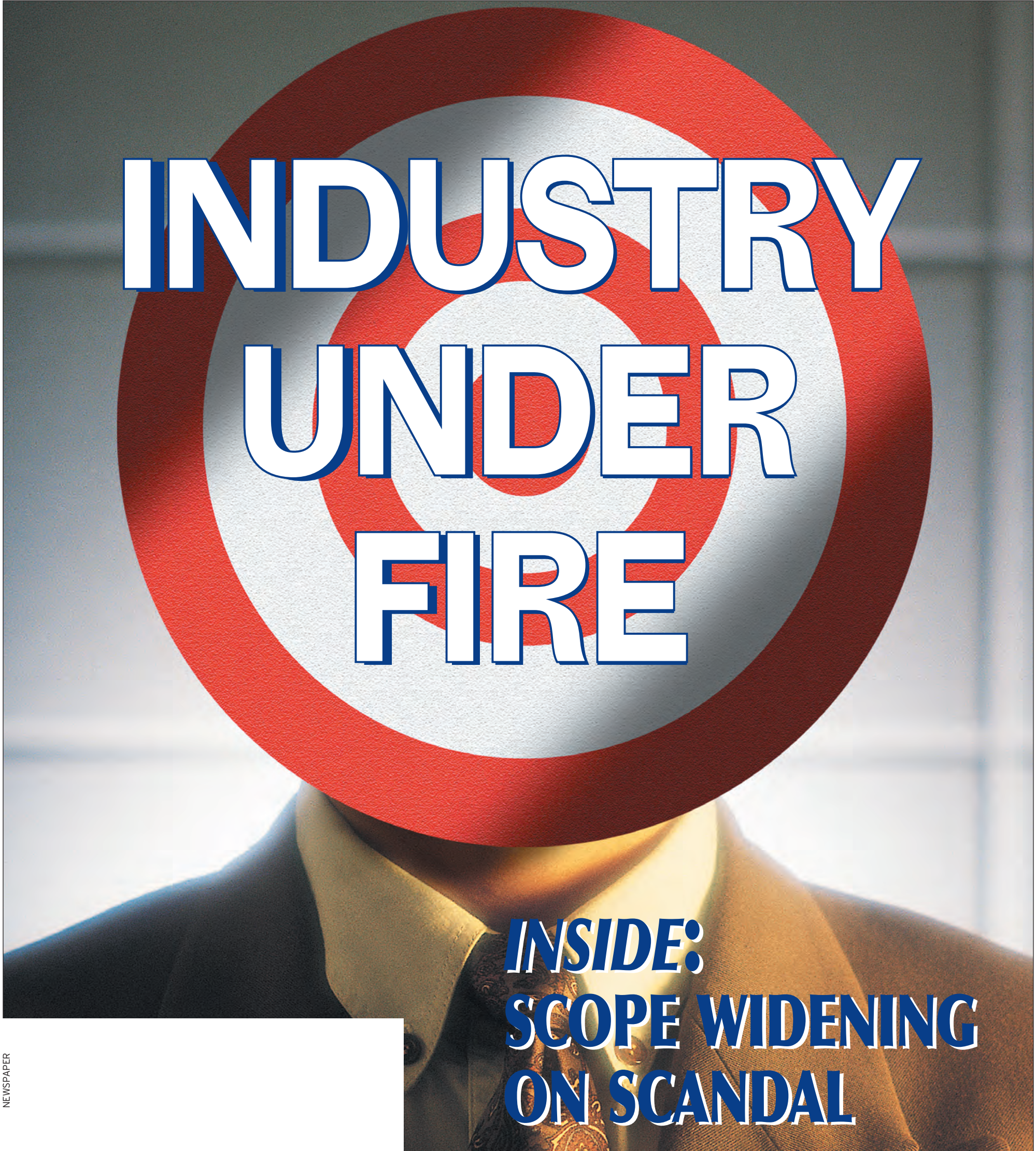
# Business Insurance

www.businessinsurance.com

November 1, 2004

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\$5



# INDUSTRY UNDER FIRE

***INSIDE:***  
**SCOPE WIDENING  
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\$5

## AIG, ACE lead Marsh's D&O

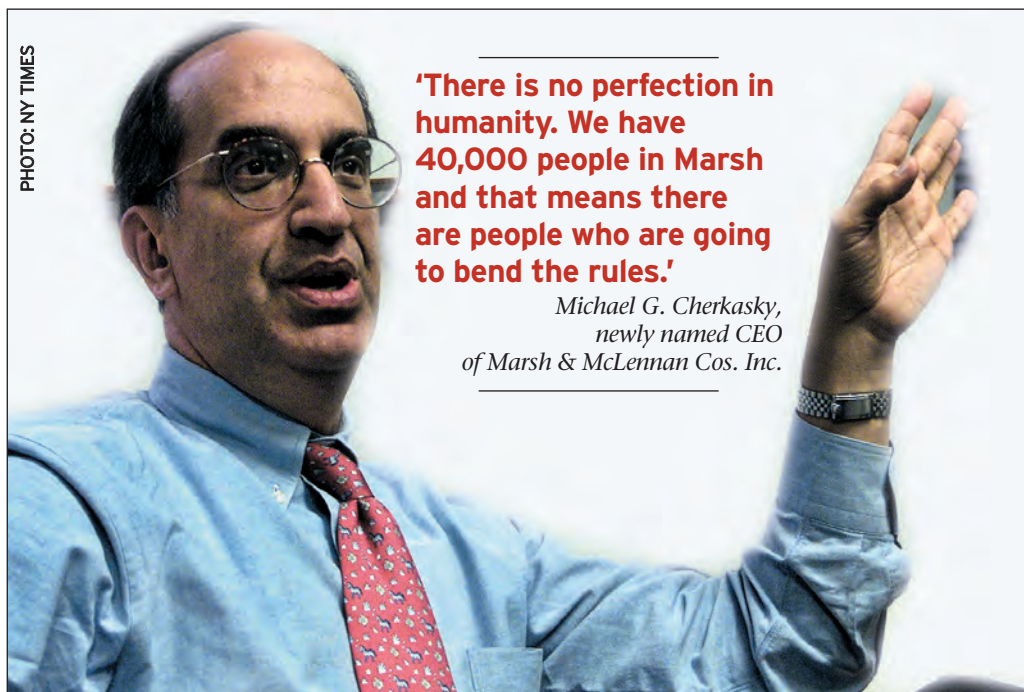


PHOTO: NY TIMES

**'There is no perfection in humanity. We have 40,000 people in Marsh and that means there are people who are going to bend the rules.'**

*Michael G. Cherkasky,  
newly named CEO  
of Marsh & McLennan Cos. Inc.*

By DAVE LENCKUS

**NEW YORK**—Primary and excess executive risk coverage for Marsh & McLennan Group Cos. Inc. is led by insurers—American International Group Inc. and ACE Ltd.—that allegedly participated with MMC in bid-rigging activities that have triggered shareholder lawsuits against all three companies.

The program's limits, however, would cover only a portion of the damages that the shareholders are seeking in litigation triggered by the investigation into the insurance industry's contingent commission arrangements, sources say.

Meanwhile, lawsuits filed by shareholders of the brokerages and insurers at the center of the investigation pose some potentially knotty coverage issues, say directors and officers liability insurance attorneys.

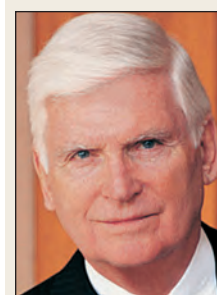
The securities lawsuits filed by MMC shareholders, who are seeking class-action status, were filed after MMC's share price fell in the wake of the fraud and antitrust charges filed by New York Attorney General Eliot Spitzer.

In a lawsuit filed in New York state court, Mr. **See D&O/page 48**

### Late News

#### Aon to lose \$50 million of contingent fees

Aon Corp. said that its recent decision to stop collecting contingent commissions from insurers will reduce its revenues by about \$50 million this year. Aon



**Aon CEO  
Patrick G. Ryan**

said that \$117 million, or about 2.3% of its \$5.15 billion in brokerage and consulting revenues for the first nine months of 2004, is attributable to contingent commissions. The company estimates that it would have received an additional \$50 million in such commissions in the fourth quarter. Following the lead of Marsh & McLennan Cos. Inc. and Willis Group Holdings Ltd., Aon announced last month that it would no longer accept the controversial commissions from insurers in the wake of New York Attorney General Eliot Spitzer's investigation into the practice. Late last week, a plaintiff's law firm sued Aon on behalf of investors (see story, page 45).

#### Senate hearing set on broker scandal

Sen. Peter Fitzgerald, R-Ill., chairman of the Senate Government Affairs Committee's Subcommittee on Financial Management, the Budget and International Security, has called a Nov. 16 hearing on the insurance brokerage compensation scandal. The hearing will be the first any congressional panel has held regarding investigations into brokerage compensation practices. Sen. Fitzgerald, who is not seeking re-election next week, is expected to call as a witness New York Attorney General Eliot Spitzer, who on Oct. 14 filed a lawsuit charging Marsh & McLennan Cos. Inc. with bid rigging and self-dealing.

#### More than 60% of ACE's contingent pay to MMC

ACE Ltd. paid \$61 million in contingent commissions to brokers **See LATE NEWS/page 47**

### Compensation Crisis Inside:

#### In the boardroom

Outsiders dominate brokers' boards **page 36**

#### Where were the regulators?

Consumer groups say states 'asleep' **page 43**

#### Northern exposure

Canadian regulators launch probe **page 43**

#### Buyers beware

Risk managers taking precautions **page 44**

#### Turn up the volume

London brokers said to face pressure **page 44**

#### MMC's Greenberg quits

Shake-up prompts changes elsewhere **page 45**

#### Additional coverage online

For BI articles and other resources on the compensation crisis, visit BI on the Web at [www.businessinsurance.com](http://www.businessinsurance.com).

## Broking center model led to abuses: Spitzer

By DOUGLAS McLEOD

**NEW YORK**—Charges of client steering and bid rigging at Marsh & McLennan Cos. Inc.'s Global Placement division are reigniting debate over the company's global broking model, which critics contend has long isolated risk managers and which may have allowed the alleged abuses to occur.

The model—followed by Marsh but not by most of its competitors—removed insurance placement from the hands of local account executives and centralized it in Marsh's New York office, along with control of the broker's contingent commission agreements with insurers.

Although newly appointed Marsh Chief Executive Officer Michael G. Cherkasky said last week that the broker will stick with the model, several risk managers, rival brokers and industry observers argue that it impedes communication between client and underwriter and concentrates so much buying power at Marsh that it creates the potential for abuse.

Near the beginning of his Oct. 14 lawsuit against Marsh, New York Attorney General Eliot Spitzer traces the historical roots of the company's alleged fraud and antitrust violations to its creation of Global Placement, then known as Global Broking.

"Beginning in the late 1990s, Marsh centralized its organization and assumed greater control over both business placement and contingent commission agreements," Mr. Spitzer's complaint says. Marsh's enormous contingent commission revenue—\$845 million in 2003—"is not happenstance, but the result of careful planning."

That revenue, rather than improved client service, was the objective of Global Broking, Mr. Spitzer charges. And the division's huge profitability gave it enormous political power within Marsh and created a culture that allowed high-handed treatment of Marsh branch office employees and underwriters, according to the complaint, former Marsh employees and others.

**See MARSH/page 46**

### Spotlight report

## D&O/E&O LIABILITY RISKS

Begins on page 10

# AIG seeking settlement of Brightpoint probe

By RUPAL PAREKH

**NEW YORK**—American International Group Inc. on Monday said it would pursue a settlement to resolve a federal grand jury's investigation into a 1998 transaction between an AIG unit and telecommunications company Brightpoint Inc.

A Securities and Exchange Commission investigation into the same matter resulted in a \$10 million settlement by AIG last September, in

which AIG did not admit any wrongdoing (*BI*, Sept. 15, 2003). The SEC had charged that AIG unit National Union Fire Insurance Co. of Pittsburgh, Pa., provided Plainfield, Ind.-based Brightpoint with an insurance contract that did not involve any actual risk transfer. This contract allowed Brightpoint to claim an insurance receivable in its financial statements, which led to an overstatement of earnings, the SEC charged.

AIG last week said that it had been informed by the U.S. Attorney for the Southern District of Indiana that it is the target of a federal grand jury investigation in connection with the Brightpoint transaction.

Of the latest inquiry, the company "has instructed its counsel to resolve the matters by reaching a prompt settlement in terms satisfactory to the government and the company," AIG said in a statement.

## Experts analyze the insurability of terrorism

# Ongoing federal role seen in coverage of terror risks

By MARK A. HOFMANN

**WASHINGTON**—The federal government likely will continue to have some sort of role in insuring against terrorism for the foreseeable future, according to a panel of experts at a recent symposium on the insurability of terrorism.

Such a role is likely, even though the federal Terrorism Risk Insurance Act may not have had as positive an impact on the U.S. economy as its supporters claimed, according to an academic specializing in risk management and insurance.

J. David Cummins, the Harry J. Loman professor of insurance and risk management at the Wharton School of the University of Pennsylvania in Philadelphia, cited as an example the fact that private-sector construction employment did not pick up after the enactment of TRIA.

Enactment of TRIA, which created a federal backstop for insurers that would have to pay losses from a future catastrophic terrorism attack,



**'Terrorism is a means of conducting war for political ends.'**

Gordon Stewart  
Insurance Information Institute

had been promoted as necessary to protect construction jobs in areas likely to be terrorist targets, such as New York City, he noted during the Washington symposium, sponsored by GE Insurance Solutions.

Mr. Cummins said that the question of whether the government should play a role in terrorism insurance remains unanswered. Rather the focus on the economy as a whole, perhaps a government insurance program should be focused on protecting small, private companies that would suffer the greatest

financial losses from a terrorist attack, he said.

"Terrorism is a means of conducting war for political ends," said Gordon Stewart, president of the New York-based Insurance Information Institute. Mr. Stewart noted that he was speaking for himself rather than III. Fundamentally, he said, terrorism is an act of war that people do not want to call war.

If the United States is at war, and the government cannot protect its citizens, is it reasonable to ask the private insurance industry to underwrite the risk? Mr. Stewart asked.

He noted that the private/public insurance plan that TRIA created remains "far more private" than any other government terrorism insurance program in the world.

See TRIA/page 47



PHOTO: AFP

Investigators inspect the Shinkansen bullet train that was derailed by an earthquake in late October. Service on the passenger rail line is expected to be disrupted for several weeks.

# Earthquake, typhoons not wreaking havoc on Japan property rates

By MICHAEL BRADFORD

**TOKYO**—Japanese property owners, already reeling from a series of typhoons and a deadly earthquake, may be spared a separate blow from insurers.

While the natural disasters that have pounded Japan this year are costing insurers billions of dollars, the losses probably won't be enough to cause significant increases in property rates.

So far, an earthquake that struck Niigata Prefecture in late October and 10 typhoons that swept across the island nation this year are estimated to have cost insurers between \$6 billion and \$10 billion. While damages from last month's earthquake are still being assessed, EQECAT Inc. is projecting insured losses of \$2 billion to \$5 billion caused by the temblor.

Catastrophe losses will climb

further when claims from Typhoon Tokage are counted. The deadliest typhoon to hit Japan in over a decade, Tokage's wind and heavy rains triggered mudslides and flooding that left at least 63 people dead as it moved across the country on Oct. 20.

Insurers and property owners last week were totaling damages from the Niigata earthquake, which could be more expensive than the one that struck Kobe in 1995, killing more than 5,000 people and leaving insurers with around \$3 billion in claims. The Oct. 23 earthquake has left at least 31 dead and injured more than 2,000. Severe aftershocks from the quake that measured 6.8 on the Japan Meteorological Agency's seismic intensity scale have added to the damage.

Among the commercial losses from the Niigata quake was the

See JAPAN/page 6

## Inside Business Insurance

### Aviation renewals seeing falling rates

Underwriters say that, despite lower aviation losses over the past few years, trends must be assessed over a longer term. **Page 4**

### PCI president urges state regulation overhaul

Ernst Csiszar says that the insurance industry is in 'dire need of change.' **Page 4**

### Industry scandal will not go away quietly

The elimination of contingent commissions is not enough to restore client confidence in the insurance industry, this week's editorial says. **Page 8**

### London consultant sentenced for fraud

London company took premiums, but didn't obtain coverage. **Page 41**



### Potential health risks from nanotechnology

The U.K.'s Health and Safety Executive issued a report stressing the need to assess the health risks of nanotechnology. **Page 41**

## Online

• *Business Insurance* has compiled past *BI* articles and other resources on the New York Attorney General's lawsuit against Marsh & McLennan Cos. Inc.

• Searchable **directories** provide access to all the listings of industry vendors found in *BI*'s Market Sourcebook.

• New **Opinion Poll** for readers: Do you think Congress will launch its own investigation of broker bid rigging and other illegal practices?

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### REPORTING ON CORPORATE RISK AND EMPLOYEE BENEFIT MANAGEMENT NEWS

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RIDE ALONG ENCLOSED IN EDITION 11

# RIMS survey finds prices decreasing across most lines

By RUPAL PAREKH

Buyers of commercial insurance are benefiting from continued market softening, as policy renewal prices have declined for a third straight quarter, a survey shows.

Rate decreases were applied across most major coverage lines, according to the "RIMS Benchmark Survey," which is conducted by the New York-based Risk & Insurance Management Society Inc. and summarized by Advisen Ltd., also in New York.

"The numbers this quarter firmly declare that we are experiencing a

soft market, though the declines are not excessive in any segment," David Bradford, editor-in-chief at Advisen, said in a statement.

Rates for property, excess liability and fiduciary liability coverage were all down between 2% and 3% on average, while directors and officers and general liability prices were just under 1% lower, the survey found.

Among the major coverage lines, workers compensation rates were the only exception to the third consecutive quarter of price breaks, experiencing an increase of slightly more than 1.5%.

Daniel H. Kugler, RIMS' vp-mem-

bership, who also is assistant treasurer-corporate risk management for Pleasant Prairie, Wis.-based Snap-on Inc., predicted that the rate declines "will last through the year" despite the sizeable losses incurred as a result of this year's heavy hurricane season.

"At this point, the loss estimates can be digested by the current carriers and not affect rates," Mr. Kugler said.

The results of the "RIMS Benchmark Survey" are available for purchase. For more information, call Advisen at 866-238-4736.

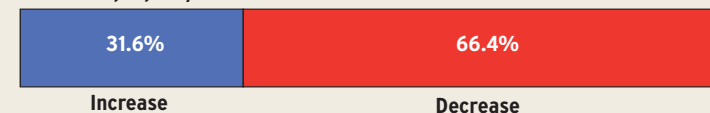
## LOWER IN SOME LINES

A survey of risk managers shows most saw rates drop in the third quarter

Directors and officers liability



Domestic property



Source: Advisen Ltd.



## Aviation renewals see rates descend amid lower losses

By PETA MILLER

**LONDON**—Aviation insurance rates have been cut by up to 15% so far in the 2004 renewal season, and airlines say their recent loss experience warrants further reductions.

Airlines, noting that crash-avoidance systems have helped reduce aircraft accidents, argue that the resulting lower losses of the past several years should be recognized in rates for policies renewing during the Oct. 1-Dec. 1 renewal season, when most airlines renew their coverage.

But underwriters, who stress that claims trends must be assessed over a longer cycle, are striving to minimize reductions. In addition, some are maintaining premium volume by wrapping more third-party war and terrorism liability coverage into all-risk policies.

Prices are falling, but buyers would like to see that trend accelerate in light of the high pre-

miums of the past three years, said Ralf Oelssner, director of corporate insurance for Cologne, Germany-based airline Lufthansa A.G.

Aviation all-risk premiums were reduced by 15%, on average, in October, and, in the absence of losses, similar reductions should be expected on the Nov. 1 and Dec. 1 renewals, said Steven Doyle, manager of the aviation and aerospace global practice group at Aon Corp. in London.

"Underwriters are trying to hold firm and are talking a good game, but at the end of the day this market is driven by capacity and claims. And there is still enough capacity and not many claims," said Mr. Doyle.

Total airline premium volume in October was down around 10% compared to 2003 levels, looking at the same airlines, said Brad Ottolangui, divisional director of aerospace at Willis

See AVIATION/page 34

## 2004 NIRA National Conference

# PCI president promotes need for state regulation overhaul

By JERRY GEISEL

**WASHINGTON**—State regulation of the insurance industry needs to be drastically overhauled, a top industry official and former regulator says.

"This is an industry in dire need of change," says Ernst Csiszar, president of the Property Casualty Insurers Assn. of America, based in Des Plaines, Ill.

Speaking earlier this month in Washington at the annual conference of the National Risk Retention Assn., Mr. Csiszar, the prior president of the National Assn. of Insurance Commissioners and director of the South Carolina Department of Insurance, said the focus of insurance

regulation should be on substance, not form.

"We overregulate what is trivial and yet underregulate what ought to be regulated," he said.



**'We overregulate what is trivial and yet underregulate what ought to be regulated.'**

Ernst Csiszar  
Property Casualty Insurers  
Assn. of America

The focus of regulation, Mr. Csiszar said, should be on ensuring the financial solvency of insurers. Instead, he said, regulators get overly involved in issues that have

nothing to do with the financial health of the companies they are supposed to regulate.

The NAIC, he said, does not care about outcomes. "They care about processes," he said.

To that end, when an insurance company wants to change its name, for example, it may have to file papers "several inches high." While regulators are drowning themselves in paperwork, they aren't paying enough attention to truly important issues, he said.

Though state regulation may be flawed, Mr. Csiszar is not an advocate of federal regulation. While state regulation is an "albatross" around the neck of the industry, Mr. Csiszar is not convinced that a switch to federal regulation

See CSISZAR/page 29

## ASHRM 2004 Annual Conference & Exhibition

# Quickly admitting mistakes can cut hospital litigation costs

By DAVE LENCKUS

**ORLANDO, Fla.**—For hospitals that make medical treatment blunders, the truth will set them free—or at least hold down their litigation costs, according to a risk management consultant.

Hospitals that promptly admit their treatment mistakes to patients or their families and then use their input to design procedures to prevent future errors can defuse a lot of anger, said consultant Kathryn K. Wire of St. Louis-based Wire Risk Strategies.

While hospitals should not expect such an approach to eliminate large settlements, they can expect to keep their litigation costs much lower, Ms. Wire told attendees at the American Society for Healthcare

Risk Management's recent annual conference and exhibition in Orlando, Fla.

"The key difference is how we address things," Ms. Wire said.

"It's important to have the patient involved in the event," Ms. Wire said. That involves examining what happened and correcting the problems that led to the treatment error.

"I don't think we do a very good

job in including them," she said. "Why not make them part of the larger process? All we talk about is money; we never bring them into the large picture. That causes many patients to become aggressive and active."

Some insurance defense attorneys and hospital administrators think that including patients in that manner is "not a good idea," Ms. Wire acknowledged.

But, she said, when hospitals have taken that approach, "there are success stories from patients and families that are really stirring."

Perhaps the case that most notably illustrates that point involves the family of toddler Josie King and Johns Hopkins Children's Center. The 18-month-old died in early

See MISTAKES/page 25

**ASHRM**  
American Society for  
Healthcare Risk Management  
Continued coverage  
on page 26

# Puzzled?

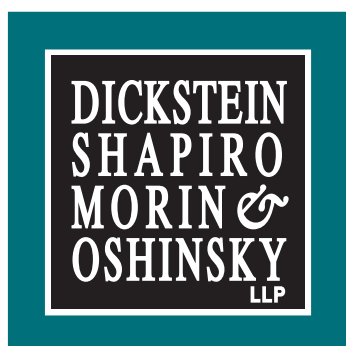
What is the key to this sequence?



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## Japan: Cat losses

Continued from page 3

first-ever derailment of several cars of Japan's Shinkansen high-speed railroad. Service is expected to be disrupted for several weeks as damages are assessed.

"The damage in Kobe was significantly greater," said Rick Clinton, president of Oakland-based EQE-CAT, a subsidiary of risk management consultant ABS Group Inc. of Houston. But insured damages from the quakes, though nine years apart, are similar, he said. That is because even though insurance covers a small percentage of property in Japan, it is more prevalent now than when the Kobe earthquake struck, he explained.

The Niigata quake is likely to result in total economic losses far lower than the Kobe quake, which created economic damages of \$100 billion, he said.

Despite the billions in natural disaster losses in Japan this year, no one is predicting large increases in coverage costs for property owners in Japan.

