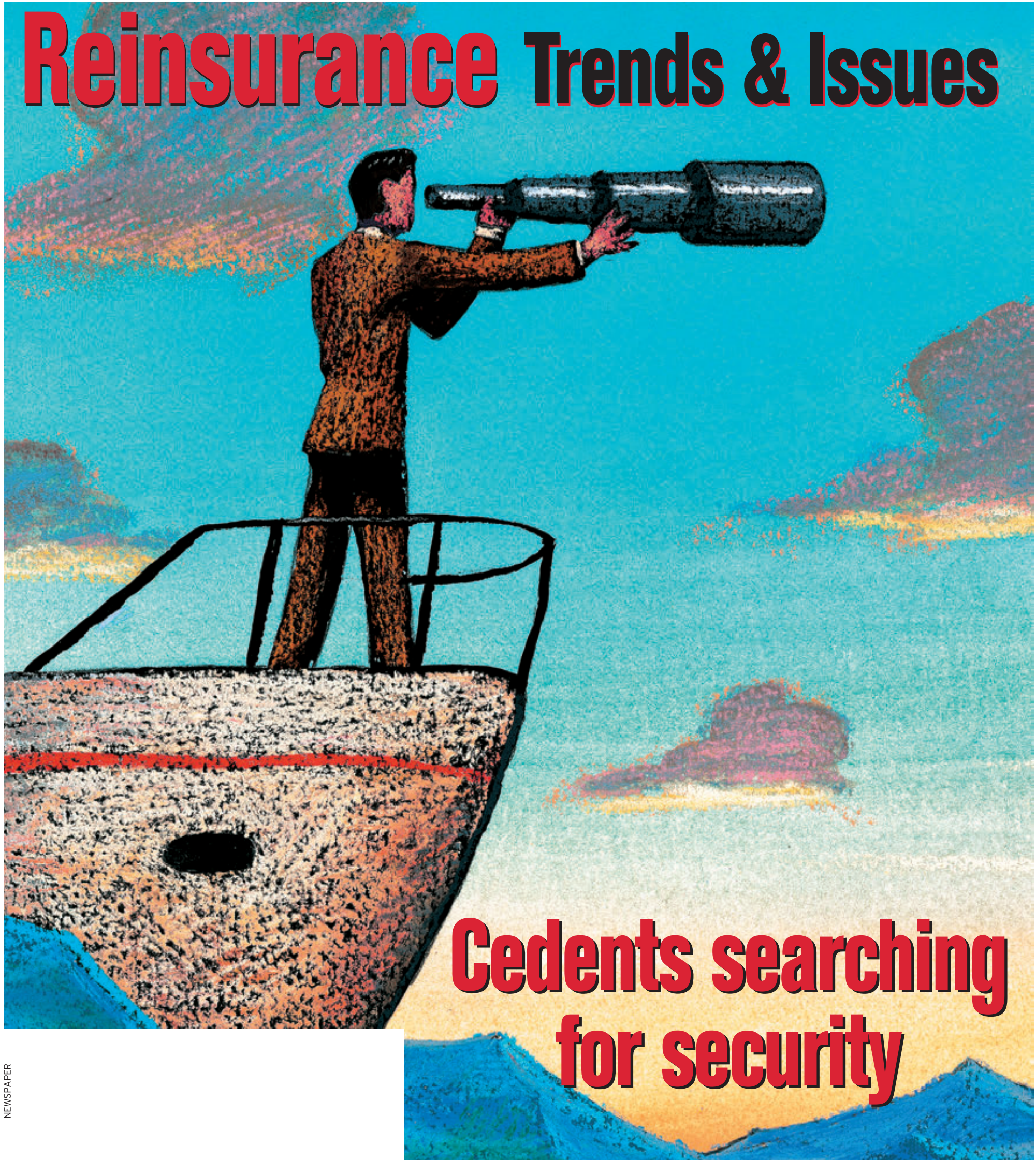


Business Insurance®

November 10, 2003

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\$4

FDA, drug makers fight efforts to ease access to lower-cost drugs

Drug import debate intensifies

By JOANNE WOJCIK

Employers are guardedly watching efforts by state and local governments to import prescription drugs from Canada that, because of government price controls, cost significantly less than those sold in the United States.

But drug makers are retaliating by limiting their supplies to Canada to diminish any surplus that could be sold to Americans.

Federal regulators, meanwhile, are trying to dissuade lawmakers from passing legislation that would permit the reimportation of lower-priced prescription drugs from Canada and elsewhere around the globe. Both drug makers and the U.S. Food and Drug Administration claim that many of these drugs, especially if they are purchased over the Internet, could be counterfeit or mishandled if they do not enter the country through normal channels, which are closely regulated by the FDA.

But even if the reimportation measures are enacted and employers are permitted to obtain lower-priced prescription drugs from other countries, it would be only a short-term solution to the much larger problem of unbridled health care inflation in this country, industry experts warn.

The debate over the reimportation of drugs from Canada began earlier this year, when several cash-strapped states and

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PHOTO: AFP

U.S. lawmakers are trying to make it easier for employers to purchase lower-cost prescription drugs in Canada and elsewhere, a move that's drawing opposition.