"Certainly a single event is not going to cause them major concern or heartache," said Mr. Clinton, referring to insurers' likely reactions to the recent earthquake. Taken with other catastrophes on a global basis, though, some pressure on prices could eventually come to bear, he said.

Domestic insurers have been "very conservative about pricing and careful about accumulating catastrophe reserves," said Runa Ichihari, director of insurance ratings at Standard & Poor's Tokyo office. "In terms of ratings and credit quality, we don't think the series of typhoons will result in a significant impact on nonlife insurance companies."

As for the potential for rate increases, Ms. Ichihari said insurers likely will wait until they have a clearer picture of their financial condition when their fiscal years end next spring before making decisions on whether to raise insurance prices.

Only around 11% of property owners in Niigata have earthquake insurance, which will limit insurers' losses, according to Tomishi Ishida, an insurance analyst with Goldman Sachs Asset Management Co. Ltd. in Tokyo. Earthquake insurance is written as an extension of fire insurance in Japan and rates for the fire coverage could go up, he said, although he could not predict how much.

Japan-based insurers are taking big hits from the catastrophes and the losses also are showing up on foreign insurers' books.

Millea Holdings Inc., the Tokyo-based parent of Tokio Marine & Nichido Fire Insurance Co. Ltd., reported that five of the typhoons and two heavy rainstorms are costing the company \$797.5 million before reinsurance recoveries.

American International Group Inc. also has been affected by the typhoons. Three of the storms, along with losses from four hurricanes that struck Florida this year, are expected to cost AIG \$500 million to \$515 million in after-tax losses. The

insurer did not specify how much of the loss would be attributable to the storms in Japan.

A spokesman for Munich Re Group said the group's reinsurance operations expect losses of around \$635.3 million from two of the typhoons and the Atlantic hurricanes.

Those losses are not expected to cause a jump in treaty renewal prices, he said. As for upcoming renewals, Munich Re expects current pricing and conditions to remain "stable on the whole," according to the spokesman.

Munich Re does not expect significant losses from the earthquake, he said, because most residential buildings are not insured for the risk and



PHOTO: AFP

July's Typhoon Chataan was one of 10 tropical cyclones to pound Japan so far this year.

the Japanese government operates an earthquake reinsurance facility that will pick up some of the losses.

Property owners in Japan may actually have been spared worse damage from the typhoons because the storms weakened considerably before reaching land, according to Jayanta Guin, vp of research and modeling for AIR Worldwide Corp., a Boston-based unit of Insurance Services Office Inc. in Jersey City, N.J.

And, Mr. Guin noted, typhoon losses of around \$5 billion during the storm season from March through December are not highly unusual and can be expected to occur around every seven years. A \$6 billion loss is generally a 10-year event, Mr. Guin pointed out.

The number of storms that have sprung up in the Pacific is "not very unusual," Mr. Guin said. "What is a little unusual is that 10 have made landfall in Japan." That number of landfalls is considered a 140-year event, he added.

David Snyder, vp at the American Insurance Assn. in Washington, said that weather conditions like those that spawned the spate of Atlantic hurricanes and Pacific typhoons in Japan have to be studied to determine whether they can be corrected. If the conditions stem from a cause, such as global warming, that can be addressed, "everyone, including insurers, will have to examine these challenges," he said.

"It behooves everyone to take a look at preventative measures," Mr. Snyder said of ways to determine if weather trends are changing and if they can be manipulated.

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## Editorial

# Let housecleaning proceed

IF THE EVENTS of the last two weeks have shown anything, it's that the insurance industry's housecleaning has been long overdue, and not just in the executive suite.

Consider, for starters, the following. After New York Attorney General Eliot Spitzer sued Marsh & McLennan Cos. Inc. late last month on fraud and bid-rigging charges:

- MMC ousted its chairman and chief executive officer, Jeffrey W. Greenberg, an action that no doubt helped MMC to avoid criminal charges. Mr. Greenberg's successor, Michael G. Cherkasky, was only recently named the head of unit Marsh Inc. In a strange twist, Mr. Cherkasky once was Mr. Spitzer's boss.

- One by one, at least six of the world's 10 largest brokerage firms permanently ceased taking contingent compensation for placing insurance.

- Mr. Spitzer announced plans to expand his investigation to other areas, including reinsurance and employee benefit business, and issued subpoenas to other brokers, insurers and managed care companies. The New York attorney general is also keeping his eye on Aon Corp., which owns the world's largest reinsurance and wholesale brokers and is the second-largest retail broker.

- State insurance regulators across the nation plan to launch or already have launched investigations into industry practices.

- A host of civil suits was filed on behalf of investors in MMC, Aon and others.

A mere three weeks ago, who would have predicted such developments? Mr. Spitzer's lawsuit, as we continue to report, is shaking the industry to its foundation. Executives of companies with subpoenas are quickly pledging cooperation with the attorney general's office. Others are keeping their heads down, hoping the storm will pass them by.

Insurance executives, if they haven't already, must realize that this sordid affair is not going to end quietly. And we don't think it will go away any time soon, not until the rest of the industry confronts the inherent conflicts of interest in contingent compensation agreements.

As we've noted earlier, there is a clear difference between brokers accepting income for meeting certain

sales goals or rendering services to insurance companies and their orchestrating false quotes to steer business to insurers that pay higher contingent compensation. Contingent commissions are not now and have never been illegal. That's not the point. We have maintained that such compensation is inappropriate because of the temptation it creates for brokers to put their own interests ahead of their clients'.

If contingent compensation is not a conflict of interest, why have Marsh, Aon, Willis, Arthur J. Gallagher, Jardine Lloyd Thompson and Heath Lambert decided not to accept them ever again? It's because in the court of public opinion, the appearance of a conflict is tantamount to a conflict, and no firm is eager to argue otherwise.

Is bid rigging—the most stunning charge Mr. Spitzer leveled against Marsh—widespread? Many industry observers say no, but the fact is few even suspected it until the suit was filed. Still, we believe that most insurance industry professionals are honest and have their clients' interest at heart.

But we also have to ask, why didn't the industry see this coming? Questions about the appropriateness of contingent compensation were first raised years ago. Full disclosure was proposed as the solution then, and, indeed, some still cling to that notion now. As some insurance buyers have learned, though, not every broker has been able to state the amount of contingent compensation it receives on specific accounts. The inability to tell risk managers how much was earned on their individual accounts isn't a very satisfying excuse. It suggests that the broker either doesn't know how to manage its money or, worse, is hiding something. Given the tenor of the times, which conclusion are most consumers apt to draw first?

The actions taken by numerous brokers to eliminate contingent commissions is a good and absolutely necessary step to regain the confidence of their customers, but it isn't enough. Now, however long it takes, they will have to go through their placements to be sure that contingent arrangements never compromised what their clients paid them to do: get the best coverage at the best price.

Only then will there be any chance to restore their clients' confidence in them.

## Letters to the Editor

### No benefit to clients in contingency fees

To the editor: I may be naïve and missing the salient points brought out by insurance brokers as to the benefits of contingency commissions, but I just don't get it.

For years, brokers believed that contingency commissions were a right, with no questions asked, or at least with little information provided should they be asked. Brokers believed that contingency commissions did not cause a conflict of interest between the client (whom they were supposed to serve) and themselves.

As we know, a client provides the broker with compensation, through placement commissions upfront and/or fees. Most risk managers believed that was how brokers were compensated. We didn't fully understand the back-end dealings brokers had with the insurance markets.

We surely didn't appreciate the gravity of the situation until New York Attorney General Eliot Spitzer made public what the brokerage community kept under wraps for all these years. This sends visions of back-room dealings and dead-of-night agreements that were prevalent between brokers and markets for years. Only now do the risk managers get to realize how brokers took advantage of the situation and how little we really understood how brokers benefited.

Most brokers were preaching the irrelevance of contingency commissions. Supposedly, these broker profits did not interfere with the service they provided to their clients. Contingency fees had nothing to do with the markets brokers would go to when placing business on behalf of their clients. The same broker you trusted all this time had your best interest in mind.

Brokers would still be doing what they were doing up until three weeks ago if not for the New York attorney general. Their recent change of heart has nothing to do with what is best for their clients. The change of direction by the brokers has everything to do with trying to spin what is and has always been a bad deal for their clients.

There is absolutely no upside benefit for the clients for brokers getting contingency fees. Clients do not get better access to the markets. Markets are open to us regardless of what agreements brokers may have with insurance companies regarding contingency fees. Actually, the opposite might be true. If a broker could not get a market to sign a contingency fee agreement, then perhaps this market was not available to us.

Brokers' claim that they should get additional benefits from insurance placements is absurd. Why should brokers be paid additionally for doing their job? We already pay them to do their job. Why should brokers be paid additionally for profitable placements? Isn't it the job of the broker to work with us and the insurance companies and present the placement in the best light? Isn't

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## Schillerstrom



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# D&O, E&O risks tough to juggle

Spotlight Editor: Dave Lenckus



## Exposures not thinning popularity of bariatric surgery

By SALLY ROBERTS

As a growing population of obese Americans turns to surgery as a drastic means to shed pounds, hospitals performing these procedures are seeing their liability exposures rise.

Hospitals are seeing a surge in demand for bariatric surgery—procedures to treat obesity by reducing the size of the stomach—and a potential financial windfall associated with performing such surgeries. But with more procedures also comes increased medical malpractice risk for the providers and facilities performing these procedures.

Having policies and procedures in place that require safe and appropriate equipment, trained and competent nonphysician staff and credentialed physicians, will go a long way in mitigating any potential problems, medical risk management experts say.

**Of the estimated 60 million obese individuals living in the United States, 9 million are considered morbidly obese.**

Of the estimated 60 million obese individuals living in the United States, 9 million are considered morbidly obese, or at least 100 pounds over the ideal body weight for a male and 80 pounds over the ideal weight for a female, according to the Washington-based American Obesity Assn.

Not surprisingly, the growing obesity epidemic has spawned increased demand for bariatric surgeries, the most popular of which is gastric bypass surgery, a procedure that creates a small pouch in the stomach by stapling shut the upper portion of the stomach and attaching the pouch

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## Review indemnification provisions to strengthen D&O liability coverage

By DAVE LENCKUS

Efforts by risk managers to strengthen their corporate directors and officers liability insurance programs as the D&O market's hard edge softens could be far less effective than they expect, insurance experts say.

Negotiating lower rates and better terms certainly will benefit the organization, D&O experts say. But risk managers who have not also re-

cently reviewed and updated their organizations' indemnification provisions may be leaving either executives underprotected or their organizations overexposed to various risks, experts say.

A review of corporate indemnification provisions likely would highlight for some risk managers that their organizations' provisions are out of line with current state indemnification laws, case law, state-

of-art indemnification concepts and their D&O policies.

"They should do that regularly," advised Ann Longmore, a New York-based senior vp and the D&O product leader with the Executive Risk practice at Willis North America, a unit of Willis Group Holdings Ltd.

Many organizations have reviewed their indemnification provisions lately, often expanding their

indemnification obligations to attract high-quality board members, according to market experts.

"We suspect, though, there are a number of companies that have not gone through this process and would encourage them to do that" with the aid of outside counsel because of the complexity of the matter, said Gary Dubois, chief underwriting officer for New York-based

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**U.S. more competitive in Side A cover for executives**  
page 18

**Attorneys suing to recover fees may court malpractice suits**  
page 24

# Indemnify: Review of company provisions crucial

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Liberty International Underwriters, part of Liberty Mutual Group Inc. of Boston.

Other insurers, as well as brokers and attorneys, agree that many organizations' indemnification provisions are out of date by as much as 10 years.

Company bylaws or certificates of incorporation dictate an organization's obligation to indemnify company officials and even their spouses for their legal expenses if they are named in directors and officers litigation. Organizations then seek reimbursement under Side B of the D&O policies they purchase.

Even if an out-of-date indemnifi-

tion filed in community property states, noted Ms. Longmore of Willis. Plaintiffs target the spouses to circumvent any attempts by defendants to protect their assets by shifting them to a trusted party who is not named in the litigation.

While most D&O policies presume spouses would be indemnified, most companies do not mandate spousal indemnification, Ms. Longmore said.

A far more significant problem with many indemnification provisions is they do not address advancing funds to cover executives' defense costs, according to Mr. Bailey.

Courts consistently have ruled that an indemnification requirement without a provision mandating advancements would force executives to bear their legal costs until their cases have been resolved, he explained.

"That's a frequent deficiency I see in bylaws' indemnity provisions," Mr. Bailey said. Corporate indemnification provisions should require, rather than permit, the company to advance those funds, he advised.

Mr. Bailey also noted that most states' indemnification statutes authorize companies to indemnify directors and officers under broader

circumstances than those statutes outline.

Typically, on a case-by-case basis, statutes permit a company's disinterested board members, independent legal counsel or a court to authorize indemnification when they are satisfied an executive acted in good faith in the company's best interest, experts said.

Courts are divided over how much more broadly companies can design their indemnification provisions, Mr. Bailey noted. To provide maximum protection for executives, companies should mandate indemnification "to the fullest ex-

tent authorized by law," including in cases of gross negligence and recklessness, he advised.

## Indemnifying execs

Indemnifying executives for their legal costs, however, is one area where some companies are considering bucking the trend of expanding indemnification—and is a move more companies should consider, according to some market executives.

Some companies are vetting their indemnification provisions "to de-

**Continued on next page**

**'I've seen a lot of "may" language go to "shall,"' as organizations have modified their indemnification provisions to better safeguard executives.**

*Lou Ann Layton  
Marsh Inc.*

cation provision is more restrictive than state incorporation law or does not address a risk that state law permits an organization to indemnify, most Side B D&O policies contractually impose that indemnification requirement on their policyholders through a presumptive indemnification provision, experts note.

Meanwhile, as more organizations purchase additional Side A coverage, some have discarded Side B coverage entirely. But Side A coverage responds only when state incorporation law bars a company from indemnifying covered individuals—regardless of whether the company has Side B coverage. Typically, Side A responds when the company is in bankruptcy or when the executives of a financially strong company face a derivative-action lawsuit.

## Key problems

A basic problem with corporate indemnification provisions is that their language mirrors state statutes by permitting, rather than mandating, indemnification, said insurer attorney Dan A. Bailey, a partner with Bailey Cavalieri L.L.C. of Columbus, Ohio. That could leave many executives inadequately protected, which is not the environment in which they would want to serve, he said.

Many organizations that have re-evaluated their indemnification provisions have detected and modified that language to better safeguard executives, said Lou Ann Layton, managing director and national D&O practice leader for New York-based Marsh Inc.

"I've seen a lot of 'may' language go to 'shall,'" Ms. Layton said.

For example, a common mismatch of indemnity provisions and D&O policy wording involves coverage for executives' spouses, whom plaintiffs sometimes name in litiga-

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## From HR to HERO

(All thanks to MetLife Disability)



PHOTO: AFP

The mounting cost of defending Enron Corp. executives such as former Chief Executive Officer Ken Lay underscores how a company can lose control over litigation funds.

Continued from previous page  
cide whether they should be tightened," said John Rafferty, vp and directors and officers liability product manager with Hartford Financial Products, a New York-based unit of Hartford Financial Services Group Inc.

With an eye on the cost of litigation over Enron Corp.'s collapse, about 20% of the clients of Lockton Cos. Inc. of Kansas City, Mo., are examining whether to tighten their defense cost indemnification provisions, said Dana Kopper, a senior vp and director with Lockton Financial Services in Los Angeles.

The Enron case underscores how a company can lose control over those funds, thereby also diluting its D&O insurance limits, said Mr.

Kopper and Brian Kawamoto, a Kansas City-based executive vp and managing director with Lockton.

Of Enron's \$350 million of D&O insurance, about \$200 million is still available, but defense costs are eating up at least \$5 million to \$6 million each month, said attorney William Lerach of Lerach Coughlin Stoia Geller Rudman & Robbins L.L.P. in San Diego. He represents the regents of the employee pension system for the Oakland-based University of California, the lead plaintiff in a fraud lawsuit against Enron and its executives.

Even if, as in the Enron case, executives plead guilty and cooperate with the prosecution, many D&O policies continue to cover defendants' legal fees until their cases

reach final adjudication—when the defendants are sentenced.

At that point, the company and the insurer may seek reimbursement of the funds they have advanced to defendants. But, "then, how do you get your money back?" when the defendant is going to jail and is bankrupt, asked John Keogh, president and chief executive officer of National Union Fire Insurance Co. of Pittsburgh, Pa., a New York-based subsidiary of American International Group Inc.

And out-of-court-settlements keep defendants tapped into D&O policy proceeds, because a settlement is not an adjudication.

"Companies want to have a liberal provision to attract directors and officers, but they also want to control the funds going out the door," Mr. Kawamoto said.

That would involve modifying not only the corporate indemnification provision but also D&O policy terms to cease coverage when, for example, a defendant negotiates a plea bargain or guilt is established in court, experts said.

As the D&O insurance market softens, risk managers generally are pressing for the final adjudication provision, market experts agree.

But, "we're suggesting that clients look at those personal conduct exclusions and tighten them up," Ms. Longmore said, referring to corpo-

**'Companies want to have a liberal provision to attract directors and officers, but they also want to control the funds going out the door.'**

*Brian Kawamoto  
Lockton Cos. Inc.*

rate indemnification provisions. Policy wording also can be altered to prevent corrupt officials from usurping policy limits, she said.

"The two should be worked at together to achieve the best outcome for the company," Ms. Longmore said. If a policy responds when there is no indemnification, "then your goal really hasn't been met."

"A majority of people haven't thought this through ahead of time and only do so during the claim process," Mr. Keogh said. "You need to do that before the policy is written" to ensure that the company controls defense cost funds without jeopardizing indemnification and coverage for innocent directors and officers, he noted.

Risk managers also must consider whether their D&O insurers would drop their presumptive indemnification provisions. If the insurers refuse and a company's indemnification provision is not as broad as state law permits, then executives could face a gaping hole in protection from where corporate indemnity drops off and Side B D&O limits pick up, market experts note.

For example, Chubb Corp. would "not reject" a policyholder request to drop its presumptive indemnification provision before evaluating how the buyer's modified indemnification provision might impact losses, said Tony Galban, the War-

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# Indemnify: Review of company provisions crucial

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 ren, N.J.-based senior vp and global D&O product manager with Chubb Special Insurance.

"That's going back to what we did in 1980-whatever," before the market widely adopted the presumptive indemnification provision, Mr. Galban noted.

But Mr. Dubois said that Liberty Mutual is "generally reluctant" to drop the provision.

"It's a significant safeguard that avoids abuse of the D&O policy" by preventing policyholders from unilaterally shifting Side B losses, which carry large retentions, to

first-dollar Side A coverage by refusing to extend corporate indemnification of those losses, he explained.

Mr. Bailey warned that a potential ramification of limiting indemnity could be "taking yourself out" of the Side A-only market.

Additional fallout could include lawsuits filed against the company by corporate executives facing unindemnified legal costs, Marsh's Ms. Layton said.

Ms. Layton said she has seen very few companies reduce their defense cost coverage, "because many suits are frivolous, and there are not that many bad actors. So I think clients

**Presumptive indemnification is 'a significant safeguard that avoids abuse of the D&O policy.'**

*Gary Dubois  
 Liberty International Underwriters*

are still striving for final adjudication, and underwriters are trying to not provide it."

Another problem is that some indemnity provisions require a company to cover legal costs of execu-

tives who sue the company or other executives, experts say.

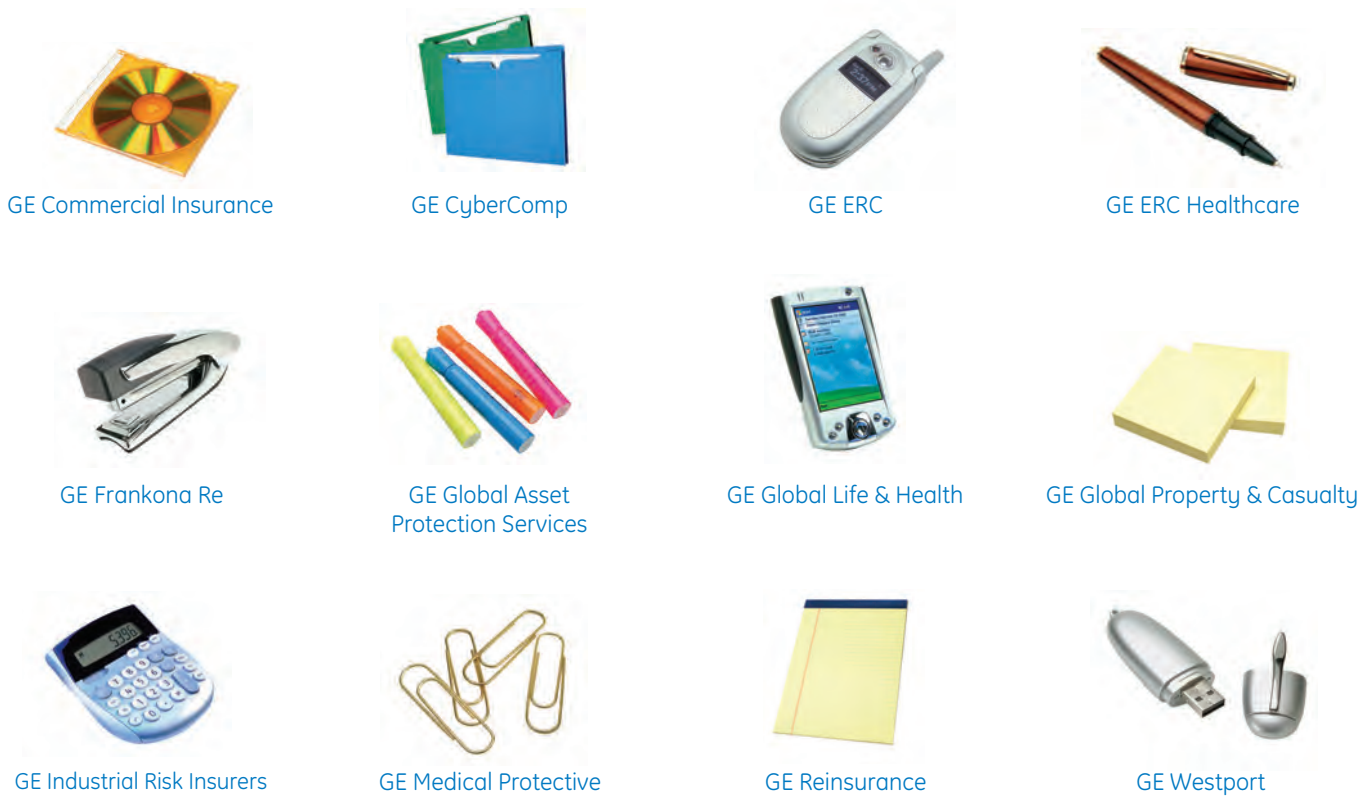
An indemnification provision that provides a contractual right to indemnification would preclude a company's current board from wrongfully denying indemnification to former board members, Mr. Bailey said. But loose indemnification wording could obligate the company to indemnify current and former executives for their legal costs in any type of suit they file against the company or other executives, Mr. Bailey noted.

Risk managers also should not forget to evaluate their global in-

demnification provisions, Willis' Ms. Longmore advised.

For executives of global subsidiaries, the indemnification provisions typically are narrow. Organizations traditionally have considered their executives' liability exposure to be much smaller overseas, where the legal environment has not been as litigious as it is in the United States.

But new case law overseas has been expanding executives' liability, Ms. Longmore said. Without expanded corporate indemnity, those executives could face a gap in protection, she said.



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# U.S. insurers broadening Side A policies

By GLORIA GONZALEZ

Although Bermuda has traditionally been seen as the home of the broadest Side A directors and officers liability coverage available, U.S. insurers have grown more competitive in recent years by expanding the scope of the coverage they offer.

Side A D&O policies directly cover company executives' losses when their organizations cannot indemnify them because of corporate governance or statutory restrictions.

The newest Side A policies, known as broad-form difference in conditions policies, can also offer coverage if the company refuses to indemnify the directors and officers. Brokers say this is an important feature because traditional D&O policies contain a presumptive indemnification provision, which states that the insurer assumes the company indemnifies to the fullest extent permitted by state law—even if the company doesn't provide that indemnification.

The broad-form DIC policies, however, respond to claims in the event the company refuses to indemnify individuals, even if an underlying D&O policy contains the provision. The broad-form DIC policies would cover the individual and pay defense costs and then subrogate against the company.

"The beauty of these A Side policies is that they step in and immediately protect the directors and officers," said Steve Shappelle, the Denver-based managing director of Aon Financial Service Group's legal department.

The broad-form DIC policies are especially popular with large companies, brokers say. For example, more than 50% of Marsh Inc.'s Fortune 100 companies purchase Side A DIC coverage, while about 40% to 50% of its Fortune 200 companies buy the coverage, according to Lou Ann Layton, managing director and national D&O practice leader of Marsh Inc., who is based in New York. The percentage of companies buying the coverage declines after that level because of price and the need for smaller companies to adequately protect both the company and directors and officers by buying full insurance vs. just Side A coverage, Ms. Layton said.

In the past, most companies purchased their Side A DIC coverage in Bermuda, but more companies are now buying it in the United States, she said.

Although the Side A policy written by Corporate Officers & Directors Assurance Ltd.—a subsidiary of Hamilton-based ACE Ltd.—is widely acknowledged to be the broadest policy form for Side A D&O insurance, some U.S. insurers now are writing policies that offer nearly the same scope of coverage, in some cases at a lower cost, market observers say.

But other factors further differentiate the Bermuda and U.S. markets, including dispute resolution provisions, the limits available, and the types of risks that each favors.

London D&O underwriters, meanwhile, have not expanded their Side A offerings significantly and tend to focus on tailored policies for specialized risks.

## Coverage differences

CODA's Side A policy is nonrenewable and can be canceled only for nonpayment of premium. In addition, it provides for full severability, meaning the policy provides coverage for innocent executives for losses generated by the illegal, and thus uninsured, acts of other executives.

The CODA policy also does not have exclusions for pollution, punitive damages, errors and omissions, or claims related to the Employee Retirement Income Security Act, while the few exclusions it does feature are difficult to invoke, observers say. For

example, its conduct exclusion can be triggered only after a final adjudication process finds misconduct.

"Bermuda is really the home of Side A coverage," said Patrick Tannock, senior vp-professional lines for CODA.

Other Bermuda insurers offer Side A policies with terms and conditions similar to CODA, brokers say.

As recently as 2002, Bermuda insurers essentially cornered the market on Side A D&O policies, but U.S. insurers have made strides in the last 18 months in gaining a share of that market, in part by making their policies less restrictive, observers say.

Although the U.S. policies often contain standard exclusions that Bermuda policies do not have, U.S. insurers have been willing to negotiate them out of the policies. U.S. policies, for example, in many cases contain pollution or ERISA exclusions that CODA does not, but the domestic insurers have been willing to remove exclusions in some cases.

"These don't have to be take-it-or-leave-it policies," said Carolyn Rosenberg, a partner and head of the insurance coverage group of law firm Sachnoff & Weaver in Chicago. "You have some flexibility to negotiate. And you should, because you're pay-

ing for this coverage."

However, U.S. insurers typically will not remove all of their standard exclusions. "The carriers are not anxious to give up all the tools in their arsenal to deny or rescind coverage," said Ann Longmore, senior vp and D&O product leader for the Executive Risks practice at Willis North America in New York.

Despite the changes U.S. insurers are making to their D&O policies, some basic differences remain that set the coverage apart from that generally available in Bermuda.

Under the domestic policies, U.S. insurers can be sued over coverage disputes in United States, while Bermuda policies mandate arbitration in Bermuda, Canada or England

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Continued from previous page to resolve coverage disputes.

"Bermuda does not subject itself to the U.S. jurisdiction," Mr. Shappelle said. "That's something that the domestic carriers are capitalizing on. It's of significance to a lot of people."

"If you are an individual D&O and you are having a dispute with your carrier, it may impose a burden to arbitrate that dispute in Toronto or London, rather than resolving the dispute in your home town," Ms. Rosenberg said.

The ability to resolve coverage disputes in the United States is an advantage U.S. insurers frequently cite.

"I think you're better off being here," said Greg Flood, senior vp and chief operating officer of National Union Fire Insurance Co. of Pitts-

burgh, Pa., a subsidiary of American International Group Inc. in New York.

In addition, Bermuda policies provide coverage for punitive damages that U.S. policies may not be legally allowed to cover because of state laws that deem punitive damages uninsurable. Bermuda insurers often cite this as an advantage to their policies, Mr. Shappelle said.

Whether this is an actual advantage, though, has not been tested, because most securities claims do not involve punitive damages, said John Schwonke, senior vp-financial services group at broker ABD Insurance & Financial Services in Redwood City, Calif. "It's a technical advantage, but it doesn't seem to be that compelling to most clients," he said.

### Other differentiators

While the wordings of Bermuda and U.S. Side A policies have come closer together, other factors still separate the two D&O markets.

Bermuda has the benefit of having a consistent claims history, as Side A policies have been available there for 20 years. As a result, Bermuda insurers can illustrate for buyers the ways in which their policies have performed in certain situations, while domestic forms may still have question marks because they are relatively new.

"It's going to be interesting, in this current litigation environment, to see how the domestic carriers step up to the plate," Ms. Longmore said. "On the underwriting side, there

may be some tightening up as the polices come into play."

The U.S. insurers, however, say they have had enough claims experience to properly evaluate and underwrite Side A risks.

"The underwriting we've taken on has done a good job in pricing risks appropriately," said Rob Schueler, a Hartford, Conn.-based vp of St. Paul Travelers Cos. Inc. "We're pleased with the results to date."

Bermuda's underwriting model tends to be more conservative, focusing on well-managed, financially sound Fortune 1000 companies, while U.S. insurers are more willing to write nontraditional risks—such as initial public offerings—or industries, such as technology companies, that can see big stock fluctuations, brokers

and insurers say.

"We've been an open market to just about every industry out there," Mr. Schueler said.

Bermuda insurers tend to focus on large, stable companies and generally will not write Side A policies for small to midsize companies. These companies, however, have found a home in the U.S. market as the appetite of U.S. insurers for Side A coverage has grown, brokers note.

Although U.S. capacity for Side A D&O insurance is increasing, large companies purchasing substantial limits often go to Bermuda because domestic insurers generally do not offer the same limits, brokers say. For example, CODA will offer up to \$75 million in Side A D&O, while most domestic insurers offer limits of \$25 million.

The Bermuda marketplace has the ability "to deploy large limits more efficiently," Mr. Tannock said.

ABD's Mr. Schwonke agreed, saying large companies purchasing hundreds of millions of dollars in limits use the Bermuda market.

Although some brokers note that Bermuda's coverage can be more expensive, others say the two markets are competitive in their pricing.

"The gold standard is not a cheap standard to buy," Willis' Ms. Longmore said. "Pricing in Bermuda is very stable, but it generally starts at a higher rate than the U.S. They don't really want to get into a price war with anyone."

Other brokers say pricing in the two regions is comparable and not much of a factor when buyers make decisions on their Side A coverage.

"I don't think one jurisdiction stands out as having better pricing than the other," said Marsh's Ms. Layton. "I don't see Bermuda being cheaper or more expensive."

"CODA can sometimes be more expensive, but in the current environment, it's quite competitive," Aon's Mr. Shappelle said.

Buyers purchasing D&O cover in the domestic market do not have to pay the 4% federal excise tax that those purchasing in Bermuda must, which may be a pricing advantage for U.S. insurers, brokers say.

### London limits

London is not considered a major player in the Side A D&O market.

"London has not been an issue for us competitively in the last few years," National Union's Mr. Flood said.

Underwriters at Lloyd's of London tend to focus on creating tailored Side A D&O policies for specific clients but have not expanded their capacity for Side A coverage.

"There's a general reduction in appetite for U.S. D&O business, certainly securities-exposed business," said Rick Welsh, unit head, management liability for SVB Syndicates Ltd. in London.

With ample capacity in the U.S. and Bermuda markets and U.S. insurers so eager to accommodate broker requests on policy wording, brokers have little reason to place their Side A business in London, he said.

Pricing can also be a disadvantage for London. "The rates started softening in the U.S. and Bermuda more than they did in London," Mr. Welsh said. "I'm not sure we would like to follow the market down."

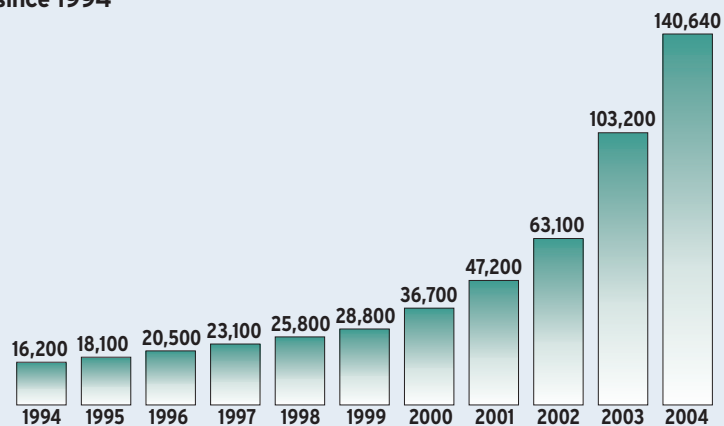
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## BARIATRIC SURGERY TRENDS

Estimated number of bariatric surgeries performed since 1994



Source: American Society for Bariatric Surgery

# Surgery: Bariatric procedures

Continued from page 10  
to the small intestine.

At the same time, high-profile gastric bypass surgeries performed on such celebrities as pop singer Carnie Wilson, NBC weatherman Al Roker and American Idol's Randy Jackson, have also further publicized the surgery and fueled additional consumer demand for the procedure.

In 2004, the number of bariatric surgeries performed is expected to top 140,000, according to the Gainesville, Fla.-based American Society for Bariatric Surgery. That is up 36.3% from the number of pro-

cedures performed in 2003 and up 122.9% from estimated 63,100 procedures performed in 2002.

But it's not just demand for the procedures that is inducing hospitals to offer bariatric programs, experts say. With an average price tag of \$25,000 per surgery—of which surgeons receive between \$6,000 and \$8,000 and the hospital the rest—it's become very lucrative for bariatric surgeons and the hospitals that offer bariatric procedures today.

And that can be a risky proposition.

"It's a lot more dangerous than

hospitals perceive," said Terri Edwards, a vp with Palmer & Cay Inc.'s health care industry practice in Atlanta. "A lot of facilities are convinced that it's a quick way to make money because there's a lot of need for it. It's gone beyond health issues, and is now almost becoming cosmetic," she said, of the procedures. "We're not doing enough research into why a patient is seeking this type of surgery and whether all other areas have been exhausted as far as the patient being able to lose weight. People don't realize it's a very, very drastic procedure."

In reality, "you're doing very extensive abdominal surgery on very sick people—people with very significant co-morbidities," said Paul Simonson, a plaintiff attorney in the New York law firm of Simonson Hess & Leibowitz P.C. "Putting aside the malpractice issue, I think there is significant risk of interoperative complications, postoperative complications and certainly postoperative leaks, which are probably the most common source of problems that result in litigation," he said.

"On the average day, we will see five to 10 inquiries from gastric bypass patients. That doesn't mean that every one of them has a malpractice case—far from it—but they all have problems of some nature," Mr. Simonson said.

Experts say most of the medical malpractice cases today from bariatric surgery arise from postoperative complications.

"I think the issue of infection is very significant," said Scott D. Buchholz of Dummit Briegleb Boyce & Buchholz in San Diego. "The only thing that is special with regard to this surgery as opposed to other abdominal surgery...is the issue of the stapler," he said. "Quite often, the surgeons do their best to staple off...the stomach and sometimes the staple breaks or it doesn't affix. And any time you get stomach contents in the abdomen area, you're talking infection. And when you have infection with these people, whose immune system is already compromised, not just because of the surgery but because of underlying co-morbidities, it's like a wildfire."

Another issue is the "mentality of the surgeons," according to Mr. Simonson said. In many instances, he said, surgeons "know that something is a complication and that it can occur with good techniques, but when it happens to them, they don't want to believe that it is happening to them. And that is where we see a lot of delayed diagnosis in anastomotic leak cases where people...are dying," he said.

Further complicating the issue, Mr. Buchholz noted, is that in order to determine whether there is a leakage problem with the staple, a computerized axial tomography scan is needed, and typical CAT scan machines are built only to fit patients weighing up to 400 pounds.

"So you've got to make sure you've got the right-sized CAT scan that can hold 750 pounds or 1,000

See **SURGERY**/page 22

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## Surgery: Bariatric procedures

Continued from page 20

pounds. I've got a couple of cases where I've dealt with patients who claim there was a delay in finding out there was a staple problem because (the hospital) couldn't fit them into the CAT scan," he said.

Indeed, experts say that having the appropriate hospital equipment to handle obese patients, though very expensive, is necessary to minimize their exposure to potential malpractice claims.

"Patient safety is a big issue," said Wendy Campbell of San Diego-based legal and risk management consulting firm Campbell & Associ-

ates. "The hospital can certainly mitigate some of its risk with the appropriate equipment."

This includes lifting and moving devices, wheelchairs, beds, shower chairs, walkers and special clothing designed to fit obese patients, she said. "All of these are available, but they really need to be considered and obtained prior to providing the service."

Having competent and trained staff within the bariatric program—from the physician down to the nutritionist—also is very important in mitigating medical malpractice exposure, experts say.

"From a risk management standpoint, a great, great deal of the issue deals with the number of procedures that you perform and how skilled and trained the surgeons are," said Peggy Nakamura, assistant vp, chief risk officer and associate counsel for Adventist Health System/West in Roseville, Calif. The facility offers bariatric surgeries in three of its hospitals, two of which began offering the procedures within the past year.

"In each of our situations, the surgeons who were instrumental in getting the program started had participated in hundreds and hun-

dreds of bypass and other types of bariatric procedures prior to getting our program started," she said. "That's been a tremendous asset for those programs. We're not talking someone who's maybe done 10 procedures, we're talking about people with years of experience in this area."

Indeed, plaintiff's attorney Mr. Simonson said that if he were setting up a bariatric surgery program at a hospital today, he "would definitely set up some minimum standard for experience before I would allow (surgery) privileges. And if they were going to do laparoscopic surgery...I would require a fellowship in minimally invasive surgery before I allowed someone to do bariatric surgery laparoscopically,"

he said.

"Training of the staff is essential; all the staff, meaning nursing, radiology, food/nutrition services, social services, intake. It's really a multidisciplinary approach," Ms. Campbell said. Medication dosages, for example, are different with obese patients and nurses need to know that in addition to all the other postsurgical procedures that go along with abdominal surgery and obese patients, she said.

Although many hospital risk managers may take the initiative in implementing such policies and procedures, in some cases, medical malpractice insurers are demanding that such practices be in place before issuing a policy.

"We can and will provide coverage for facilities that are performing bariatric procedures provided we can underwrite to the exposure and feel comfortable with the risk," said Meg Gaffney, medical malpractice product manager for Avon, Conn.-based One Beacon Professional Partners.

**'Patient safety is a big issue. The hospital can certainly mitigate some of its risk with the appropriate equipment.'**

*Wendy Campbell  
Campbell & Associates*

# 20:20

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One Beacon looks at how many surgeries the physicians perform each year and whether physicians are certified by the American Board of Surgery to practice bariatric surgery. The underwriter also wants to know more about the time interval between when a patient makes the decision to undergo the procedure and when the surgery is performed, Ms. Gaffney said.

"In our opinion, the longer the interval the better, because we feel that during that period of time, there should be a counseling component for the patient and a nutritional component between the patient and the provider." Patients also should demonstrate that all nonsurgical means and methods of losing weight have been exhausted, she said.

Zurich American Insurance Co. also is taking a closer look at hospitals providing bariatric surgery, according to Susan Salpeter, assistant vp-health care risk management services in Chicago.

"We look at how they credential their physicians" and whether they are following the American Society for Bariatric Surgery guidelines for granting privileges in bariatric surgery, she said. Zurich also looks to see if the hospital is training its staff, has the appropriate equipment and is putting together a team approach so people in nursing, anesthesia, surgery, mental health and nutrition are all working together.

"We also look to see if they have criteria for patient selection," Ms. Salpeter said. "It's always a big concern to be sure they are (performing the surgery) on the people who need the procedure and are committed to a really long-term life changing procedure," she said.

# Attorneys swing for nonpayment court countersuits

## Lawyers advised on steps to reduce risk of E&O claims

By MEG FLETCHER

Lawyers that sue clients to recover unpaid fees may get more than they bargained for.

In some cases, such litigation spurs clients to countersue, alleging professional negligence against the firms. While clients' malpractice allegations vary and opinions differ on the extent of the problem, lawyers and insurance industry representatives agree that there are steps lawyers can take to reduce the risk of being sued by a nonpaying client.

"We absolutely are seeing an increase in countersuits against attorneys that sue for fees" by companies of various sizes, said George T. Rawding Jr., vp-business development and professional markets for Bertholon-Rowland Corp., a division of USI Affinity in Briarcliff Manor, N.Y. His company is the administrator of lawyer professional liability insurance programs nationwide; approximately 18,000 law firms participate in the programs, many of which are affiliated with state-specific bar associations.

The Oklahoma Attorneys Mutual Insurance Co. estimates that about 7% of all pending lawyer malpractice claims stem from a lawsuit for fees, said Phillip D. Fraim, president and chief executive officer of the Oklahoma City-based insurer. "I think that is a pretty constant average," he said.

The Hartford Financial Services Group Inc., though, has not seen a significant number of such claims, said Robyn Golden, vp-underwriting manager of the insurer's lawyers professional liability division in New York.

A typical claim that falls under a lawyers errors and omissions policy alleges that the lawyer was negligent for not performing his or her duties as a reasonable professional should have performed them, said John Sachs, a partner with the New York-based firm of Ohrenstein & Brown L.L.P.

That allegation also is among those cited in malpractice claims filed in response to lawsuits for fees, according to Messrs. Rawding and Fraim.

In addition, they both agreed that other alleged errors in fee-related lawsuits include failure to know and properly apply the law; failure to know and follow deadlines; failure to perform adequate discovery or investigation; and failure to obtain consent or keep the client informed.

Allegations of malpractice can hurt not only a lawyer's reputation but also his or her bank balance. They face potentially higher insurance premiums merely from the fact that such a lawsuit has been filed, regardless of its outcome.

"There are a lot of admitted carriers that won't write a law firm with any open or pending lawyer liability claims," said Terri Galentine, an underwriter with Allsouth Professional Liability Inc., a Tampa, Fla.-based wholesale broker. Such firms

typically have to get coverage from surplus lines insurers, which is "generally at a higher cost because they are considered higher risk," she said.

To avoid such problems, attorneys and underwriters recommend that lawyers take several steps.

Ms. Golden urges lawyers to have "a good client intake program," including screening new clients to ensure that their credit rating are good and they are considered responsible by industry peers.

Most sources recommend that lawyers send new clients a clearly worded letter outlining the services and fees.

But many lawyers "are reluctant to send retention letters at all, because it casts a pall on what might be a long-term relationship," said Fred Warder, a partner with Patterson, Belknap, Webb & Tyler L.L.P. in New York.

When work is completed, Mr. Rawding also recommends that lawyers send a "disengagement" let-

ter to ensure that the client understands that the lawyer is no longer involved with the case.

In addition, lawyers increasingly are including provisions for arbitration of disputes, said David Schack, an attorney in the Los Angeles office of Kirkpatrick & Lockhart L.L.P.

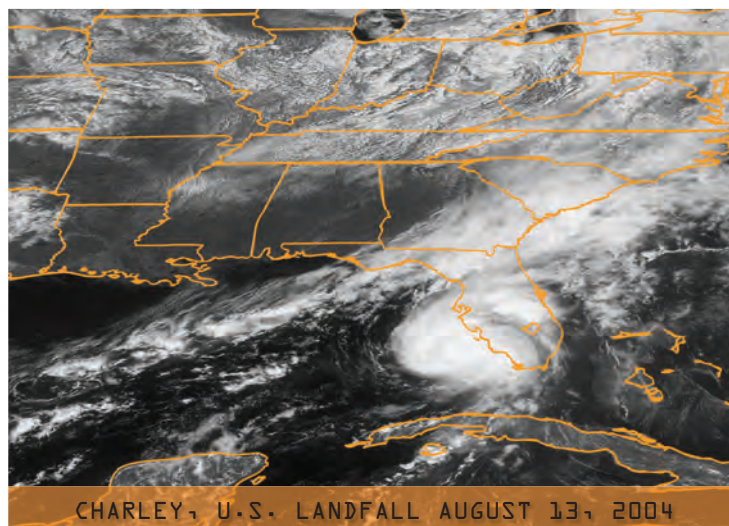
Once a relationship is established between the law firm and the client, it is important to manage billing appropriately, sources say. For example, clients with transactional work should be billed routinely and records kept about past-due payments. Meanwhile, clients whose work is taken on a contin-

gency-fee basis are typically billed after the legal dispute is resolved.

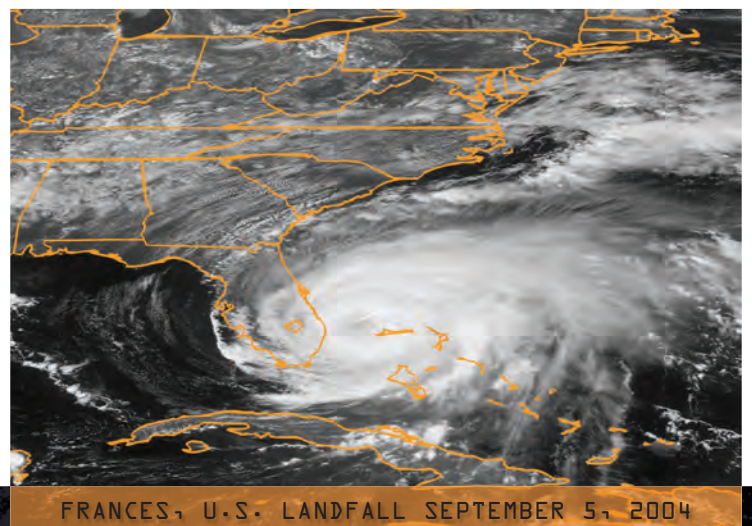
If bills remain unpaid, a patient attorney may be able to take advantage of a state's statutes of limitation, Mr. Sachs said.

Under New York law, for example, the statute of limitations for a client to sue an attorney for malpractice is three years, while the statute of limitations for breach of contract is six years, he said. Some attorneys wait until three years have passed to pursue payment of bills to avoid the possibility of clients filing retaliatory lawsuits, he said.

Last time this happened, Cleveland was president.



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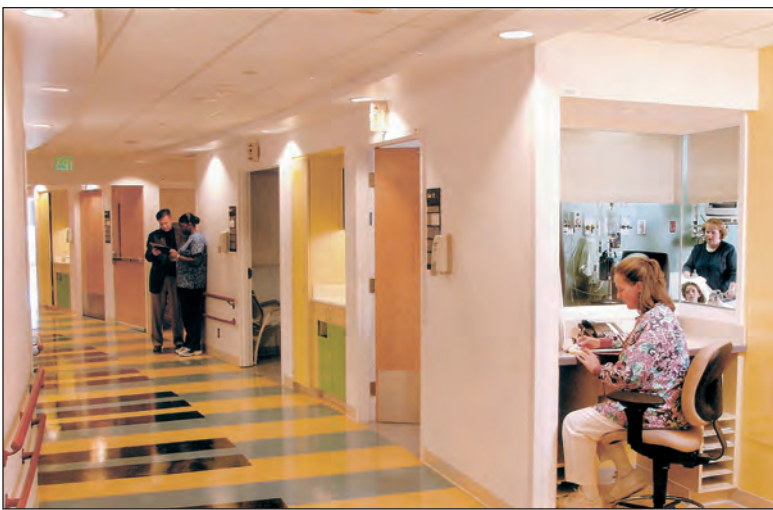
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The 2001 death of a toddler treated at Johns Hopkins Children's Center in Baltimore led the hospital and the child's family to establish a program to address medical errors and patient safety issues.

## Mistakes: Cutting legal costs

Continued from page 4

2001 after a series of errors at Johns Hopkins allowed her to dehydrate. The child was receiving medical care at the facility for scalding burns she suffered after climbing into a family bathtub and filling it with hot water. At the time of her death, she was recovering from her burns and was expected to be released shortly.

The head of the facility's medical staff came to the young girl's family home to explain what the facility had learned from the tragedy, Ms. Wire explained.

The visit rechanneled the fami-

ly's energy, Ms. Wire said. Instead of focusing on a court battle with Johns Hopkins, the family negotiated a settlement and used the proceeds to establish the Josie King Pediatric Patient Safety Program at Johns Hopkins.

The program is designed to improve the systems of care at the Children's Center. The key to the program is understanding why medical errors happen so that they can be prevented. Traditionally, hospital error reviews have focused on an individual's action rather than the system in which the error occurred, according to materials on

the safety program's Web site, [www.josieking.org](http://www.josieking.org).

By following critical steps, other hospitals at the center of malpractice incidents can greatly improve their chances of similarly working constructively with patients or their families, Ms. Wire said.

After a treatment error, risk managers should:

- First ensure that the event is reported early and completely to the involved physician's medical malpractice insurer to obtain its support for compensating the patient or the patient's family before a contentious claim dispute erupts.

That will require the cooperation and support of the physician who made the error. But obtaining the physician's support could be challenging if he or she believes the penalty for cooperating will be the loss of coverage, Ms. Wire said.

"What I find is they want moral support," she said. "Doctors really

**'Doctors really want to disclose' medical treatment errors. 'They're just scared to' because outside of a hospital setting, 'they're just massive bundles of insecurity.'**

*Kathryn K. Wire  
Wire Risk Strategies*

want to disclose" medical treatment errors, she said. "They're just scared to" because outside of a hospital setting, "they're just massive bundles of insecurity."

To that end, all physicians should be educated about the hospital's patient disclosure policy before an event, Ms. Wire said.

Ms. Wire noted that some malpractice insurers are easier to work with than others, "but this only works if the doctor is willing to report the event" to his or her insurer.

- Contact the patient or family "when it's clear an event happened" but before a claim is filed.

Again, "the physician has to be involved if he or she is potentially liable," Ms. Wire said.

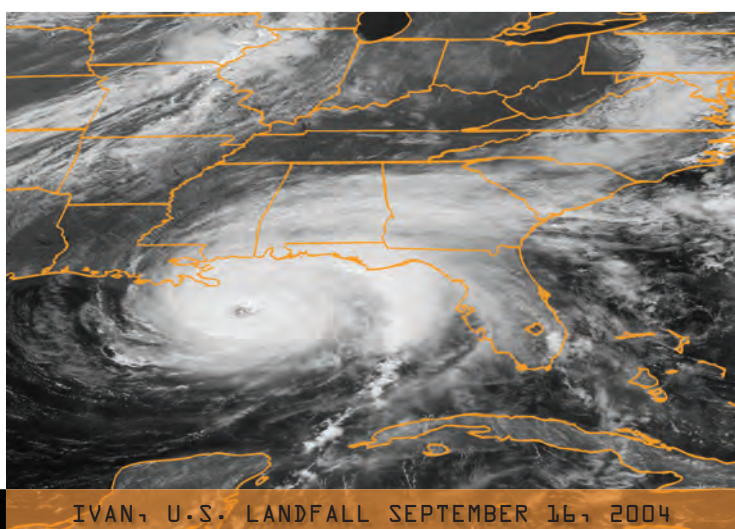
In discussions with the patient or family, "if there's an issue about patient care in the future, it's best for the physician to address that," Ms. Wire said. "But the risk manager should be the money person."

Ms. Wire explained that the person who is being "warm and fuzzy" in disclosing the treatment mistakes and how that will be corrected in the future should not be the same person who might have to reject some demands for damages that the hospital considers excessive.

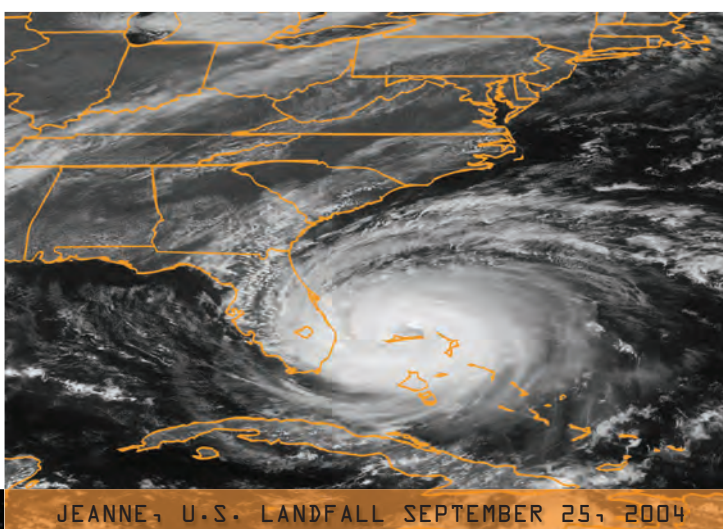
The risk manager also should clearly present the patient or family with a timeline of the process involved in procuring their damages.

In addition, the risk manager should be prepared to explain to the patient or family what kind of information about the event cannot be shared and why, Ms. Wire said.

See **MISTAKES**/next page



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# Mistakes: Admitting errors can cut litigation costs

## Continued from previous page

• Confer with the physician's insurer early enough to be able to settle with the patient or family immediately after closing the hospital's investigation of the incident.

The window for reaching an early settlement opens with the event and closes shortly after the investigation ends, Ms. Wire said.

"You have to be ready to resolve the claim then. The earlier you can talk business, the more seriously the patient or family will take your position," she said.

Ms. Wire also reminded risk managers that an incentive for the pa-

tient or family to settle early is that, typically, an attorney is not entitled to a portion of a settlement offered to the plaintiff before the attorney became involved in the case.

• Make sure the hospital conducts a thorough investigation.

Ms. Wire stressed that, despite many risk managers' thoughts to the contrary, an investigation is not the first step the hospital should take. She said the investigation should try to determine the root causes behind the error.

The staff and attending physician should be involved, but the risk manager need not direct or control

**'One of the strongest emotions by a family is that they didn't suffer a loss for nothing.'**

*Kathryn K. Wire  
Wire Risk Strategies*

the investigation, she said. But the investigation should avoid using the same physicians who participate in peer reviews, because doing so could destroy the confidentiality of the peer review process, Ms. Wire said.

The results of the investigation should be reported to the hospital administration and the physician's malpractice insurer as soon as possible, Ms. Wire said.

• Get authority to offer the patient or family a settlement, if the facts warrant it.

• Make a thoughtful, clear and complete presentation of the facts surrounding the event to the patient or family.

"Think of it as a closing argument of a trial," Ms. Wire said.

The risk manager should be prepared at this point to discuss all facts that are not going to be pro-

tected and a settlement amount. "This is the time you lay it all out on the table," Ms. Wire said.

If the facts of the case point to the need for a system change in the hospital, then the hospital should take the appropriate measures to make that change. Suggestions from the patient or family should be encouraged, and their ideas should be incorporated into fixing the system problem that led to the treatment error, Ms. Wire said.

"One of the strongest emotions by a family is that they didn't suffer a loss for nothing," she said.



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## Record number attend ASHRM conference

**ORLANDO, Fla.**—A record 1,900 attendees participated in 49 different educational sessions and visited 153 exhibitions and at the 26th annual American Society for Healthcare Risk Management's annual conference and exhibition in Orlando, Fla., Oct. 17-20.

ASHRM attendees also learned that the organization plans to offer a new patient safety curriculum and an online risk financing course next year.



Members also can sign up for patient safety or risk financing/claims administration "interest networks."

ASHRM will send members that sign up for a network an electronic newsletter with content that focuses on their particular area of professional interest.

More information on the new educational and newsletter programs is available at [www.ashrm.org](http://www.ashrm.org).

At a luncheon during the conference, ASHRM's incoming board and president were sworn in. The organization's new officers are scheduled to take office on Jan. 1.

ASHRM's 2005 conference and exhibition is scheduled for Oct. 23-26 at the Henry B. Gonzalez Convention Center in San Antonio. Additional information about the event is available by contacting ASHRM at 312-422-3980.

## ASHRM 2004 Annual Conference &amp; Exhibition

# Simple tools can help in managing enterprise risk

## Theory of ERM often discourages hospitals from adopting method, consultants contend

By **DAVE LENCKUS**

Moving from the theory of enterprise risk management to its practical implementation is far easier than hospital risk managers may expect, according to a panel of health care risk management consultants.

Discussions and papers on enterprise risk management often are "too academic and too theoretical," said Janet L. Hale, a Houston-based executive vp of Capital Risk L.L.C., a unit of Jardine Lloyd Thompson Group P.L.C. of London.

That problem has discouraged many risk managers from adopting the enterprise risk management approach, she said.

**Enterprise risk management is 'similar to what you're doing now, but it's a broader look at both the internal and external risk. You really have to protect the entire corporate family,' which includes clinic facilities, joint ventures and outsourced operations.**

*Janet L. Hale  
Capital Risk L.L.C.*

But there are some simple tools available to aid risk managers who want to move from "theory to action," Ms. Hale told a group of attendees during a session at the American Society for Healthcare Risk Management's recent annual conference and exhibition in Orlando, Fla.

"It's a new world" for hospital risk managers, and it goes beyond medical malpractice, workers compensation and property risks, Ms. Hale said.

"Risks are changing daily," she said. Risk managers now have to be wary of, for example, risks associated with research conflicts of interests, the misuse of federal grants, hackers accessing medical files, improper organ removal, inaccurate Web site information, the performance liability of temporary nurses and new surgical departments that perform procedures on patients trying to control their weight (see story, page 10).

"Enterprise risk can assist you in evaluating new risk in your institution," Ms. Hale said.

Risk managers can adopt that approach even though they do not have a background in all of the disciplines that enterprise risk management models suggest they have, she said. Those disciplines include insurance, economics and law.

While gathering and sharing information can be difficult in a large

organization, enterprise risk management boils down to analyzing how to treat risk, Ms. Hale said.

"It's similar to what you're doing now, but it's a broader look at both the internal and external risk," she said. "You really have to protect the entire corporate family," which includes clinic facilities, joint ventures and outsourced operations.

But because of all the disciplines involved, "you can't do it all your-

self," said Robin Maley, president of Maley Healthcare Strategies of New York.

Risk managers first should identify the various domains of risk in their facilities, Ms. Maley said. Those areas would include operations or clinics, finance, human capital, strategic customer and community relations, legal, regulatory and technology.

Support from top management

and middle management is equally important, according to Ms. Maley. Risk managers must count on middle managers in gathering information on risk from across the enterprise, but their cooperation could be languid without visible top management support, she said.

An effective tool that could help muster top management support is a strategy and risk management matrix, Ms. Hale said. The matrix

outlines the company's key long-term and short-term goals, the risks associated with those goals and proposed measures to mitigate those risks.

"If you align these and present them to senior management, I guarantee you that you'll get some attention, you'll get more respect and you may even get more money," Ms. Hale said.

See ERM/next page



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Hospitals can use some simple tools to manage their enterprise risks, risk management consultants say.

## ERM: Easing the transition to enterprise risk management

Continued from previous page

Ms. Hale suggested planning a one-day retreat annually with the company's chief executive officer, chief operating officer and chief financial officer to review the organization's goals and to sort out how risk management can help achieve them.

In enlisting support from middle managers, risk managers should ask those responsible for their facilities' various functions and processes to identify risks in their areas and to

help develop plans to mitigate them, Ms. Maley said.

Risk managers could solicit the managers' help in a setting as formal as a group retreat or as informal as one-on-one lunches, she said.

When identifying risk, managers of various functions and processes should consider the current trends in their area and anticipate where litigation could arise for their facilities, Ms. Maley said.

The risks should be ranked by severity and frequency, she said.

"Seventy-five percent of the risks you'll come up with either are not managed or not covered by insurance," said Ms. Maley, underscoring a graphic of hospitals' enterprise-wide risk that Ms. Hale displayed earlier in the session.

Next, plans to address those risks must be developed. But each plan must be tailored specifically for each risk, Ms. Maley emphasized. "It's not one set of controls for all business units," she said.

For example, one hospital discontinued a blood bank because poor management created too much risk for the facility, she said.

Another hospital that began conducting clinical trials redesigned its captive insurance program to cover

**Hospital risk managers 'need to keep an eye on' the marketing department. 'Marketing just wants to do the deal' and often does not consider the risk management implications.**

Robin Maley  
Maley Healthcare Strategies

risks that could arise from that new operation, she said.

Through policies and procedures, risk managers also have to be "wired" into their facilities' various business units so they have advance knowledge and input into new business undertakings, Ms. Maley said.

Without that, facilities often overlook risks associated with research, marketing and advertising, contracts and outsourcing, she said.

Besides the assistance necessary from middle management, risk managers should consider establishing an enterprise risk management roundtable, Ms. Maley said. The roundtable of executives from various disciplines at the hospital would provide the risk manager, acting as a chief risk officer, the background necessary for creating and implementing an enterprise risk management plan that is tied to the company's goals, she said.

The roundtable should include the directors of operations, the medical staff, research, legal, safety, human resources, information technology, marketing, regulatory and compliance and finance.

Ms. Maley noted that "one of the most difficult things to do is to get the medical staff to the table."

In addition, risk managers "need to keep an eye on" the marketing department, she said. "Marketing just wants to do the deal" and often does not consider the risk management implications, she said.

Bonnie Boone, an Oakbrook Terrace, Ill.-based executive vp with Capital Risk, also spoke at the session.

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# Csiszar: State-based regulation in need of overhaul

## Continued from page 4

would necessarily be an improvement.

"Be careful when you go to the federal government. We may end up with something" worse, he warned.

Indeed, while state insurance departments may be drowning in a sea of bureaucracy, the federal government has its own bureaucratic tendencies, he noted.

In Washington, there are huge bureaucracies in many federal agencies, he noted, which each year churn out thousands of pages of notices and regulations. In addition, federal politics can interfere with effective regulation, he said.

Mr. Csiszar, noted for example, that the political consideration of making coverage widely available has taken precedence over sound underwriting in one of the few insurance programs—flood insurance—in which the federal government is involved.

Rather than moving to federal regulation, "We have to work with each miserable state" to improve the quality and focus of insurance regulation, Mr. Csiszar said.

Turning to other areas, Mr. Csiszar said he is puzzled by the market conduct of some insurers, which he said tend to jump in and out of markets and are too quick to raise rates after a loss.

"You can't raise rates 300% in one year because of one claim," he said.

Similarly, some insurers don't closely examine the experience at an individual risk.

"You can't paint everyone with the same brush," he said.

That lack of careful underwriting is driving buyers to the alternative risk financing market, such as to

**'If insurers go in and out of markets,' buyers will look at alternatives to better assure themselves of coverage stability.**

*Ernst Csiszar  
Property Casualty Insurers  
Assn. of America*

risk retention groups. "If insurers go in and out of markets," buyers will look at alternatives to better assure themselves of coverage sta-

bility, he said.

Mr. Csiszar frankly acknowledged that some state insurance commissioners have yet to accept RRGs, an opposition rooted in their resentment of the federal pre-emption of their authority to regulate RRGs.

Still, Mr. Csiszar said, RRGs have to accept that the federal law that authorized them does impose certain restrictions on their activities. For example, RRGs only can provide commercial coverage to policyholder-owners, and not to the public.

If RRGs breach that rule, then

they have to abide by the rules traditional insurers have to follow, he said.

Mr. Csiszar told the NRRA attendees that buyers and insurers will need to make bigger financial contributions to political campaigns if they are to have any chance of reforming the nation's tort system.

"Money is the mother's milk of politics," he said.

While the trial bar understands that hard reality, many insurers do not, he said. "We need to dig into our pocketbooks" to gain access to legislators, he said.

Consider the possibilities.



## Over 100 at NRRA conference

**WASHINGTON**—More than 100 people attended the National Risk Retention Assn.'s annual conference Oct. 18-19 in Washington. Attendees heard speakers on a wide range of topics, including the failings of state regulation of the insurance industry, problems risk retention groups continue to face in dealing with state

regulators, and the status of a Government Accountability Office report examining how well the Risk Retention Act is working.

The NRRA has not finalized the exact date of its 2005 annual conference, though NRRA officials say it will be held in Philadelphia sometime in October 2005.

The NRRA, whose membership includes risk retention groups, risk purchasing groups, insurers, reinsurers and other service providers, can be reached at 952-928-4656 or at [www.nrta-usa.org](http://www.nrta-usa.org).



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## 2004 NRRA National Conference

# Some states still levying fees on RRGs, raising costs

By JERRY GEISEL

**WASHINGTON**—State-imposed fees on risk retention groups, which the groups say violate federal law, are driving up RRG costs.

While the fees, which include registration, application, examination, annual and renewal fees, individually don't amount to much—some are as little as \$100—they add up, said Robert H. Myers Jr., Washington counsel for the National Risk Retention Assn.

Speaking earlier this month in

Washington at the annual NRRA conference, Mr. Myers said an RRG operating in all 50 states can be hit with as much as \$25,000 in fees.

The fees not only are costly, but they also violate the Risk Retention Act, the federal law that authorized RRGs, which are special captive insurers that write commercial coverage for policyholder-owners.

While the state in which an RRG is licensed can charge it various fees, the only financial assessments other states can impose on the groups are premium and other tax-

es they charge other insurers, said Mr. Myers, who also is a partner with Morris, Manning & Martin L.L.P.

A fee, Mr. Myers noted, is not a tax and thus is pre-empted by the Risk Retention Act.

Congress specifically excluded RRGs from assessments other than premium and other taxes because legislators wanted the groups to operate in the most cost-efficient way, RRG advocates often have said.

This interpretation of the Risk Re-

tention Act has, in fact, been upheld by several courts.

In what was believed to be the first ruling on the issue, a federal judge in 1996 said the Risk Retention Act pre-empted a Louisiana law that, among other things, imposed an annual \$1,000 examination fee on RRGs licensed in other states that wanted to do business in Louisiana. Judge John Parker said that under the Risk Retention Act, a nondomiciliary state lacked the authority to impose an examination fee as a prerequisite of providing

coverage to the group's policyholders in Louisiana.

And more recently, a federal judge said the Risk Retention Act pre-empted the Michigan Office of Financial and Insurance Services from imposing a fee on premiums paid by policyholders for coverage written by RRGs licensed in other states (*BI*, Dec. 10, 2001).

But those court victories haven't deterred states from imposing fees. Indeed, earlier this year, the Louisiana Legislature passed a measure that imposed a new \$1,000 registration fee on RRGs licensed in other states that provide coverage to Louisiana policyholders.

Mr. Myers said he has written to Louisiana insurance regulators protesting the new fee, but said he has not yet received a response.

Fees aren't the only problems RRGs are facing from states.

Sanford Elsass, president and chief executive officer of Uni-Ter Underwriting Management Corp. in New York, which has assisted in the formation of several RRGs providing coverage to assisted living facilities, says states in some cases have requested notarization of information supplied to them, which the Risk Retention Act does not require.

Problems RRGs have had with state regulators are nothing new. In fact, they started almost from the time Congress in 1981 passed the original Risk Retention Act.

Mr. Myers said one reason RRGs have faced difficulties with state regulators is that some resent the federal pre-emption of their authority.

RRGs "are not beloved" by regulators, said Ernst Csiszar, president and CEO of the Property Casualty Insurers Assn. of America and a former director of the South Carolina Department of Insurance and president of National Assn. of Insurance Commissioners.

But not all the problems RRGs have encountered with states have been the result of state hostility, Mr. Myers said. In many cases, state regulators and officials simply do not understand RRGs and the federal law that created them.

"There is a lot of misunderstanding out there," and that has been the case for many years, he said. "If we could improve understanding of the law," problems RRGs face at the state level likely would be reduced, he said.

Some state regulators do respond quickly and appropriately when told that actions they have taken involving RRGs are at odds with the Risk Retention Act.

For example, after being contacted by NRRA and told the requirement violated the act, a New Jersey guaranty fund earlier this year rescinded an order that RRGs licensed in other states pay into the fund that compensates victims of car accidents caused by uninsured or unidentified motorists, Mr. Myers said.

The fund attributed the problem to a clerical error.

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**2004 NRRA National Conference**

# RRG report will be first federal analysis in 15 years

By **JERRY GEISEL**

**WASHINGTON**—The first comprehensive government analysis in 15 years of how well the federal Risk Retention Act is working should be released early next year.

For nearly a year, the Government Accountability Office has been collecting information to determine the impact risk retention groups—the special, multiple-owner captive insurance companies authorized by the 1981 federal law—have had on the availability and affordability of commercial liability insurance.

**The Government Accountability Office report will look at both the impact risk retention groups have had on the market and other significant issues related to implementation of the Risk Retention Act.**

The last federal analysis of the law was done by the U.S. Department of Commerce in 1989, just three years after Congress expanded the original law to allow RRGs to cover all commercial liability risks other than workers compensation. The 1981 law limited RRGs' scope to the funding of product liability and completed operations coverage. The intent of both laws was to give buyers of commercial insurance an alternative to the traditional market when coverage is unavailable or prohibitively expensive.

With so much time passing since the Commerce Department report, legislators felt a new analysis was

long overdue, said Lawrence Cluff, the GAO's assistant director of financial markets and community investment, who is directing the GAO report.

Speaking last month in Washington at the annual meeting of the National Risk Retention Assn., Mr. Cluff said the report, requested by Rep. Mike Oxley, R-Ohio, chairman of the House Financial Services Committee, will look at both the impact RRGs have had on the market and other significant issues related to implementation of the Risk

Retention Act.

That federal law allows RRGs to operate nationwide after meeting the licensing requirements of one state. The groups, though, can write coverage only for policyholders, not the general public. About 170 risk retention groups now operate in the United States, with the greatest concentration in Vermont, which is home to 73 RRGs.

Mr. Cluff said a range of parties—including risk retention groups, insurance regulators and industry as-

sociations—have been interviewed in conducting the study.

While the cooperation has been "remarkable—with, for example, 50 of the nation's 51 insurance departments responding to the GAO's inquiries—the opinions received have been diverse, he said.

"We are attempting to sort through all the data and opinions," Mr. Cluff said, noting that he hopes the report "adds some light rather than just heat" regarding RRG-related issues.

It isn't known what impact the

GAO's recommendations will have on federal legislators. NRRA, for example, has recommended that the law be expanded to allow RRGs to fund property risks.

However, Robert H. Myers, the NRRA's Washington counsel and a managing partner with Morris, Martin & Manning L.L.P., told the NRRA attendees that GAO reports traditionally have carried a great deal of weight on Capitol Hill because of the thoroughness of the GAO's work and its reputation for impartiality.

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## Products & Services

### St. Paul Travelers unit enhances museum cover

**HARTFORD, Conn.**—The Inland Marine division of St. Paul Travelers Cos. Inc. has enhanced its coverage program for U.S.-based art, history, natural history, sports, aviation, automobile, and science and technology museums, including specialized cultural institutions.

The program covers museum collections and protects such works held by a museum, whether on exhibit or on loan to other institutions. The program also



protects works in transit, including works of other museums for which the policyholder museum is responsible.

The Hartford, Conn.-based Inland Marine division's program enhancements include worldwide coverage, current market valuation coverage, optional full coverage for partial damage to pairs and sets, and automatic inclusion to offer a reward in the event of loss or theft.

Some program exclusions have also been removed, such as one that limited placement of excess

insurance.

The limits available for this coverage range from \$1 million to \$100 million.

More information can be obtained by contacting Grace Thomas, national director for inland marine, at 973-401-3210 or by visiting the company Web site at [www.inlandmarineexperts.com](http://www.inlandmarineexperts.com).

### NIF Group offers E&O program

**MANHASSET, N.Y.**—NIF Group has launched a new miscellaneous

errors and omissions program for specified professions.

The professional liability program is designed to cover consultants and media-related and real-estate professions. The policy offers personal injury coverage and includes an automatic 60-day extended reporting period. The limits available are \$2 million per occurrence and \$2 million aggregate with a \$2,500 minimum deductible.



The Manhasset, N.Y.-based, NIF Group's NIF Professional Liability Risk Solutions will administer the program.

For more information, contact Ed Velasquez, executive vp of Professional Liability Risk Solutions, at 908-508-9696, ext. 16 or visit the company's Web site, [www.nifgroup.com](http://www.nifgroup.com).

### Return-to-work guide offered to employers

**SAN DIEGO**—The Disability Management Employer Coalition, a nonprofit organization, has released a return-to-work guide for employers.

The San Diego-based DMEC's latest edition, "The Return-to-Work Manual: A Definitive Guide for Employers," sets out a return-to-work program for employers. It provides information on the development and implementation of a company policy, on calculations of the total cost of disability and on federal and state regulation.

The product is available in print or DVD formats.

Information on ordering the guide is available at [www.dmec.org](http://www.dmec.org).

### Firm offers consulting for agents/brokers

**DOUGLAS, Mass.**—Austin & Stanovich Risk Managers L.L.C., a national risk management consulting and insurance advisory services provider, is now offering consulting services for agents and brokers.

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Continued on next page

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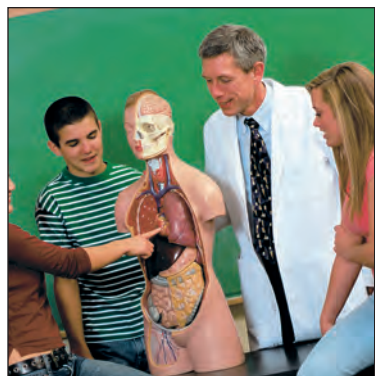
**Continued from previous page** commentary on risk management programs; and suggesting alternative risk financing programs.

More information can be obtained by contacting William K. Austin, principal and consultant, at 508-476-3347 or by visiting the Douglas, Mass.-based company's Web site, [www.austinstanovich.com](http://www.austinstanovich.com).

### Lighthouse offers E&O, EPL for insurance agencies

**ANNANDALE, Va.**—Lighthouse Cos., a program underwriting firm, is offering a new errors and omissions and employment practices liability program.

The program, ProGold, combines professional liability and employment practices liability coverage with risk management, audit and compliance services. The risk management services are



provided by York, Pa.-based Gold Seal Risk Management Ltd.

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For more information, contact Peter Stanislaw, professional liability program director, at 703-770-3700, ext. 304 or by e-mail at [pstanislaw@lighthousecompanies.com](mailto:pstanislaw@lighthousecompanies.com).

### Schinnerer broadens public entity cover

**SAN FRANCISCO**—The public entities department of Victor O. Schinnerer & Co. Inc. has introduced several new lines of coverage for public entities.

The new coverage options include auto physical damage, crime, blanket occupational accident, and accident and health coverages. The auto physical damage coverage is available for buses, trucks and emergency vehicles for single-unit and pooled entities; crime coverage protects against fidelity threats, such as credit-card forgery and losses due to employee dishonesty and is available to all public entities.

The blanket occupational accident insurance is an accident-only reimbursement policy and is intended to help entities buy down



deductibles, especially those entities with high workers compensation deductibles and self-insured retentions. And the

accident and health coverage is available for children's camps, licensed daycare providers, community organizations and youth sports teams. Coverage limits for the programs are customizable.

For more information, contact Kim Wells, vp of Schinnerer Insurance Services, at 415-344-8925 or [kim.wells@schinnerer.com](mailto:kim.wells@schinnerer.com).

### Best enhances online state filing database

**OLDWICK, N.J.**—A.M. Best Co. has

enhanced its "Best's State Rating Filings" by including information from two more states.

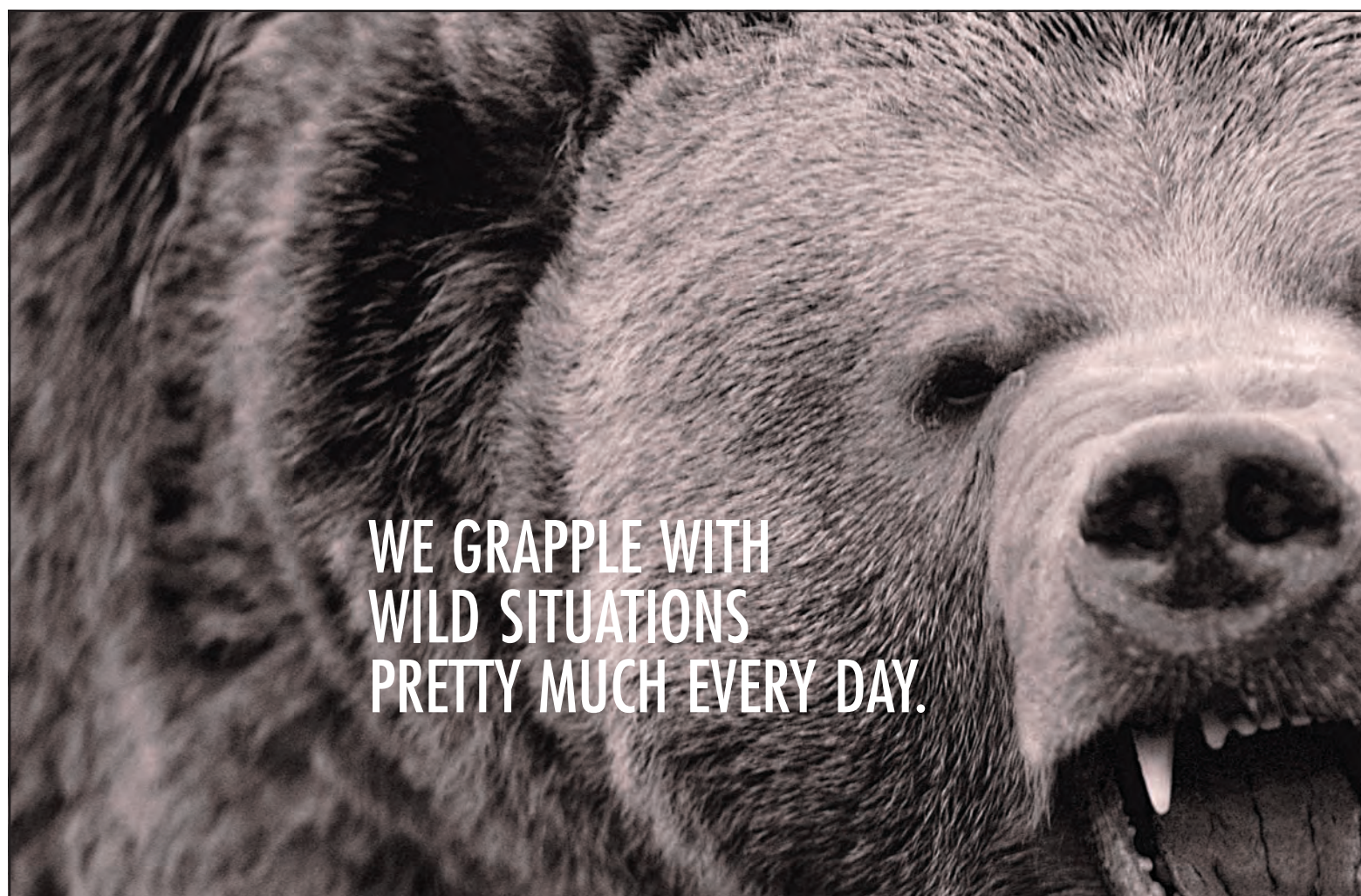
Best's online database provides state-specific information, including approved filings, form revisions and policy rate changes. The two new state additions are Kentucky and West Virginia. Oldwick, N.J.-based A.M. Best's database now includes information from 39 states.

The database is updated daily and allows users to search across multiple states, sort query results by categories and view market-share

data by state and by line.

For more information, call 908-439-2200, ext. 5674 or visit [www.beststateratefilings.com](http://www.beststateratefilings.com).

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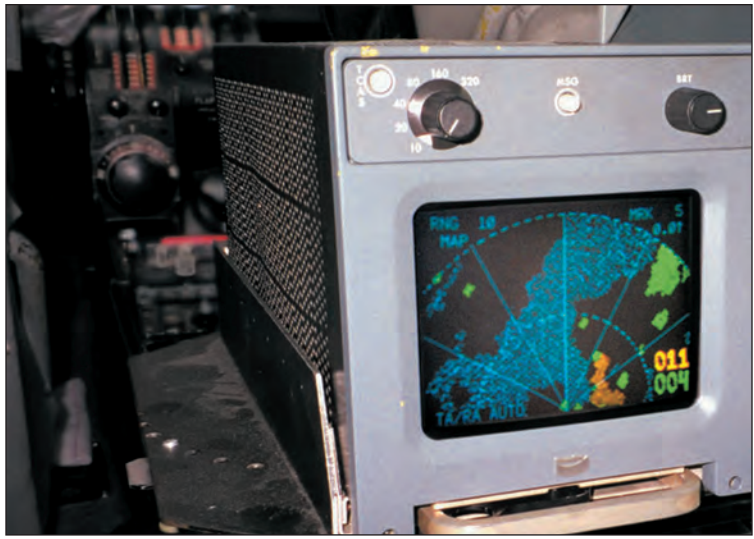


PHOTO: KRT

Crash avoidance systems installed on airlines are credited by some in the industry for a decrease in losses.

## Aviation: Rates fall at renewals

Continued from page 4  
Group Holdings Ltd.

"Against a backdrop of continued overcapacity, underwriters will be fighting to keep premium up at existing levels, (but) whether they succeed is doubtful," said David George, executive director and marketing director of aerospace at London-based Willis.

Rates slipped by between 15% and 20% during the first nine months of the year and by a further 5% in October, said Andreas Peter, global head of aviation and space at Swiss Reinsurance Co. in Zurich.

"Rating levels have come down

to the bone in many instances," he added.

Peter Bilsby, joint managing director of aviation at Markel International Ltd. in London, said the market seems to be hardening slightly for the final quarter, though.

Stephen Riley, underwriting executive at London-based Global Aerospace Underwriting Managers Ltd., also noted that rate cuts are slowing.

But policyholders think further reductions are justified, as airlines have submitted relatively few claims over the past three years.

Buyers believe that rates should

continue to drop because they have had a very good loss ratio over the past three years and underwriters have made a lot of money, said Mr. Oelssner.

"The loss experience of recent years has been phenomenal," said Aon's Mr. Doyle, noting that 2004, in particular, has been exceptional.

This year, there have been only four losses in excess of \$10 million, compared with 18 losses of that size in both 2002 and 2003, he said.

To some degree, underwriters must admit they have seen a reduction in the frequency and severity of claims, particularly in the \$300 million to \$500 million range, said Swiss Re's Mr. Peter.

Lufthansa's Mr. Oelssner attributed the decrease in losses in part to the use of sophisticated crash-avoidance systems on modern fleets. "It would not be correct to consider three years running as a fluke; it is a bit too long for a fluke," he noted.

**'Against a backdrop of continued overcapacity, underwriters will be fighting to keep premium up at existing levels, (but) whether they succeed is doubtful.'**

David George  
Willis Group Holdings Ltd.

Whether those years "are statistical blips, no one knows. But you need to get through at least five years before insurers would say it is becoming a trend," said Willis' Mr. Ottolangui. "I am sure systems help to a certain degree," he said.

In addition, incidents that have occurred have not resulted in substantial liability losses, he said.

Swiss Re's Mr. Peter stressed, though, that insurers' exposure must be considered.

"People forget exposure; we must not forget that underwriters are highly exposed. It is a highly exposed industry with hundreds of billions of dollars in potential liability," he said.

### Coverage changes

A key change in the market this renewal season is the return of larger third-party war and terrorism liability limits to the aviation all-risk market.

After the Sept. 11, 2001, terrorist attacks, so-called AV52 cover for third-party losses was stripped from policies, and many governments temporarily stepped in to offer such coverage to airlines. While the U.S. government continues to offer the coverage, airlines in other countries have had to return to the commercial market.

Until recently, all-risk underwriters still offered only \$50 million in coverage, so several insurers began offering specialty excess cover. But this October, several all-risk underwriters began offering primary limits for the AV52 cover of up to \$150 million, while others offered \$250

See AVIATION/next page

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November 1, 2004

# Aviation: Renewal rates fall

Continued from previous page

million, according to Mr. George. "Underwriters have seen, in the last two years, income going to nontraditional markets," which have not incurred any losses, he said. All-risk insurers "are under pressure on core rates; therefore, in an attempt to retain premium income, they are prepared to accept higher primary AV52 limits," he explained.

"Cover has been restricted, clients have been pressuring us to allow that back. As a market, we are less willing to consider reductions, and this (increase in cover) is something we can consider that goes some way toward tackling clients' concerns," said Rod Mearing, joint managing director of aviation at Markel.

Another major change this year to renewals is that some major risks have migrated to December from October, Mr. Doyle said.

"Everybody wants to be behind everyone else," to find out what the market trend is, said Mr. Oelssner.

# Airlines urge governments to cover WMDs

By PETA MILLER

**MONTREAL**—Airlines are urging governments to provide coverage for losses stemming from acts of terrorism involving nuclear, biological and chemical weapons, because such risks will be excluded from war and terrorism coverages starting next year.

London underwriters earlier this year drafted a clause to exclude such risks from policies written for airlines, airports and service providers. The clause, AVN48C, excludes coverage for hull and third-party losses resulting from the hos-

tile use of radioactive contamination or matter, such as in so-called "dirty bombs"; electromagnetic pulses; and chemical or biological weapons. The exclusion also classifies such exposures as uninsurable, meaning they will no longer be written back into policies.

As a result, airlines are pushing governments to provide coverage for the risks and to limit airlines' liability for related losses.

In a working paper presented at the International Civil Aviation Organization's recent assembly in Montreal, the International Air Transport Assn. notes that the

Montreal Convention does not limit liability and requires states under Article 50 to "require their carriers to maintain adequate insurance covering their liability under" the convention.

The ICAO, the United Nations agency concerned with civil aviation, developed the Montreal Convention in 1999. The convention governs airline liability in 14 countries, including the United States and United Kingdom.

The IATA paper also notes that under a new rule in Europe, European Community Regulation 785/2004, air carriers and aircraft

operators must meet minimum insurance requirements to cover war and terror passenger and third-party liability.

Regulatory complications aside, airlines and related companies could face financial ruin in the event of an incident involving one of the excluded exposures, the Montreal-based IATA states in the paper.

As a result of such concerns, the IATA invited the ICAO assembly to urge countries to grant government coverage guarantees and to instruct its council to draft a limitation of liability for war and terrorism losses.

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# Broker boards weighted toward outside members

## Governance concerns have driven the shift away from insider-heavy boards

As the brokerage industry undergoes scrutiny for some of its practices, one focus of attention is the makeup of the companies' boards of directors.

Marsh & McLennan Cos. Inc., a target of the investigation and a lawsuit by New York Attorney General Eliot Spitzer, has the largest board of directors among the publicly held U.S. brokerages, with 15 members, as well as the most insiders, at six.

### Compensation Crisis

The outside directors on the MMC board are credited with initiating the settlement talks that led to the ouster last week of Jeffrey W. Greenberg as chairman and chief

executive officer and the appointment of Michael G. Cherkasky, CEO of its brokerage unit, to fill those roles. Outside directors are also leading efforts to reform other practices to resolve any legal or regulatory complaints.

Even before this controversy erupted last month, the publicly held brokerages were moving toward more independent boards, spurred by various changes in corporate governance rules affecting

public companies (*BI*, Feb. 2).

A *Business Insurance* analysis of the largest publicly held brokers in the United States finds that most have predominantly independent directors, though the makeup of the boards varies widely: From largest to smallest public U.S. brokers, the analysis follows:

#### Marsh & McLennan Cos. Inc.

15 board members, six of whom are insiders. Directors are:



Michael G. Cherkasky

**Lewis W. Bernard**, retired former chief of finance, administration and operations of Morgan Stanley & Co. Inc.

**Mathis Caballaveta**, vice chairman of MMC, chairman of MMC Global Development and a member of MMC's international advisory board.

**Zachary W. Carter**, partner at the law firm of Dorsey & Whitney L.L.P. and a former U.S. attorney.

**Michael G. Cherkasky**, president and CEO of MMC, as well as chairman and CEO of brokerage unit Marsh Inc.

**Peter Coster**, president of benefits consulting unit Mercer Inc.

**Charles A. Davis**, vice chairman of MMC and chairman and

CEO of its MMC Capital subsidiary.

**Robert F. Erburu**, lead director and retired former chairman of The Times Mirror Co.

**Oscar Fanjul**, vice chairman and CEO of Omega Capital, a Spanish investment firm.

**Stephen R. Hardis**, retired former chairman of Eaton Corp.

**Gwendolyn S. King**, president of Podium Prose, a speaker's bureau and speechwriting service.

**Lord Ian Lang**, a former member of the U.K. Parliament, and chairman of BFS US Special Opportunities Trust P.L.C., Thistle Mining Inc. and Second Scottish National Trust P.L.C.

**David A. Olsen**, a retired former vice chairman of MMC, and former chairman of Johnson & Higgins, acquired by MMC in 1997.

**Morton O. Schapiro**, president of Williams College.

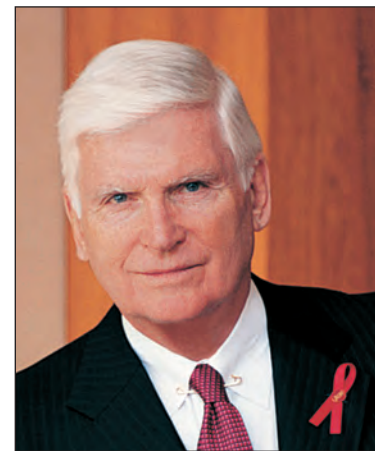
**Adele S. Simmons**, vice chair of civic nonprofit group Chicago Metropolis 2020 and president of the Global Philanthropy Partnership, and former president of the John D. and Catherine T. MacArthur Foundation.

**A.J.C. Smith**, chairman of Putnam Investments, a unit of MMC, and former chairman of MMC.

#### Aon Corp.

13 board members, two of whom are insiders. Directors are:

**Edgar D. Jannotta**, chairman



Patrick G. Ryan

of William Blair & Co. L.L.C.

**Jan Kalf**, former chairman of the managing board of ABN AMRO Holding N.V./ABN AMRO Bank N.V.

**Lester B. Knight**, a partner of RoundTable Healthcare Partners, a private equity firm, and former vice chairman of Cardinal Health Inc.

**Michael J. Losh**, former chief financial officer and executive vp of General Motors Corp.

**R. Eden Martin**, a partner of law firm Sidley Austin Brown & Wood L.L.P.

**Andrew J. McKenna**, chairman and CEO of Schwarz Paper Co. Mr. McKenna has served on the board of Aon and its predecessor companies since 1970.

**Robert S. Morrison**, retired former vice chairman of PepsiCo Inc., and former chairman and CEO of The Quaker Oats Co.

Continued on next page

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**Richard C. Notebaert**, chairman and CEO of Qwest Communications International Inc.

**Michael D. O'Halleran**, senior executive vp of Aon. Mr. O'Halleran, who recently relinquished the titles of president and chief operating officer, said he did not wish to be considered for re-election as a director in 2005.

**John W. Rogers Jr.**, chairman and CEO of Ariel Capital Management Inc.

**Patrick G. Ryan**, chairman of the board and CEO. Mr. Ryan plans to step down as CEO once a successor is named.

**Gloria Santona**, executive vp, general counsel and secretary of McDonald's Corp.

**Carolyn Y. Woo**, dean of the Mendoza College of Business at the University of Notre Dame.

### Willis Group Holdings Ltd.

11 board members, one of whom is an insider. Directors are:

**Gordon Bethune**, chairman and CEO of Continental Airlines.



Joseph J. Plumeri

**William W. Bradley**, managing director of Allen & Co. L.L.C., and a former U.S. senator.

**Joseph A. Califano**, chairman and president of the National Center on Addiction and Substance Abuse at Columbia University, and a former U.S. secretary for Health, Education and Welfare.

**James Fisher**, managing mem-

ber and majority owner of Fisher Capital Corp. L.L.C., and a former executive of American Re Corp.

**Perry Golkin**, a member of Kohlberg Kravis Roberts & Co. L.L.C., which owns 23% of Willis.

**Paul M. Hazen**, retired former chairman and CEO of Wells Fargo & Co.

**Wendy E. Lane**, chairman of Lane Holdings Inc.

**James F. McCann**, chairman and CEO of 1-800-FLOWERS.COM Inc.

**Scott C. Nuttall**, an executive of KKR.

**Joseph J. Plumeri**, chairman and CEO of Willis.

**Douglas B. Roberts**, interim director for the Institute for Public Policy and Social Research at Michigan State University and a former official of the state of Michigan.

### Arthur J. Gallagher & Co.

10 board members, three of whom



Robert E. Gallagher

are insiders. Directors are:

**T. Kimball Brooker**, president of Barbara Oil Co.

**Gary P. Coughlan**, former senior vp and chief financial officer of Abbott Laboratories.

**James W. Durkin Jr.**, president of Gallagher Benefit Services Inc.

Continued on next page

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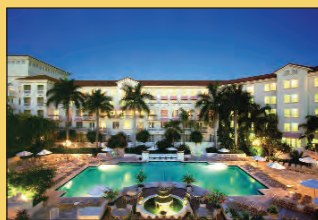
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Continued from previous page

**J. Patrick Gallagher Jr.**, president and CEO of AJG.

**Robert E. Gallagher**, chairman and former CEO of AJG.

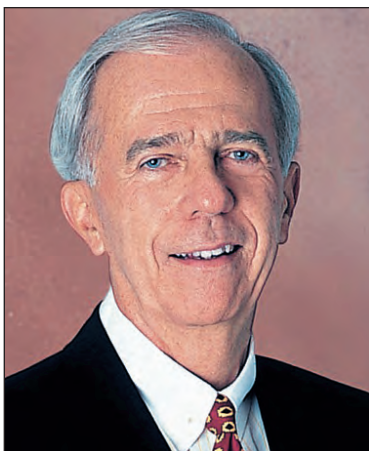
**Irene S. Gordon**, president of Food Packaging Americas for Alcan Inc.

**Elbert O. Hand**, chairman of the board of Hartmarx Corp.

**Bernard J. Hengesbaugh**, ex-chairman of CNA Financial Corp.

**David S. Johnson**, president of North America Commercial for Kraft Foods Inc.

**James R. Wimmer**, a former partner of Lord, Bissell & Brook.



J. Hyatt Brown

**Brown & Brown Inc.**

10 board members, two of whom are insiders and one who was an ex-

ecutive at an acquired company. Directors are:

**Samuel P. Bell III**, shareholder

of law firm Pennington, Moore, Wilkinson, Bell & Dunbar P.A., and a former Florida state lawmaker.

**Hugh M. Brown**, former CEO of engineering firm BAMSI Inc.

**J. Hyatt Brown**, chairman and CEO of Brown & Brown.

**Bradley Currey Jr.**, former CEO of Rock-Tenn Co.

**Jim W. Henderson**, president and chief operating officer of Brown & Brown.

**Theodore J. Hoepner**, vice chairman of SunTrust Banks Inc.

**David H. Hughes**, CEO of Hughes Supply Inc.

**John R. Riedman**, former chairman of Riedman Corp., which merged in 2000 with Brown & Brown.

**Jan E. Smith**, president of Jan Smith & Co.

**Chilton D. Varner**, a partner in the law firm of King & Spalding L.L.P.

**Hilb Rogal & Hobbs Co.**

12 board members, three of whom are insiders.



Martin L. Vaughan III

**Theodore L. Chandler Jr.**, president and chief operating officer of LandAmerica Financial Group Inc., and a former partner of law firm Williams Mullen, which represents HRH.

**Norwood H. Davis Jr.**, former chairman of Trigon Healthcare Inc.

**Robert W. Fiondella**, retired former chairman of The Phoenix Cos. Inc.

**J.S.M. French**, chairman of Dunn Investment Co.

**Robert H. Hilb**, chairman

emeritus of HRH.

**Timothy J. Korman**, executive vp-finance and administration for HRH, and a first cousin of director Robert S. Ukrop.

**Anthony F. Markel**, president and chief operating officer of Markel Corp.

**Thomas H. O'Brien**, retired former chairman and CEO of The PNC Financial Services Group Inc.

**Julius P. Smith Jr.**, chairman and CEO of law firm Williams Mullen, which represents HRH.

**Warren M. Thompson**, chairman of Thompson Hospitality Corp.

**Robert S. Ukrop**, president and CEO of Ukrop's Super Markets Inc., and a first cousin of Timothy J. Korman.

**Martin L. Vaughan III**, chairman and CEO of HRH.

**Compensation Crisis updates**

To help readers stay on top of breaking developments in the ongoing investigation into broker compensation and related news in the insurance marketplace, *Business Insurance* is filing news on these subjects as they occur at [www.businessinsurance.com](http://www.businessinsurance.com).

In addition, registered users of the *Business Insurance Daily News* e-mail product are automatically receiving an e-mail alert of breaking news as it is published online.

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## Letters to the Editor

Continued from page 8

that what we would call "doing your job"?

Sharing in placements and profits seems only a one-way benefit for the brokers. As risk managers, we always had the final say where our policies would originate. So we agreed to the insurance placements.

But sharing in the profits? Why should brokers get something back in return for a profitable placement? What made the placement profitable? I claim it had more to do with us than either the broker or the insurance company. If anyone should have shared in the placement profits, then the companies we work for should have received something back in return.

I don't see the brokers sharing in the loss of a placement. Should my company experience losses beyond "normal," then both we and the insurance company share in the loss. My company's premiums will probably rise, and the insurance company will pay the losses. I don't see the broker sharing in the downside.

Now, maybe if the broker was willing to accept the downside risk as much as it enjoyed the upside potential, we might have something to talk about.

**Craig M. Miller**  
Corporate Risk Manager  
UOP L.L.C.  
Des Plaines, Ill.

## Insurer compensation not inherently wrong

To the editor: I almost always enjoy Paul Winston's column and agree with him more often than not, but I do not agree with his latest in the Oct. 25 issue, "Industry Actions Invite Nightmare."

New York Attorney General Eliot Spitzer's assault is a mixed bag—he's combined some genuine discovery of wrongdoing with some nearly unrelated misunderstandings and painted all of them with the same tarry brush. I read *Business Insurance* to help me know the difference between the phony controversies and the real ones, and you're not helping here.

I can't think of a single good thing to say about the quote-rigging allegations; anyone caught by that is deservedly hung out to dry. But it's the problem of contingent commissions that's getting most of the attention among insurance folks, even though I doubt it's top of mind for the general public.

*BI* has been saying for years that contingent commissions create pressures on the relationship between insured and agent that are trouble looking for a place to happen, and I agree. But when Mr. Winston's commentary notes, "Insurance brokers have a duty to represent the interests of their clients, insurance buyers. When they are compensated by the seller, that

duty and trust has been fouled," he goes too far.

Insurance producers have always been compensated by insurers, whether they were agents or brokers (and, indeed, the difference regularly gets ignored, to the vexation of us lawyers). Most consumers are vaguely aware that, although "your Big I insurance agent works for you," they're not paying him—the insurance company is. Does that create a temptation to sell them as much insurance as possible at the highest possible price/commission, whether it's in the insured's best interest or not? Of course it does—witness the vanishing premium mess in life insurance. Would they rather pay a broker themselves? Fuggedaboutit!

Commercial insureds, by and large, are no different. Although fee-for-service plans are available, allegedly sophisticated risk managers continue to select traditional compensation plans—even when they are aware of contingent commission arrangements. Perhaps they do so because the "disclosures" of contingent commissions are insufficiently frank. Perhaps they accept these schemes because they don't believe that a commission structure that pressures the agent to market premium at any cost is any better than one that pressures the agent to market good risks and good pricing.

There is a whole catalog of ills

that would be avoided if we gave up on commission-based compensation for brokers—contingent or otherwise—though it remains to be seen what ills we would get in their place. But suggesting that any arrangement where the broker is compensated by the insurer creates an intolerable conflict of interest impugns the integrity of risk managers who place insurance on a commission basis. The overbroad allegation risks blunting your very legitimate point that some brokers have lost track of whom they're working for, and some risk managers have been way too easy to please.

By the way, the online *BI* Compensation Crisis Archive on your Web site is one of your best ideas ever and highlights the fact that *BI* has been on top of this issue, and keeping its readers informed about it, for a lot longer than Mr. Spitzer


has. Much appreciated.

**Mary Cannon Veed**  
Partner  
Arnstein & Lehr  
Chicago

## Industry 'insider trading' should be contained

To the editor: The charges by the state of New York against Marsh & McLennan Cos. Inc. would appear to be an effect and not a cause of this "business opportunity." Of course, "business opportunity" is a loose definition of alleged greed for agents and insurance companies, subsidized by consumers, even if those consumers are large corporations.

When the federal government  
See **LETTERS**/next page



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# Between the Lines

Compiled by BI staff

## It's a relationship business, for sure

New York Attorney General Eliot Spitzer may not be the most popular man in insurance circles at the moment, but despite what some executives may say about him, he's not afraid to bite the hand that feeds.

In addition to accepting political contributions from American International Group Inc., which has become embroiled in Mr. Spitzer's investigation into contingent commissions, since 2002 Mr. Spitzer also has received \$14,500 in contributions from Michael Cherkasky, the newly appointed head of Marsh & McLennan Cos. Inc.

MMC, of course, is the target of a lawsuit that Mr. Spitzer filed, charging the broker with bid-rigging and channeling clients to insurers that paid the biggest contingent commissions.

Mr. Cherkasky, who was once Mr. Spitzer's mentor and boss in the Manhattan district attorney's office, was called in to run MMC last week following the resignation of Jeffrey W. Greenberg.

Mr. Spitzer will have to do without any further contributions from Mr. Cherkasky or AIG for a while. Although not required to do so by law, Mr. Spitzer does not accept contributions from anyone with whom he has "any pending business matter," a spokesman in his office said.

Mr. Cherkasky's link to Mr. Spitzer is just one of the personal links in the contingent commissions affair. In addition to AIG, which is headed by Jeffrey W. Greenberg's father, Maurice R. Greenberg, one of the other insurers named in Mr. Spitzer's suit is ACE Ltd., which is headed by Evan Greenberg, another son of Maurice, who is better known as "Hank."



Mr. Spitzer

PHOTO: RICHARD LEVENE/PS

## Some things not going rocker's way

Lenny Kravitz may want to invest in a plunger.

It would be cheaper than paying the \$333,849 that Lincoln, R.I.-based Amica Mutual Insurance Co. is seeking from the pop star. The suit claims an overflowing toilet in Mr. Kravitz's Manhattan penthouse in August caused "catastrophic water damage" to a neighbor's downstairs apartment.

Amica Mutual did not return calls.

The insurer's suit in New York State Supreme Court charges the Grammy-award winner with "negligence and carelessness" for "allowing a commode to become blocked, clogged, and congested with various materials." Amica "respectfully

demands" reimbursement of the damage claim, plus interest.

Well, Mr. Kravitz can at least be thankful his "various materials" didn't leak into the home of another rocker-tenant in the building, Courtney Love; her calendar of court appearances is booked solid.

## Sedgwick CMS among the chosen

Sedgwick Claims Management Services Inc. credits its employee benefits and professional development programs for helping it become the first insurance industry company to achieve the Employer of Choice certification.

The Employer of Choice program, which benchmarks employers in various industries on their ability to attract and retain workers, was created by the management consulting firm The Herman Group.

Memphis, Tenn.-based Sedgwick CMS cited its low-deductible health plan and retirement benefits—comprising a 401(k) and a defined benefit plan—as well as its employee education programs, for setting it apart.

The company celebrated last month by treating its approximately 4,000 employees to lunch. "The award is something our colleagues earned. The best source (of new talent) is referrals from our existing colleagues," said James B. Wiertelak, Sedgwick's executive vp and chief operating officer.

Tips and feedback from readers are welcomed. Please send information to [jwojcik@businessinsurance.com](mailto:jwojcik@businessinsurance.com).

## Letters to the Editor

Continued from previous page

changed its banking and insurance rules to allow mergers, acquisitions and/or consolidations of business entities, it resulted in limiting the competitive options of the consumer, which in this case happens primarily to be publicly held companies. At the same time, it increased the ability of the giant brokerage firms to make such back-room deals with insurance companies. As we have seen in recent decades, price gouging by the giant business seems to be more prevalent.

I have been in the insurance business for 48 years. In that time, my guess is that far less than 50% of the national insurance companies exist today than there were 20 years ago.

It appears that Washington did not do its homework; with their left hand, lawmakers were allowing the formation of quasi-monopolies caused by a shrinking number of competitors. With their other hand, in Washington's infinite wisdom, lawmakers deregulated such monopolistic industries as the utilities that created a chaos of availability and pricing, which affects the vast majority of the population of the United States, all under the guise of the competitive nature of our capitalistic society.

This alleged insurance industry method of "insider trading" should be contained, as it has a direct effect on the lives of every American. The monopolistic phone systems may be the only exceptions and seem to be working within their own competitive nature.

I have a feeling that what is happening in the 2000s is potentially only the tip of the iceberg for further inequities of price gouging and misrepresentations that are affecting the average American household.

**Thomas E. Hatz**  
President

Hatz-Bosworth-LaFrance Inc.  
Farmington Hills, Mich.

*Business Insurance welcomes letters to the editor. This section is intended to be a forum for readers' opinions and comments. We reserve the right to edit letters for clarity or space. We will not publish unsigned letters.*

*Please send your letters to Letters to the Editor, Business Insurance, 360 N. Michigan Ave., Chicago, Ill. 60601-3806; e-mail: [rcoccia@businessinsurance.com](mailto:rcoccia@businessinsurance.com)*

# N.J. enacts flu vaccine rules

By RUPAL PAREKH

**TRENTON, N.J.**—Health care providers in New Jersey that administer influenza vaccinations to low-risk patients could face penalties under legislation enacted last week by Gov. James E. McGreevey.

"Given the serious nationwide shortage of available flu vaccine, it is imperative that we fulfill our obligation to protect the health of New Jersey's citizens who are most at risk for influenza," the governor said in a statement.

The U.S. Centers for Disease Control and Prevention identifies infants, senior citizens, pregnant women, health care workers and individuals with chronic illnesses among those at high risk for influenza. New Jersey is following the CDC's guidelines.

According to the new law, state Department of Health and Senior Services Commissioner Clifton R. Lacy is authorized to "reallocate current and anticipated supplies of influenza vaccine" for distribution to high-priority groups.

Doctors, pharmacies and health care facilities dispensing flu vaccines to low-priority persons are liable for civil fines of \$500 per violation, the bill states.

New Jersey joins other

states, including Massachusetts, Oregon and New Mexico, that earlier this month issued similar orders, with varying penalties and even prison sentences.



PHOTO: NY TIMES

**New Jersey has passed a law imposing penalties on health care providers who administer flu vaccinations to low-risk patients.**

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# Some insurers growing concerned about health risks of nanotechnology

By CAROLYN ALDRED

The growing use of nanotechnology is prompting some concerns about possible health risks to workers, with some observers drawing parallels between some nanotech-engineered materials and asbestos.

Nanotechnology is the ability to manipulate and organize matter the size of 1 billionth to 100 billionths of a meter. Nanoparticles often exhibit exceptional qualities—such as higher strength or greater electrical conductivity—compared with conventional materials, which presents significant opportunities for their use in various industrial sectors, including electronics, pharmaceuticals, cosmetics, engineering, materials and construction, experts say.

Indeed, nanotechnology has broad applications and is likely to be used by most large industrial companies, said Marcel Buerge,

head of risk engineering for Zurich, Switzerland-based Swiss Reinsurance Co. Consequently, it is vital for insurers and reinsurers to monitor its development and ensure adequate risk assessment and management, he said.

"The reason why we have a question mark over nanotechnology is that not enough is known about nanoparticles' behavior when they come in contact with living organisms," said Mr. Buerge.

The National Science Foundation, an independent agency of the U.S. government, estimates that about half of all pharmaceutical production will be dependent on nanotechnology within 10 to 15 years. The NSF notes that more than 100 nano-based products have already been developed in the United States, including cosmetic products that use nanoparticles to filter out ultraviolet light, and com-

See **TECHNOLOGY**/next page



PHOTO: NYTIMES

Somerset, N.J.-based NanoOpto Corp. workers produce optical wafers for use in the telecommunications industry. Some insurers are growing concerned about possible health effects of nanotechnology.

## U.K. consultant sentenced for fraud

**LONDON**—An insurance consultant in London has been convicted of fraudulently collecting premiums and falsely claiming to have placed coverage at Lloyd's of London.

Following an investigation by the Serious Fraud Office and the City of London Police, Robert Damon-Aspen was convicted last week in London's Kingston Crown Court and ordered to pay £210,110 (\$376,096) and serve a prison term of two-and-a-half years for defrauding 44 clients.

Mr. Damon-Aspen ran a business called CFT Corporate Group Insurance Services, which operated from December 1998 to September 2001. The London-based company promoted itself as an intermediary for professional indemnity, public liability and employers liability insurance, principally for customers in the information technology industry, according to a statement from the SFO.

About 5,000 clients purchased insurance contracts via CFT, which operated mainly over the Internet, paying premiums of about £1.3 million (\$2.3 million), the statement said.

The SFO found that, in many cases, Mr. Damon-Aspen took premiums from clients without obtaining coverage at Lloyd's as he claimed, and that he forged policy documents in order to cover up this deception.

The fraud was uncovered when some customers contacted Lloyd's to ask why temporary cover notes had not been replaced by policy documents. Lloyd's then reported the scam to the Financial Services Authority, the U.K. financial services regulator.

—By Sarah Veysey

## U.K. forming panel to study vocational rehabilitation

### Rising cost of coverage prompts concerns

By SARAH VEYSEY

**LONDON**—The U.K. government's Department for Work and Pensions is forming a steering group to explore ways to encourage greater use of vocational rehabilitation among U.K. employers.

The DWP said the group would be made up of both government officials and representatives of other interested parties, including employers, insurers and health professionals. The steering group's role will include producing ideas and advice on ways to improve vocational rehabilitation in the United Kingdom, the DWP said in a report, "Building Capacity for Work: a U.K. Framework for Vocational Rehabilitation."

The move, announced last week, stems from an ongoing DWP review of employers liability insurance, which covers employee injury and illness. The department launched its review in response to employer concerns about the rising cost of the coverage, which is compulsory in the United Kingdom.

Previous reports by the DWP suggested that improving employee access to vocational rehabilitation would help reduce the cost of employers liability claims and help get employees back to work sooner after an injury or illness. The DWP said it had received more than 300 responses from interested parties to a discussion paper on vocational rehabilitation it published in May.

The DWP also said that, in response to concerns from employers and insurers, among others, it had set up a pilot project for resolving employers liability claims more quickly. This project initially will focus on low-value claims—those of less than £10,000 (\$17,900)—and will explore ways to reduce claims costs, the DWP said. For example, the report notes, it would look at ways to reduce the costs associated with employers' investigations of workplace injury or illness and look at ways to process, negotiate and settle



The Department for Work and Pensions in the United Kingdom is forming a panel to study ways to encourage greater use of vocational rehabilitation.

claims more swiftly and less expensively.

Jane Kennedy, the U.K. Minister of State for Work, said in a statement that vocational rehabilitation programs can enable employers to retain staff and allow employees to continue working in situations when they might otherwise have been retired for health reasons.

Copies of the DWP report can be viewed at [www.dwp.gov.uk](http://www.dwp.gov.uk).

## World Updates

### U.K. bill would provide same-sex pension rights

The U.K. government has announced a legislative proposal that would give same-sex couples the same pension rights as married couples. Under the proposal, contained in amendment to the Civil Partnership Bill, a member of an occupational pension plan could designate a same-sex partner as the beneficiary of his or her death benefits in the plan. The Civil Partnership Bill also would give same-sex partners the right to compensation if their partner is injured as well as certain tax benefits currently available only to heterosexual partnerships. The bill was introduced in March 2004. Many U.K. employers already offer same-sex benefits, including pension benefits.

### Reserve boosts, storms fuel loss at Converium

Converium Holding A.G. reported a net loss of \$710.6 million for the first nine months of 2004, following reserve strengthening and third-quarter windstorm losses. The Zug, Switzerland-based reinsurer reported a \$128.9 million profit for the same period last year. Contributing to the nine-month loss were a \$384.7 million reserve increase for prior-year liability losses in the second quarter and a \$96.4 million reserve increase in third quarter. The company also faces \$95.8 million in windstorm losses in the third quarter. Converium reported \$3.44 billion in gross premiums written in the first nine months of 2004, a 6.9% increase.

### Prettejohn to serve on FSA panel

Nick Prettejohn, chief executive of Lloyd's of London, has been appointed to the Financial Services Authority's Financial Services Practitioner Panel. In his role on the panel, he will represent the interests of the multiline insurance industry. The panel is a statutory body charged with ensuring that the FSA takes account of the concerns of firms it regulates when making policy.

### Liberty Mutual unit merging syndicates

Lloyd's of London-based managing agency Liberty Syndicates is merging its two syndicates, marine syndicate 282 and nonmarine syndicate 190, for the 2005 year of account. For 2004, the two syndicates had an aggregate capacity of £794 million (\$1.42 billion). The enlarged syndicate will be known as syndicate 4472 and will write marine, property, casualty and contingent-loss coverages, among others.

# Technology: Concerns growing on nanoparticle risks

Continued from previous page  
puter technology.

However, as the technology proliferates, potential health risks to workers involved in the nanotech industry have not been adequately assessed, according to a recent report commissioned by the United Kingdom's Health and Safety Executive.

The Institute of Occupational Medicine, which prepared the report, estimates that the number of British workers exposed to nanoparticles in the academic sector and in emerging nanoparticle-producing companies may be up to 2,000 but that as many as 1 million more workers may be exposed to the nanoparticles that are created through incidental production processes, such as welding.

For the companies involved in nanotechnology, workplace health and safety is a high priority, said to Dai Hayward, director and general manager of Thomas Swan & Co. Ltd. in Consett, England. Thomas Swan produces relatively small quantities of nanomaterials known as single-wall carbon nanotubes.

Carbon nanotubes are 100 times

stronger than steel and a sixth of the weight, and they exhibit high conductivity and unique electronic properties. They also are of particular concern to some in the insurance industry.

"Nanotubes are something that we really want to watch carefully," said Swiss Re's Mr. Buerge, adding that "they have a size and shape that is very reminiscent of asbestos, and the comparison is too close to stand aside and wait."

Mr. Hayward said he is acutely aware of the health and safety concerns surrounding nanotechnology—particularly nanotubes—and is working closely with the HSE, the company's insurer and others to manage the risks under existing and anticipated hazardous materials safety legislation.

In addition, he disputed the comparison of nanotubes to asbestos.

"There has been a lot of comparison made between carbon nanotubes and asbestos. There is a big difference between the two. At the time of early asbestos production, not very much was known about the risks and it appears that much of that information was suppressed.

"While we know that we don't know everything about the risks of nanotechnology, we are exercising the precautionary principle and are actively and openly collaborating with interested parties to ensure safety issues are properly addressed. The industry is determined to learn from the experience of asbestos," said Mr. Hayward.

Charlie Kingdollar, vp of Stamford, Conn.-based General Re Corp. and author of a Gen Re report on nanotechnology, said that "concern is building that harmful nanomaterials may pass through cellular walls and through the blood-brain barrier." According to his report, research has determined that nanoparticles can cause lung, brain and liver damage in animals.

"The moment something can penetrate through cells there is a question over what it can do there," said Mr. Buerge.

The Institute of Occupational Medicine points out that because of nanoparticles' ability to pass through cells, occupational exposure to nanoparticles may come through inhalation, exposure to the skin and ingestion.

Because of the huge potential for aggregations of claims across many industries, reinsurers need to carefully monitor and assess the risk of nanotechnology and work closely with their industrial clients, said Mr. Buerge.

"Protecting people may require new measures. For example, a traditional dust mask is not adequate to protect against particles so small," he said.

"We do not want to stand aside

from this huge new development. We want to help our clients. It is no different to 100 years ago when the insurance industry helped companies insure high risk facilities by introducing sprinklers, for example," he said.

"From where we stand now, there are too many unknowns to adequately analyze the impact or potential risks created by this new technology," said Gen Re's Mr. Kingdollar.

## Election wrap-up Nov. 8



How will the results of the Nov. 2 presidential and congressional elections affect the drive for tort and health care reform, as well as a slew of other risk management and employee benefit issues in the year ahead?

*Business Insurance*, in its Nov. 8 issue, will have the answers in a comprehensive report. Plus, *BI* will report on the outcomes of insurance commissioner races and state ballot initiatives—including one calling for the repeal of California's "play or pay" health care mandate.

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Any person wishing to obtain a copy of the Order should contact Theresa D'Agostino at (212) 610-6300 or at [dagostit@allenoverly.com](mailto:dagostit@allenoverly.com). The Order and the Restated Scheme Rules are also available to review and download at [www.angloamericaninsurance.co.uk](http://www.angloamericaninsurance.co.uk).

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# Regulators 'asleep at the switch': Consumer advocates

## NAIC proposes plan to fight fraud, require disclosure

By MEG FLETCHER

Regulators should have done more to stamp out bid rigging and funneling policyholders to insurers that pay higher contingent commissions to brokers long before the alleged frauds were laid out last month by New York Attorney General Eliot Spitzer, consumer advocates for policyholders say.

These advocacy groups point out that even though the insurance buyers that suffered the alleged fraud were sophisticated commercial policyholders, they clearly needed regulatory protection, and most states' insurance departments failed to act.

But insurer groups counter that regulators have a limited ability to investigate. They stress that the primary role of regulators is to assist consumers by ensuring competitive but solvent markets, rather than to investigate fraud.

Still, in the wake of the alleged fraud, state insurance regulators are increasing their scrutiny of corporate policyholders' needs, despite past efforts by risk managers

to press for a more loosely regulated environment for commercial insurance placements.

Historically, representatives of commercial policyholder groups have lobbied for exemption from insurance regulation. The New York-based Risk & Insurance Management Society Inc. and the Washington-based National Assn. of Manufacturers have repeatedly argued that their members—large corporations, often with multistate and multinational operations—are



**'Most of the state insurance commissioners who are charged with overseeing the insurance industry were asleep at the switch while these abuses were occurring.'**

J. Robert Hunter  
Consumer Federation of America

sophisticated insurance buyers that do not need the same protection that state insurance regulators provide for individuals and small businesses.

While neither RIMS nor NAM would comment on regulators' response to the lawsuit filed by Mr. Spitzer against Marsh & McLennan & Cos. Inc. last month and its allegations of bid rigging and the fraudulent use of contingent commission arrangements, other interested observers and consumer groups argue that increased oversight would have better protected these corporate buyers.

"From my point of view, state

insurance regulators dropped the ball," said Craig Miller, corporate risk manager for UOP L.L.C. in Des Plaines, Ill., a technology provider to the petroleum and petrochemical industries.

"It would seem that every state but New York shut their eyes" to the conflict of interest issues inherent in contingent commissions, Mr. Miller said.

"Most of the state insurance commissioners who are charged with overseeing the insurance industry were asleep at the switch while these abuses were occurring," said J. Robert Hunter, director of insurance for the Washington-based Consumer Federation of America, which represents small businesses and individuals.

"The Spitzer investigation reveals that even the most sophisticated buyers of insurance can be duped by insurers and brokers in this often-uncompetitive market," Mr. Hunter said. To resolve that problem, he urged that Congress repeal a federal law that prohibits the Federal Trade Commission from investigating the insurance industry.

"The bid-rigging scandal documents the need for affirmative regulation of insurance," even among sophisticated buyers, said Kevin P. Henosy, president of Spread the Risk Inc., who attends the National Assn. of Insurance Commissioners' quarterly meeting as an unfunded consumer representative. "I hope that this scandal drives the proverbial stake through the proverbial heart of the insurance deregulation movement," he said. Spread the Risk is a Kansas City, Mo.-based insurance consumer advocacy organization.

But Diane Koken, the Pennsylvania insurance commissioner, who is the NAIC's current president, said she "wholeheartedly" disagrees with critics who say that the NAIC largely ignores corporate buyers in its consumer protection efforts.

Ms. Koken noted that the NAIC

has made recent efforts to improve the insurance environment for corporate consumers, including speeding new products to market and fighting companies that sell fraudulent health insurance programs.

Ms. Koken also said last week that the NAIC's new 13-member steering committee has adopted a three-pronged plan to cope with market issues stemming from the allegations of fraud and bid rigging. By year end, the committee will develop and adopt a model regulation that will require brokers to reveal more details of their compensation arrangements; by the start of next year, it also will expand its Web site so that tipsters can report fraudulent activity anonymously; and it is developing a survey that individual state regulators will use to probe the market practices of insurers and brokers.

Regulators are also expected to consider the experience of the New York Insurance Department since 1998 in directing the insurance industry "to fully disclose placement service agreements," according to a statement by Insurance Superintendent Gregory V. Serio. "After receiving complaints of nondisclosure, the department commenced an investigation, even though we never received complaints of criminal activity," he said.

Now the New York Insurance



**'After receiving complaints of nondisclosure, the department commenced an investigation, even though we never received complaints of criminal activity.'**

Gregory V. Serio  
New York Insurance Department

Department, which continues to cooperate with the investigation, will resolve the civil and regulatory aspects of the matter. The prosecution of alleged criminal activities under state law is handled by the attorney general, he said.

And though New York, according to the Council of Insurance Agents & Brokers, was the only state to have rules about broker compensation disclosure in place before Mr. Spitzer filed suit against Marsh, Oregon had taken steps to clarify broker commissions. Since that legal action was filed, California has announced that it is proposing disclosure regulations, and many other states are considering following suit.

Also, the NAIC has urged corporate consumers to report inappropriate marketplace activities to their respective state insurance departments.

Several insurer groups, meanwhile, have come to the defense of state insurance regulators, with statements in support of the anti-fraud efforts they have already undertaken.

"State regulators are doing the right thing" by looking into compensation arrangements, said

## Compensation Crisis

Roger Schmelzer, senior vp-state and regulatory affairs for the Indianapolis-based National Assn. of Mutual Insurance Cos.

"I don't think you could accuse regulators generally of being asleep at the switch because they didn't detect criminal activity," said Robert Detlefsen, NAMIC's director of public policy.

Peter Bisbecos, NAMIC's director of legal and regulatory affairs, pointed out that even when a regulator finds possible misconduct, there is "a fine, dangerous line" between his or her rooting out criminal activity and violating the defendant's constitutional rights against self-incrimination.

According to the U.S. Supreme Court's 1967 finding in *Garrity et al. vs. New Jersey*, an official with nonprosecutorial authority must turn over any suspicious information that might lead to a criminal charge to a designated prosecutor, or face the possibility of inadvertently precluding its use in any criminal prosecution, Mr. Bisbecos said.

The American Insurance Assn.

"strongly believes that solvency and market conduct regulation should be the focus of state regulators' resources, not price and product controls," an AIA spokeswoman said.

"All the regulation in the world won't prevent unscrupulous individuals from breaking the law," according to a statement by the Property Casualty Insurers Assn. of America in Des Plaines, Ill.

"Civil regulation is intended to deter illegal acts, not preclude them. Individuals and corporations that violated the law are subject to arrest and prosecution after the fact. That is exactly what is happening in the Spitzer probe," the PCI stated.

While the PCI "supports a competitive marketplace based on transparency and disclosure," it "does not believe that these contractual relationships between insurers and agents and brokers should be subject to review by regulators or law enforcement officials," the statement said.

"It is poor public policy for legislators and regulators to dictate the terms and conditions of contracts between private parties," the PCI said.

## U.S. investigation sparks Canadian probe of brokers

By GLORIA GONZALEZ

**TORONTO**—Canadian insurance regulators have launched reviews of broker compensation arrangements in light of the ongoing investigations in the United States.

The Toronto-based Financial Services Commission of Ontario, the provincial insurance regulator, is conducting a review of compensation arrangements at the request of provincial government officials, said Ontario Minister of Finance Greg Sorbara. Mr. Sorbara stressed, though, that "there's no evidence in Ontario of the kinds of allegations that are being discussed in New York state," referring to New York Attorney General Eliot Spitzer's charges of bid rigging and self-dealing at Marsh & McLennan Cos. Inc.

Government officials said they would consider further action on contingent commission arrangements if deemed necessary by the FSCO report.

In addition, the Toronto-based Canadian Council of Insurance Regulators and the Canadian Insurance Services Regulatory Organizations have established a committee to enable regulators to work together

as they examine the relationships between brokers and insurers, the organizations said. The provincial and territorial regulators are preparing to review market practices within their respective jurisdictions.

Meanwhile, brokers and insurers in Ontario have agreed to a voluntary system of disclosure for base commissions and contingent commissions, Mr. Sorbara said.

Before the agreement, there were no disclosure requirements for compensation arrangements, said a spokesman for the Toronto-based Insurance Bureau of Canada, the national trade association of property/casualty insurers. Details of the disclosure system have yet to be finalized, he said.

Although the disclosure system would be in use only in Ontario, the IBC spokesman said he expected the agreement to be adopted in the other provinces.

The top 43 Canadian property/casualty insurers paid \$252.9 million in contingent commissions in 2003, according to the Toronto-based Office of the Superintendent of Financial Institutions, the federal insurance regulator.

# Wary risk managers taking precautions with brokers

By MARK A. HOFMANN

As allegations of fraud and self-dealing at the world's largest brokerage continue to reverberate through the insurance industry, risk managers are working to guard against illegal or unethical behavior by their brokers.

Their tactics include demanding that brokers reveal their fees and commissions upfront, including specifically disclosing any contingent commission arrangements—those paid by insurers based on the volume or profitability of the business brokers bring. In his recent lawsuit against Marsh & McLennan Cos. Inc., New York Attorney General Eliot Spitzer accuses the company of rigging bids to ensure that clients' business went to those insurers paying it the highest contingent commissions, among other charges.

To help guard against such problems, risk managers also are requiring that their brokers make available to them all quotes on a given submission. In addition, some risk managers are seeking to at least partially bypass the broker and deal directly with the underwriters for certain coverages. Risk managers are also comparing prices for similar coverage offered by broker markets and direct writers.

And buyers are demanding that brokers provide—in writing—a pledge that they are not engaging in any illegal activities. Still, they acknowledge that no system is perfect and that, in the end, there must be trust between buyer and intermediary.

## Protecting yourself

Getting all details of the broker-buyer relationship in writing upfront is crucial, say risk managers.

"In our contracts, we have specified that brokers can only take what we pay them as a flat fee," said Terry D. Fleming, director-division of risk management for Montgomery County in Rockville, Md. "We ask them to disclose any contingent fees that they get every year. Typically, what happens is, they will get a small amount and give us credit" toward the premium, Mr. Fleming said.

"We're going back to review every one of (our) annual contracts to make sure that we have the letters that we asked for and all the documentation that we can get," said Mr. Fleming. Montgomery County is currently an Aon Corp. client.

"We have always requested that our broker declare upfront what their fees and commissions are from all parties," said Joseph Hardy, director-risk management and insurance for Hudson's Bay Co. in Toronto, another Aon client.

Risk managers also should require their brokers to benchmark annually their premiums to confirm that their premiums are competitive, said Jane Downey, president of Guelph Mills, Pa.-based risk management consulting firm Clarity Concepts Inc.

"Even if the broker favored one insurer, this will document that you have market pricing for your company size and risk. Ironically, Marsh has the best benchmarking database in the industry," she said.

"If you are concerned there was broker foul play, ask for copies of insurer communication on competitive proposals for your account for the last three years. I recommend that you focus on the excess liability layers where direct communication with the markets is less frequent and where the (Spitzer) investigation is targeted," said Ms. Downey.

Maintaining direct relationships with underwriters can also help prevent unethical behavior, according to risk managers.

"For years, we have nurtured a relationship directly with the underwriters," said John Phelps, director-risk management for Blue Cross & Blue Shield of Florida Inc. in Jacksonville and a Marsh client. "That's probably the most important one. Beyond that, we have always asked for disclosure on the quotes from all the bidding companies. The underwriter sends the quote to Marsh, and they send an unadulterated version to us so we can review it."

Another important step is to ask for the service provider's ethics statement, said Barbara A. Devine, manager-risk management and contract administration for TAP Pharmaceutical Products Inc. in Lake Forest, Ill.

"Listen to your gut. If it doesn't feel right, there's probably something unethical occurring," she said. Risk managers should write a statement regarding ethical behavior into service agreements with brokers and insurers. "Ask your ser-

vice provider what processes and procedures are in place to ensure that transactions are completed in a legal and ethical manner, including what measures are taken when unethical behavior is identified. Ask your service provider for a copy of their ethics statement; it's no guarantee, but it demonstrates that the corporate leadership places value on ethical behavior," said Ms. Devine, who is not a Marsh client.

Hudson's Bay Co.'s Mr. Hardy said that he has requested that his brokers provide a written statement that they are not involved in illegal activities and to confirm that, if they received contingent fees, that the fees "had no negative financial impact to our company," such as increased premiums or reductions in coverage.

Reassessing relationships

"Price-fixing is truly a breach of (broker/client) trust, and it's an integrity issue," said Lance Ewing, vp-risk management at Caesars Entertainment Inc. in Las Vegas. "Many folks who feel wronged based on this situation are going to need to re-evaluate their relationship."

Ultimately, though, risk managers say they have to accept that they must trust their brokers.

"As to whether or not we'd be able to detect (problems), I really don't know," said Mr. Phelps. "Like any other business relationship, at some point you have to trust the people you're dealing with. That's the case here."

"We place a great deal of trust in the Marsh relationship, and for the past 12 years, they have met or exceeded our expectations. It's unfortunate that this investigation is finding a few bad apples in a very large and ethical basket. And they're all being treated alike—and that's unfortunate, but it will change."

"We are viewing with caution our existing relationship with Marsh as a result of the investigation but have no reason to believe at this point that we need to alter that relationship" with Marsh's managed care practice group in Atlanta, Mr. Phelps said.

## Compensation Crisis

A direct relationship with an underwriter "would help you detect bid rigging," said Richard S. Betterley, president of Betterley Risk Consultants Inc. in Sterling, Mass. "No risk manager has the time to do this kind of work for all lines, but if it's a difficult one, that's where direct in-



**'Many folks who feel wronged based on this situation are going to need to re-evaluate their relationship.'**

Lance Ewing  
Caesars Entertainment Inc.

volvement by the risk manager would at least reduce the chance of bid rigging," he said.

Mr. Betterley added: "I don't think bid rigging is pervasive at all. I'll be really surprised and disappointed if we find this is anything more than very infrequent," he said. The frequent movement of insurance professionals among brokerage, risk management and underwriting would suggest that bid rigging is not likely to be pervasive, as it would be more widely known, he said.

Montgomery County's Mr. Fleming said he also compares the broker market with the direct writer market when looking at pricing.

Another important step is to ask for the service provider's ethics statement, said Barbara A. Devine, manager-risk management and contract administration for TAP Pharmaceutical Products Inc. in Lake Forest, Ill.

"Listen to your gut. If it doesn't feel right, there's probably something unethical occurring," she said. Risk managers should write a statement regarding ethical behavior into service agreements with brokers and insurers. "Ask your ser-

## Compensation Crisis

market insurers have paid to brokers, the broker said. These include:

- Profit commissions, which are based on the profit an underwriter makes on a book of business.
- Volume overrides, also known as placement service agreements, which are tied to the total premium a broker places.

of business and were not account-specific, said the broker.

"Spitzer shows it is client-specific data" that is driving the volume-based compensation, the broker said. "The implication of that is there is pressure on brokers to place business with certain insurers client by client," he said, adding that this also happens in the London market.

Risk managers say contingent commissions should be eliminated. "The fact there are commissions does leave the whole process open to that kind of corrupt way of operating," Paul Taylor, a risk manager

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# London market acknowledges placement pressures

By PETA MILLER  
and SARAH VEYSEY

**LONDON**—Brokerage firms in the London market do pressure their employees to place risks with insurers that pay the highest contingent commissions, insurance sources agree.

But recent moves by several of the world's largest brokers to stop accepting contingent commissions could eliminate this practice in London and elsewhere.

Meanwhile, sources say there is no evidence to suggest that bid rigging is occurring in the London market, especially given the sub-

scription method widely used to assemble coverage for a risk.

This scrutiny of contingent commissions in the London market follows the Oct. 14 lawsuit by New York Attorney General Eliot Spitzer accusing Marsh & McLennan Cos. Inc. of fraud in placing customers' risks (BI, Oct. 25).

The lawsuit sent shockwaves across the industry, particularly in London, where "there has been a frenzy of discussion, speculation, debate and a little bit of panic in some quarters," said one broker who declined to be named.

There are three types of contin-

gents in the London market, which are tied to the total premium a broker places.

Customized commissions, to encourage brokers to place certain classes of business.

In many cases, according to the London insurance broker, clients are aware of profit commissions brokers receive on their business.

He acknowledged, though, that problems can arise from the use of volume overrides, which he said are "all over the place" in the London market, especially on business placed by the larger brokers. Other sources confirmed that volume deals are commonplace.

Historically, the argument for PSAs was that they were negotiated on an aggregate basis across a book

of business and were not account-specific, said the broker.

"Spitzer shows it is client-specific data" that is driving the volume-based compensation, the broker said. "The implication of that is there is pressure on brokers to place business with certain insurers client by client," he said, adding that this also happens in the London market.

Risk managers say contingent commissions should be eliminated. "The fact there are commissions does leave the whole process open to that kind of corrupt way of operating," Paul Taylor, a risk manager

See LONDON/next page

# MMC's Greenberg quits; Aon facing lawsuit

By SALLY ROBERTS

Although Marsh & McLennan Cos. Inc. has taken steps to resolve charges of alleged fraudulent self-dealing in placing clients' business, the legal and regulatory attack on broker compensation continues to widen, and questions remain over how other industry companies will respond.

New York Attorney General Eliot Spitzer, whose lawsuit charging MMC with bid rigging and self-dealing ignited the controversy over brokerage compensation, said last week that, following management and other changes announced by MMC, he will not pursue criminal charges against the company.

MMC last week replaced Jeffrey W. Greenberg as chief executive officer with Michael G. Cherkasky, former CEO of MMC's Marsh Kroll consulting unit. That move, along with MMC's adoption of new business procedures, a full examination of potential prior wrongdoing and a pledge of restitution to those harmed, permits "Marsh and this office to move forward toward a civil resolution of our lawsuit," Mr. Spitzer said.

Although MMC and the attorney general's office have been talking, formal settlement negotiations have yet to begin, a source close to Mr. Spitzer's investigation said late last week.

In a conference call discussing the changes at MMC, executives



Jeffrey W. Greenberg

said that the company's own internal investigation into the alleged bid rigging could take until the end of the year to complete.

"It is going to be a thorough investigation," Mr. Cherkasky said. "It's not going to be something that drags on forever. We're going to get it done certainly this year."

Although the internal probe's findings are preliminary, "we're very confident" that if any bid rigging, occurred it would have been "limited," Mr. Cherkasky said.

## Probes widen

While Mr. Spitzer may be working toward a resolution with MMC, his widespread investigation into the

## Compensation Crisis

compensation practices of the insurance brokerage industry continues.

Much of the focus last week turned to Chicago-based Aon Corp. as the next target for civil action by Mr. Spitzer.

While an official in Mr. Spitzer's office said they are investigating the use of contingent commissions at Aon and potential "tie-in" arrangements of its insurance and reinsurance placements, that doesn't mean that the attorney general will sue the world's second-largest brokerage.

"We've always had an interest in Aon. It's always been a company that has been a focus of our investigation. We happened to make a case against Marsh & McLennan first because that sort of ripened first...and we started there. It doesn't mean that we've forgotten about Aon. But on the other hand, it doesn't mean that we're going to file a lawsuit against Aon tomorrow or ever," he said.

He also noted that Mr. Spitzer's investigation is looking at several companies in addition to Aon.

Nevertheless, Aon and its top executives have been named in at

least two shareholder lawsuits, as have several other brokers and insurers.

The latest suit, filed last Thursday in the U.S. District Court for the Northern District of Illinois by the law firm of Milberg Weiss Bershad & Schulman L.L.P., charges that Aon violated securities law by disseminating materially false and misleading statements to investors by failing to disclose that a "material portion" of its revenues were derived from "illegal bid rigging and kickback schemes." Specifically, the complaint charges that Aon engaged in an illegal scheme to steer business to favored insurers in exchange for lucrative contingent commissions and that it "routinely orchestrated illusory bidding competitions" with insurers and submitted inflated bids to clients to create the appearance of a fair bidding competition.

An Aon spokesman declined to comment on the suit.

Last week also saw several other industry companies report receiving subpoenas from states attorneys general related to investigations into contingent commissions. They include: Aetna Inc.; Allstate Corp.; Anthem Inc.; Arthur J. Gallagher & Co.; CNA Financial Corp.; St. Paul Travelers Cos. Inc.; Towers Perrin; USI Holdings Corp.; and XL Capital Ltd.

## Deals out of favor?

Questions surround the issue of whether contingent commissions

will continue to be widely used, with several of the world's largest brokerages having abandoned the arrangements since the controversy began.

Last week, Itasca, Ill.-based Gallagher and London-based Jardine Lloyd Thompson Group P.L.C.—the fourth- and sixth-largest brokerages, respectively—announced that they would end the practice of accepting volume- and profit-based commissions from insurers. They followed the lead of the top three brokers—Marsh Inc., Aon and Willis Group Holdings Ltd.—which previously pledged to stop using the arrangements (*BI*, Oct. 25).

Gallagher said that contingent commissions accounted for \$31.7 million—or just under 3%—of its \$1.09 billion in total revenues for the nine months ending Sept. 30, 2004. At JLT, the commissions made up less than 2% of its brokerage revenues of £429.0 million (\$701.0 million) in 2003.

Of the remaining brokerages listed in *Business Insurance's* Top 10 worldwide rankings, Raleigh, N.C.-based BB&T Insurance Services Inc. and Glen Allen, Va.-based Hilb Rogal & Hobbs Co. said they were reviewing their practices relating to accepting contingent commissions.

South Africa's Alexander Forbes Ltd. reportedly is reviewing its business to determine whether it receives volume or profit contingent commission payments.

See **BROKERS**/next page

# London: Market acknowledging placement pressures

Continued from previous page

for a large company, said of practices exposed by Mr. Spitzer. "If there are not any, the problem goes away," said Mr. Taylor, who is a council member of the London-based Assn. of Insurance & Risk Managers.

AIRMIC plans to release in the next few weeks the results of a member survey on contingent commissions. A source familiar with the project said it has received responses from 200 risk managers, or 20% of its membership—its highest response rate ever.

The overwhelming majority of respondents are understood to have said they wanted either to ban such fees altogether or have the system investigated and regulated by the U.K. Financial Services Authority.

## Placement pressure

London market insurers acknowledge that volume-based compensation influences the placement of a risk.

"The broker broking the business would probably be aware of the conditions associated with the percentage volume override on that class," said Barbara Merry, chief executive of Hardy Underwriting P.L.C.

If there is such an agreement in place, brokers are more likely to place business with that underwrit-

er, she added.

"It is easy to be fooled into thinking that because something is market practice and has gone on for ages that makes it OK, but these arrangements are not really OK," Ms. Merry said.

A representative of a London-based insurer said that the use of contingent commission arrangements "comes down to delivering volume."

There are brokers whose firms are pressuring them to place a certain volume of business with certain underwriters, he noted.

A London-based broker agreed that employees were pressured by management to place certain volumes of business with certain underwriters in order to hit contingent commission targets.

Some brokers, he said, "are under great pressure to get volume."

At the same time, brokers pressure London insurers to offer volume-based deals to win their business.

"Some classes of business, because of the size and complexity of the risk, are very much in the hands of the big brokers, and unless an insurer agrees to sign a PSA, it cannot see the book of business at all," said Ms. Merry.

Hardy Underwriting faced this issue earlier this year, when it became apparent its financial institutions

book would not see any business at all if it did not agree to pay overrides, she added.

The insurer eventually agreed on the condition that the arrangement be disclosed to clients but does not know whether this happened, she said.

Insurers have to offer volume overrides if they want to be shown business by global brokers, said Robin Oakes, head of insurance at London accounting firm Mazars.

While brokers and insurers acknowledge that commissions are influencing the placement of risks, they say there no evidence of bid rigging and sham placements in the London market. Such fraud is unlikely to occur, they say, because of the subscription structure of the market, which makes it unlikely for one insurer to write 100% of a risk.

"Due to the operation of the London market, the opportunities for rigging are almost nonexistent, and I do not believe that is an issue," said Mark Pangborn, chairman of Howden Risk Partners, a division of Howden Insurance Brokers in London.

"If you have got to get a number of insurers signed up to one particular risk, it is much more difficult to get into rigging bids in the way that Spitzer claimed Marsh were rigging them," said Mr. Oakes of Mazars.

Asked about the fraudulent activities alleged in the Spitzer com-

plaint, Ms. Merry added: "I have no reason to believe they have found their way into the London market."

A London broker said: "My view is it would be difficult for that situation to exist without brokers knowing about it and exposing it."

## New regulator

The Financial Services Authority will take over the regulation of brokers effective Jan. 14, 2005, from the General Insurance Standards Council, a self-regulating entity.

Chris Woodburn, chief executive of the GISC, said it examined the use of contingent commissions in the London market in June, recognizing that potential conflicts of interest could arise.

He said, though, that the GISC was satisfied its rules and monitoring were satisfactory and is currently keeping "a watching brief" on developments in the United States.

The FSA, which has investigated other Spitzer-led issues such as market timing, said its rules on inducements and disclosure from its handbook, "Insurance: Conduct of Business," will apply to these issues.

Section 4.6.1. of that code states that an insurance intermediary must, if a customer asks, promptly disclose the commission he receives for placing an insurance contract in cash or at least estimate the rate

likely to apply.

Meanwhile, the issue may vanish as U.S. and U.K. brokers abolish the practice.

London-based brokers Willis Group Holdings Ltd., Jardine Lloyd Thompson Group P.L.C. and Heath Lambert Group Ltd. are among the brokers that have abolished contingent compensation following the Spitzer lawsuit. Marsh & McLennan, Aon Corp. and Arthur J. Gallagher & Co. have also ceased accepting contingency payments.

The commissions accounted for \$80 million of Willis' expected 2004 revenue, while JLT said they accounted for 2% of its £429.0 million (\$765.4 million) revenue in 2003, and Heath Lambert reported 0.52% of its £304 million (\$542.4 million) 2003 revenues from the payments.

As insurer-paid commissions disappear, risk managers are waiting to see what it will mean for their costs.

AIRMIC's Mr. Taylor questioned whether insurance rates will go down and broker commissions will go up if brokers' income and insurers' costs are reduced.

Insurers report that some brokers are already asking for higher commissions as a result of PSAs not being applied any more, according to Mazars' Mr. Oakes.

"We are still clarifying with the brokers what their attitudes are to PSAs," added Ms. Merry.

# Marsh: Broking model led to abuses, Spitzer says

Continued from page 1

Since the scandal erupted two weeks ago, Mr. Cherkasky has announced reforms in the company's business practices, including the elimination of contingent commissions and improved oversight. He also defended global broking, though, as the model that achieves the best deal for clients, and suggested that a small number of Marsh officials are responsible for the alleged fraud.

"There is no perfection in humanity," Mr. Cherkasky said in a conference call with analysts last week. "We have 40,000 employees in Marsh, and that means there are people who are going to bend the rules."

Marsh's reform plan has done little to mollify critics of the centralized placement model, though.

"When you go to the global broking model, you lose something there with your interaction with your broker and insurance carriers," said Paul Major, director of insurance for Metris Cos. Inc, a Minnetonka, Minn.-based credit card issuer and president of the Minnesota chapter of the Risk & Insurance Management Society.

"Separating the placing of business from the management of the account relationship creates an environment where it's easy to start thinking about things other than the customer, because you are a step removed from the customer," observed John F. Roskopf, a former Aon Corp. executive and now a senior director with Tave Risk Management in Northbrook, Ill.

The potential for abuse remains even with contingent commissions removed from the picture, said Tracey A. Carragher, chairman of Cambridge Integrated Services Group Inc. in Cranbury, N.J.

"When you have control of this kind of (premium) number and you have the attitude that it's not the client's business, it's Marsh's business, there's always going to be room for some kind of abuse," Ms. Carragher said.

"So much premium concentrated in such a thin channel creates opportunities for mischief," agreed John Wicher, principal with merger and acquisition specialist John Wicher & Associates in San Francisco.

Mr. Spitzer sued Marsh earlier this month, charging that executives in its Global Broking division steered client business to insurers paying Marsh the highest contingent commissions and generated phony quotes to create the appearance of competitive bidding.

Marsh last week replaced former CEO Jeffrey W. Greenberg with Mr. Cherkasky and began informal settlement talks with Mr. Spitzer. Mr. Cherkasky said the company will pay "appropriate" restitution to damaged clients, though sources familiar with the talks say the two sides have not discussed specific settlement amounts.

Mr. Cherkasky also outlined reforms to Marsh's business model, including disclosure to clients of all revenue Marsh earns on their accounts, such as retail and wholesale commissions and premium finance

fees; greater "transparency" of Marsh's negotiations with insurers on clients' programs; and expanded internal compliance procedures.

He made it clear, though, that Marsh doesn't intend to abandon its global broking model. The model allows Marsh to use the leverage of its large volume to extract the best terms for its clients, gives clients the advantage of specialists

**Separating the placing of business from the account management 'creates an environment where it's easy to start thinking about things other than the customer.'**

*John Roskopf  
Tave Risk Management*

familiar with their industries and the insurers willing to cover them and reduces errors in the placement process, Mr. Cherkasky and other Marsh officials say.

Mr. Cherkasky also noted that Marsh will have a much easier time auditing compliance in the Global Placement division than it would trying to keep track of activity in scores of branch offices.

"We are committed to it, and we think it's a substantial competitive advantage we have," he said.

## Origins of global broking

The model has developed over

several decades at Marsh. Earlier versions of the centralized placement concept were used at Marsh's Bowring North America unit and in The Quarter Club, a facility formed by Marsh and American International Group Inc. during the excess liability crisis of the early 1980s to consolidate placements for the first \$25 million layer of clients' umbrella programs.

By the late 1990s, Marsh—with the help of consultant McKinsey & Co.—had reorganized itself, specializing its operations based on client size, client industry, insurance product and brokerage function. As part of this process, the New York-based Global Broking division took control of insurance placements formerly handled at the branch level and centralized Marsh's contingent commission agreements, previously negotiated separately by the branches.

Marsh went further with this model than its competitors. Aon, as part of its corporate reorganization a few years ago, separated insurance placement duties from client "relationship management" and new business production, and centralized some functions, but it did so to a lesser degree than Marsh, sources familiar with the company say. Aon also encountered resistance from some clients and employees, though, and in some cases moved services back to branch offices, sources say.

Willis Group Holdings Ltd., by contrast, has gone the opposite direction, preserving most account servicing functions in local offices.

Centralized placement at Marsh quickly created a hub of illegal activity, Mr. Spitzer's lawsuit charges. Global Broking officials separated insurers into "tiers" based on how much contingent commission they paid, and pushed for placements with the highest-paying "Tier A and B" companies, the suit alleges. The brokerage rewarded employees for moving clients to insurers with contingent agreements, and chastised those who negotiated placements on their own rather than routing them through Global Broking; branch office shares of contingent commissions would be cut for any failure to place risks through Global Broking, the suit says.

The strategy rankled some clients and put some local Marsh executives at odds with their own New York office, former clients and Marsh officials confirm.

"It was terribly frustrating for our folks," said a former Marsh executive who now works for a competitor. He described the global broking concept as "highly inefficient," requiring more people to handle the same risk and discouraging direct contact between buyers and their local brokers on the one hand and underwriters on the other.

Global Broking officials also refused to answer local Marsh officials' questions about "back-end" revenues on accounts, telling them it was none of their business, the executive said. On one large property placement, Marsh charged \$700,000 in fees that the client was informed of but took another

See MARCH/next page

## Brokers: Scandal spurs changes

Continued from previous page

Representatives from Chicago-based Acordia Inc.—part of Wells Fargo & Co.—and Daytona Beach, Fla.-based Brown & Brown Inc. did not return phone calls.

Another large brokerage, Heath Lambert Group Ltd., also said it is withdrawing from any volume-based contingent commission agreements with insurers. Those commissions amounted to £1.6 million (\$2.9 million) of its £304 million (\$544.2 million) in revenues in 2003, Heath said.

How far the trend toward eliminating contingent commissions will go remains to be seen, observers say.

"Will contingent commissions be 100% eliminated from every single brokerage firm in every market in the world? Probably not," said Mark Lane, a principal and research analyst with William Blair & Co. in Chicago. But, "clients don't want them, and if the majority of the market is moving toward complete disclosure and elimination, you're going to have to do it," he said, of other brokerage firms.

But Ken A. Crerar, president of the Council of Insurance Agents & Brokers, noted in a statement that while some of the largest brokers are no longer accepting contingent commissions, only two insurers

have stated they are no longer willing to pay them. They are ACE Ltd. and American International Group Inc., which were both named in Mr. Spitzer's suit against Marsh.

"Contingency commissions are both legal and proper, and they have played an important and long-recognized role in the insurance equation," he said. "The debate over proper compensation for the professional services brokers provide is far from over. But however the compensation system for brokers evolves, it is imperative that there be transparency and disclosure."

## Changes at Marsh

Marsh last week "permanently eliminated" the practice of receiving any form of contingent compensation from insurers. Previously, Marsh said it was "suspending" the agreements, which amounted to \$845 million, or 12%, of Marsh's \$6.9 billion in revenues in 2003.

That change was one of several measures the brokerage said it is making in an effort to resolve Mr. Spitzer's allegations.

In addition to eliminating contingent commissions, the brokerage also has pledged to: inform clients about all revenue it earns; require all insurance companies to show commission rates on policies; seek

consistent commission rates; and "provide transparency" on its negotiations with insurers.

Marsh also has formed a global compliance organization to ensure compliance with all regulations and professional and ethical standards within the brokerage.

In the conference call last week announcing the reforms, Mr. Cherkasky also said that Marsh will agree to "appropriate restitution" of clients damaged by the alleged bid-rigging. He added, though, that he does not believe that Marsh's collection of contingent commissions harmed clients.

Executives, however, did not say how the company plans to make up for lost contingent commission revenues, although they said they don't believe clients will bear the burden in terms of higher fees.

"There will be shifts, and it will be around the entire industry, but I don't believe the client will end up paying more," Roger L. Egan, president and chief operating officer of Marsh, said during the call.

Mr. Cherkasky also added that Marsh would retain its global broking system, in which client insurance placements are centralized to provide leverage with insurers. While Mr. Spitzer's suit focused on the global broking division as the center of client-steering and price-

fixing problems, Mr. Cherkasky said that it is "the model that...works" because it provides clients the best deal and is easier to audit than non-centralized placements (see story, page 1).

Observers say MMC's moves were necessary in light of the scandal.

"I think some of the reforms they've outlined seem like good intentions, but whether they will be able to achieve them remains to be seen," Mr. Lane said, referring to such changes as requiring consistent commission rates from insurers. "Theoretically, say they require a 15% commission from everyone; what if AIG wants to pay them 10%, but because of its cost structure they can offer clients the lowest price? What are they going to do, say 'no'? There's definitely a lot of kinks that need to be worked out," Mr. Lane said.

"They did what they had to do," said Steven Ader, a credit analyst at Standard & Poor's Corp. in New York. "They pursued the right road."

Although Mr. Ader described Marsh's actions as "a stabilizing development," S&P is maintaining its negative outlook on the company.

"It's still a developing issue," Mr. Ader said, noting it is a "big positive," however, that Mr. Spitzer said he was not going to pursue criminal charges against the company.

Overall, "we believe when it's all over with, Marsh will be a viable and profitable entity," he said.

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## Late News

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last year, including \$38.5 million to Marsh & McLennan Cos. Inc., the Bermuda-based insurer said. An assistant vp in an excess casualty unit of ACE USA has pleaded guilty to a misdemeanor charge filed by New York Attorney General Eliot Spitzer in connection with his allegations of bid rigging by MMC. ACE said it is cooperating with the investigation and is conducting its own internal probe. In addition, it is no longer paying contingent commissions. ACE saw its nine-month net income drop 12% to \$857 million, due largely to storm losses. Net written premiums climbed 16.1% to \$8.87 billion.

### California legislators to probe benefits

A California Senate committee plans to hold hearings in the spring to determine whether the compensation and benefits strategies of Wal-Mart Stores Inc. and other large retailers effectively push employee health care costs onto the state. Lawmakers' decision to investigate Wal-Mart and other "large box-type stores" stems from an August report by the University of California Berkeley Labor Center that states that Wal-Mart workers are underpaid and are less likely than other retail workers to have health benefits. Wal-Mart disputes that claim, though, noting that nearly

two-thirds of its eligible California hourly employees are enrolled in its health plans.

### Broker pay challenged under California law

Attorneys claiming to represent the interests of personal lines and small commercial policyholders are seeking a ruling in California that contingent commissions paid to brokers are illegal under the state's unfair business practices law. The motion for summary judgment, filed in a San Francisco Superior Court, stems from four identical lawsuits filed in 2002 by the San Francisco Law Offices of Scott C. Turner and Anderson Kill & Olick P.C. The attorneys claim that contingent commissions amount to kickbacks that "provide the broker with a powerful economic incentive to steer business" to certain insurers.

### Synaxis president, CFO on leaves of absence

Synaxis Group Inc.'s president and its chief financial officer are on leaves of absence for reasons the brokerage will not divulge. George J. Anderson, executive vp of the Nashville, Tenn.-based brokerage and its acting interim president, would not say why the company has placed its president, David Haynes, and chief financial officer, James Marks, on leave. Mr. Anderson confirmed that Mr. Haynes is on "a paid administrative leave," but he would not say whether Mr. Marks

also is being paid while absent.

### Florida market share hits RenRe results

Hit by Florida hurricane losses, RenaissanceRe Holdings Ltd. reported a \$70.8 million loss for the nine months ended Sept. 30 vs. a \$444.7 million profit for the comparable period a year ago. The reinsurer reported \$650 million in net hurricane losses. RenaissanceRe Chairman and CEO James N. Stanard said the results "reflect our decision to have a relatively large share of the Florida market."

### Two states join reimportation plan

The states of Washington and Missouri have joined a program launched by Illinois and Wisconsin to enable their residents to buy prescription drugs from Canada and Europe. State and local governments have pursued such programs to benefit from price controls in those countries, even though federal law currently bars reimportation of drugs by anyone but the original manufacturer.

### Mitsui boosts oversight after employee arrested

Mitsui Sumitomo Insurance Co. Ltd. said it is strengthening its management oversight at its overseas subsidiaries after the Federal Bureau of Investigation arrested a former employee at a

U.S.-based unit on embezzlement charges. The Tokyo-based insurer said it fired the former assistant manager at MSI Claims (USA), a New York-based claims adjusting unit, in September. The FBI last month charged the former worker with embezzling around \$1.2 million over nearly five years, funneling checks written to MSI to accounts he had opened, the insurer said in a statement. No further details on the alleged wrongdoing were released.

### Chubb records nine-month gains

Chubb Corp.'s net income reached \$1.08 billion for the first nine months of 2004—up 46.6% over the prior-year period—after the insurer trimmed losses from a subsidiary and boosted property/casualty writings. The Warren, N.J.-based insurer's Chubb Financial Solutions unit lost \$11 million during the nine-month period, compared with a loss of \$20 million for the same period in 2003. Chubb's property/casualty net premiums written, meanwhile, grew 10% to \$9.0 billion for the nine-month period.

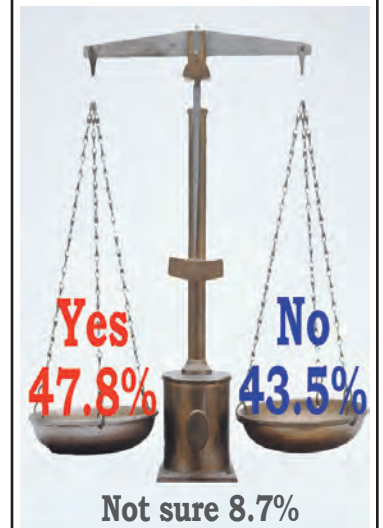
### Check out BusinessInsurance.com

Items in the Late News column originally appeared in *BI's* Daily News feature on [www.businessinsurance.com](http://www.businessinsurance.com). Visit the *BI* Web site to sign up to receive *BI's* Daily News by e-mail.

## Online Poll

[ 10/25-10/29 ]

Will New York Attorney General Eliot Spitzer's investigation into the placement of insurance contracts ultimately benefit insurance buyers?



## BI Stock Index

[ 10/25 - 10/29 ]

Up-to-the-minute data for all 87 companies that comprise the *BI* Stock Index can be found at [www.businessinsurance.com](http://www.businessinsurance.com)

Percentage change of *BI* Stock Index vs. key indicators

<b>BI Stock Index</b>	2146.87	↑ 5.32
<b>Dow Jones</b>	10027.50	↑ 2.76
<b>S&amp;P 500</b>	1130.20	↑ 3.14

### Largest gains

Fairfax Financial Holdings	15.60%
WellChoice Inc.	15.55%
Allmerica Financial Corp.	15.19%
Aetna Inc.	14.10%
CNA Surety	11.46%

### Largest losses

USI Holdings Corp.	-18.84%
Arthur J. Gallagher & Co.	-6.11%
Gainsco Inc.	-6.09%
Hilb Rogal & Hobbs	-5.29%
AFLAC Inc.	-4.47%

### Weekly change by market segment

Brokers	-2.88%
Insurers/Reinsurers	4.39%
Managed Care Organizations	7.43%

Source: FinancialContent Inc. (<http://financialcontent.com>)

## Marsh: Flaws in model?

Continued from previous page

\$500,000 in contingent commissions, wholesale commissions and other charges that the client never knew about, the executive said.

Because of Global Broking's huge profits, "these people took on so much power and political influence that they were pretty much able to bully people to comply," he said.

"These people lost their perspective (and) slowly rationalized their way to thinking profit was everything," he said. "They were absolutely enamored of the huge amount of revenue."

Initially, the push for contingent commissions was aimed at covering the cost of Marsh's reorganization,

including technology to standardize the placement process, make placement details more visible to clients and gather information that could be used to develop new products, said another former Marsh executive now working as a consultant.

The technology development stalled, though, and Global Broking increasingly focused on generating revenue, this executive said.

"I thought it was a train wreck waiting to happen in 1997," he said.

### A sound model?

The Spitzer charges have revived

a debate over whether the global broking model is good for buyers and whether it led inevitably to Marsh's current problems.

In theory, it makes sense for a few brokerage officials to bring the firm's business to an insurer rather than having account managers from across the country "traipsing to New York" to do the same job, a rival broker noted.

"The problem is, it got away from the fundamentals of how you service an account," the broker said. "The client wants a relationship with his underwriters, and the fear is you don't get that with some kind of centralized marketing arrangement."

"For a complex risk, the ability to get your story across to an underwriter is important," he added. In a global broking model, "you feel like you'll be treated like a number. Somebody you've never met is going to go out and market your account."

Mr. Major, the risk manager for Metris, agreed. Now a Willis client, Mr. Metris said he used Marsh at two previous employers and found after the shift to Global Broking that he no longer had "a high level of access" to his underwriters.

He said he now gets most services through his local brokerage office and speaks directly with underwriters when he chooses: "I don't have to have broker involvement in doing any of that stuff, and that's what I like."

## TRIA: Backstop key

Continued from page 3

But without the federal backstop, terrorism is a risk that insurers "want absolutely nothing to do with," said Bruce F. Deal, managing principal of the Analysis Group in Menlo Park, Calif.

Mr. Deal is the co-author of an industry-commissioned study on TRIA's economic impact, "The Economic Effects of Federal Participation in Terrorism Risk." That report, released in September, concluded that a failure to reauthorize TRIA would result in a loss of more than \$50 billion in gross domestic prod-

uct (*BI*, Sept. 20). TRIA is slated to expire at the end of 2005, though the House Financial Services Committee approved a bill shortly before adjournment that would extend the program through 2007.

A two-year extension is needed, said Mr. Deal. Terrorism is a risk still "too unpredictable to be fully covered by the private sector alone," he said. Even alternative risk spreading mechanisms—including new capital, pooling and terrorism catastrophe bonds—simply aren't feasible as the sole responses to the financial threat, Mr. Deal said.

# D&O: ACE, AIG lead Marsh's D&O coverage

Continued from page 1

Spitzer charges that MMC's insurance brokerage unit, Marsh Inc.—the world's largest insurance brokerage—has engaged in bid rigging and price fixing to artificially inflate its revenue. Through bid rigging, Marsh steered its clients' business to favored insurers, regardless of whether their rate quotes were higher than competing insurers, Mr. Spitzer says. The insurers that received Marsh's business paid the brokerage additional fees, or contingent commissions.

Marsh collected \$1.27 billion of contingent commissions over 18 months in 2003 and 2004.

Mr. Spitzer's office last week was in discussions with Marsh, but formal settlement negotiations had not begun. Sources were unsure whether Marsh's D&O policy would respond to any fines or whether Mr. Spitzer would permit Marsh executives to tap corporate indemnification or insurance policy proceeds.

**The coverage issues likely to arise between D&O insurers and the brokerages facing shareholder lawsuits—especially since some of those insurers also face shareholder litigation triggered by the investigation—could lead to some knotty problems for all.**

The shareholders will demand damages that could amount to billions of dollars, their attorneys say.

According to sources, AIG participates in several layers of Marsh's D&O coverage in addition to its \$15 million lead position.

ACE writes the first \$15 million layer of excess coverage, sources say.

Sources say that Marsh has between \$120 million and \$150 million of D&O coverage available to respond to any D&O-related losses.

It was unclear, though, whether those limits are the primary and excess limits dedicated to D&O losses or whether they make up a tower of D&O limits above a blended D&O and errors and omissions insurance program.

Some sources say the blended program's limits have been exhausted by E&O claims triggered by the mutual fund trading scandal that involved MMC's investment management arm, Putnam Investments. Other sources say the blended program covered only Marsh's investment management business.

Representatives for Marsh, AIG and ACE would not comment.

Both AIG and ACE also are targets of shareholder suits. In another twist, all three companies were, until last week, headed by members of the same family: Maurice R. Greenberg is chairman and chief executive officer of AIG; his eldest son, Jeffrey W. Greenberg last week re-

signed as chairman and CEO of MMC in the wake of the scandal; and another son, Evan Greenberg, is president and CEO of ACE.

Aon Corp., the world's second-largest brokerage and also a target of the investigation—though not named in Mr. Spitzer's lawsuit—faces shareholder litigation as well. Like Marsh, Aon's share price has fallen because of the attorney general's investigation.

The investigation has prompted Marsh, Aon and several other brokers to discontinue their contingent commission arrangements.

Shareholders argue that the brokerages' allegedly participated in illegal activities that artificially inflated their share prices and that share values have been and will continue to be hurt if the brokerages must pay fines and disgorge revenue generated by their contingent commission arrangements.

The coverage issues likely to arise between D&O insurers and the brokerages facing shareholder lawsuits—especially since some of those insurers also face shareholder litigation triggered by Mr. Spitzer's investigation—could lead to some knotty problems for all, attorneys said.

The reason is that the brokerages' D&O insurers are themselves D&O policyholders facing claims. Meanwhile, some of the brokerages are major producers of business for their D&O insurers, and insurers could upset that relationship by taking a tough coverage position with the brokerages, attorneys note.

"I can't think of another situation where you have this kind of an incestuous situation," an insurer attorney said.

For shareholders suing Marsh, Jeffrey W. Greenberg's resignation was a tremendously welcome development, said plaintiff's attorney Melvyn I. Weiss, whose firm represents the plaintiffs in one shareholder lawsuit filed against Marsh and its top executives.

After Mr. Greenberg resigned, Mr. Spitzer announced that he would not file criminal charges against Marsh. Instead, he said he would limit his criminal investigation to individuals and pursue a settlement with the company.

Just as they led to the demise of accounting firm Arthur Andersen in the Enron Corp. scandal, criminal charges would have brought down Marsh and negated its D&O coverage, said Mr. Weiss, a partner with Milberg Weiss Bershad & Schulman L.L.P. of New York. Shareholders would have had a difficult time recovering damages from Marsh and its executives, he said.

But other D&O insurance attorneys question whether Marsh's and Aon's shareholders can count on being able to tap the companies' D&O coverage.

Several attorneys say they expect D&O insurers to attempt to rescind the brokerages' coverage—even though at least some of the insurers that participated in Marsh's program also face D&O lawsuits over their own alleged involvement in the bid-rigging and price-fixing scandal.

One insurer attorney, though, said he doubts that Marsh's D&O insurers will attempt to rescind the brokerage's coverage.

**A major argument insurers have used in attempting to rescind coverage is unavailable to them here, because Marsh has not indicated that it will restate its financial reports.**

A major argument insurers have used in attempting to rescind coverage is unavailable to them, because Marsh has not indicated that it will restate its financial reports, the attorney noted.

In many other rescission cases, policyholders had restated their financial reports, the attorney noted. Because those reports were part of the insurance application, the insurers argued the coverage was obtained through misrepresentation.

In addition, insurers have based their past rescission decisions on the premise that their policyholders' insurance application warranties were invalid, given that the applications did not warn the insurers about brewing problems that could trigger losses.

If Marsh's D&O program at its last renewal was placed with the incumbent lead insurer, the insurer likely would not have required Marsh to submit an application and a warranty of its accuracy, the attorney said.

But policyholder attorney William G. Passannante does not agree that renewing with the incumbent lead insurer allows a policyholder to avoid submitting an application and a warranty.

Because of the level of losses D&O insurers have paid over the past several years, large risks sometimes have to submit applications and warranties annually, said Mr. Passannante, a partner with Anderson Kill & Olick P.C. of New York.

Policyholder attorney David Schack, a partner with Kirkpatrick & Lockhart L.L.P. in Los Angeles, agrees. "My experience is that you don't get a free pass," he said.

Mr. Passannante also noted that innocent executives likely would argue that their coverage should not be jeopardized even if they unwittingly signed a coverage application containing misrepresentations made by other executives.

They could run into problems, though, if the policy has a weak severability provision, he said.

Other policyholder attorneys, though, say a New York trial court's ruling in March likely would prevent D&O insurers from rescinding the brokerages' coverage. The court ruled that Chubb Corp. has a duty to cover the defense of an executive at the center of litigation sparked by allegations of massive financial problems at Tyco International Ltd. The court ruled that Chubb could not rescind its coverage before its

rescission efforts were fully litigated (*BI*, March 9).

If retained to represent a brokerage or insurer facing shareholder litigation sparked by Mr. Spitzer's investigation, "I'm citing this March ruling as the best evidence as to how courts should rule on the rescission issue," said policyholder attorney Richard Giller, a partner with Weston Benshoof Rochefort Rubalcava & MacCush L.L.P. in Los Angeles.

Some attorneys noted that insurers could avoid the rescission issue and still deny coverage by invoking either a fraud or a bad acts exclusion. While D&O policy terms and conditions vary from industry to industry and from company to company, those exclusions are frequently included in policy language, attorneys said.

**Launching a coverage battle with their brokerage policyholders could boomerang on the D&O insurers if they also face shareholder litigation and have to tap their own D&O coverage.**

Still, the brokerages and their insurers may have to advance funds to cover the brokerage executives' defense costs until the executives' roles in the scandal have been sorted out in court. That will depend on the brokerages' policy language and how the brokerages' corporate bylaws require them to indemnify their executives before seeking reimbursement under Side B of their D&O policies.

Even though some of the D&O market's largest insurers also face shareholder lawsuits because of their alleged roles in the contingent commission scandal, those insurers likely would raise coverage defenses with any brokerage policyholder facing a lawsuit over its contingent commission arrangements, policyholder attorneys say.

"In my experience, with a claim this big, insurers will go to extra lengths to avoid paying indemnity and defense coverage," Mr. Giller said.

Such an effort by insurers that also are allegedly involved in the scandal "would be a little more than disingenuous," he said. "But consistency is not always the motto of insurance companies when they are trying to limit coverage."

But launching a coverage battle with their brokerage policyholders could boomerang on the D&O insurers if they also face shareholder litigation and have to tap their own D&O coverage, attorneys said.

If the insurers win their coverage disputes with brokerages in court, the legal doctrine of collateral estoppel would bar them from making a contrary argument if they are involved in coverage disputes with their own D&O underwriters, attorneys agree.

"That's going to create some very odd situations for the insurer," Mr. Schack said.

"They are going to be trapped in certain positions they'll take" with their policyholders, said plaintiffs' attorney Darren Robbins.

"It's a difficult position to be in," said Mr. Robbins, a partner with Lerach Coughlin Stoia Geller Rudman & Robbins L.L.P. in San Diego. Lerach has filed shareholder securities litigation against MMC, Aon, AIG, ACE and AXIS Capital Holdings Ltd. over their alleged involvement in illegal activities in their contingent commission arrangements.

As underwriters, insurers can take positions that are inconsistent with those they are taking as policyholders if neither of the cases have been fully adjudicated, Mr. Robbins noted. Neither of those positions, though, would be credible, he added.

Given how the brokerages involved are major producers of business for their D&O insurers, that business relationship may trump any claim disputes the insurers might have, Mr. Schack said.

"So, I might expect them to go easy on one another and live to fight another day," he said. If Mr. Spitzer's allegations about industry collusion as part of the scandal are true, then "you don't have to have a fertile imagination to figure that out."

But such an amicable resolution could come back to haunt the insurers in the form of additional shareholder suits, if shareholder believe the insurers refused to pursue a legitimate coverage defense and paid a large claim that hurt earnings, Mr. Schack said.



## News in a flash

To help readers stay on top of breaking developments in the ongoing investigation into broker compensation and related news in the insurance marketplace, *Business Insurance* is filing breaking news items on these events as they occur at [www.businessinsurance.com](http://www.businessinsurance.com). In addition, registered users of the *Business Insurance* Daily News e-mail product are automatically receiving e-mail alerts of breaking news as it is published online.

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