Late News

Madison County named top 'judicial hellhole'

Madison County, Ill., tops the American Tort Reform Assn.'s list of 13 "judicial hellholes" for 2003. The list identifies those jurisdictions where ATRA believes "court procedures and the law are systematically applied in an unfair and unbalanced manner against defendants." The rest of the worst five on ATRA's lists were: Jefferson County, Texas; Mississippi's 22nd judicial circuit; Hidalgo County, Texas; and Orleans Parish, La.

PMA to exit reinsurance as top execs quit

Following rating downgrades and weaker financial results, PMA Capital Corp. announced it will stop writing reinsurance business and that its two top executives have resigned. Chairman Frederick W. Anton and President/Chief Executive Officer John W. Smithson resigned last week after PMA Capital reported a \$73.5 million loss for the first nine months of 2003. The insurer said it will take an aftertax charge of \$97.5 million to strengthen loss reserves for PMA Capital Insurance Co., its reinsurance operation. Earlier last week, A.M. Best Co. had downgraded the financial strength rating of PMA Capital and PMA Insurance Group to B++ from A-.

Garamendi urges 14.9% cut in work comp rates

California Insurance Commissioner John Garamendi recommends that the pure premium rate for workers compensation coverage be lowered by 14.9%, citing expected

savings from a new reform law. That is significantly greater than the 2.9% to 5.3% rate reduction proposed by the California Workers' Compensation Insurance Rating Bureau. Such rate recommendations are advisory. However, the comp reform law requires insurers to file rates that



Mr. Garamendi

See LATE NEWS/page 47

Putnam charges deemed unlikely to hurt Marsh

By SALLY ROBERTS

NEW YORK—Regulator and shareholder securities lawsuits against Putnam Investments Inc. and its parent, Marsh & McLennan Cos. Inc., are not expected to have any adverse impact on MMC's risk and insurance brokerage operations.

Although the Boston-based investment management company and New York-based Marsh Inc. have the same parent, they are separate organizations run by different management teams, which should isolate the brokerage from fallout, observers say.

And while MMC's 2003 corporate earnings will likely be lower than expected due to a decrease in assets under management at Putnam, that should not have a material impact on the corporation, analysts predict.

See PUTNAM/page 48

DOL paves way for captive benefits plan

Employer wins fast-track approval

By JERRY GEISEL

WASHINGTON—The Labor Department's approval of International Paper Co.'s request to use its captive to reinsure group life insurance benefits sets the stage for rapid approval of similar requests by other employers.

Stamford, Conn.-based International Paper will use its captive, Vermont-domiciled CircleTree Insurance Co., to reinsure life insurance policies currently written by Metropolitan Life Insurance Co. MetLife will issue the policies and reinsure 70% of the risk with CircleTree.

International Paper's application is the first in the benefits/captive funding arena to be approved under an expedited review process,

in which the Labor Department must give its initial decision within 45 days of receiving an application and a final decision about 30 days after that. The Labor Department gave its approval to the plan last week.

While International Paper is the first to win Labor Department approval under the fast-track process—available in situations where the department has approved two similar applications within the last five years—it will not be the last, risk management and employee benefit experts say.

"There now is a bright line for employers to follow," said Mitchell Cole, a principal with Towers Perrin in New York.

Indeed, several employers already are

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Spotlight

REINSURANCE TRENDS & ISSUES

Begins on page 10



World's largest reinsurance intermediaries

Ranking on page 14

International

INDIAN BROKERS PROTEST RULE

Page 41

Coregis Insurance sells public book to Argonaut

OVERLAND PARK, Kan.—The Coregis Insurance Co. unit of GE Employers Reinsurance Corp. is selling the renewal rights to its public entity insurance business to Argonaut Group Inc.

The acquisition will substantially increase the size of San Antonio-based Argonaut's public entity underwriting unit, Trident Insurance Services L.L.C., which currently generates about \$55 million to \$60 million in annual premiums, said Trident President Michael Arledge.

The Coregis business generates about \$100 million in annual premiums and consists of general liability, law enforcement liability, public officials errors and omissions, auto and property risks.

The acquisition also allows Trident—which has written mostly small to midsize public entity ac-

counts—to take over the somewhat larger "intermediate" accounts written by Coregis, Mr. Arledge said. Most of these accounts carry self-insured retentions of less than \$50,000, he said.

Trident will establish a Chicago office and will hire some of Coregis' employees, Mr. Arledge noted.

GE ERC will continue to use Chicago-based Coregis to underwrite workers compensation and other lines of coverage.

Separately, GE ERC announced that it is revamping its global life and health reinsurance operations, halting new life reinsurance underwriting in the United States and ceasing life and health reinsurance underwriting in Canada, Latin America and the Asia-Pacific region.

The company will continue to write accident and health reinsurance in the United States and will

offer a full line of life and health products in Europe, the company said.

The discontinued business generated about \$1 billion in annual premiums, \$800 million of which was from the United States, according to a GE ERC spokesman.

The reinsurer's ongoing global life and health business produces about \$1.5 billion in premiums, he said.

The cutbacks will result in the loss of about 90 jobs, the company said.

"By focusing on these select products and regions, we will be creating a sustainable, customer-focused business that generates strong returns," Ronald R. Pressman, GE ERC's chairman, president and chief executive officer, said in a statement.

—By Douglas McLeod

House panel hears debate on insurance regulation

By **MARK A. HOFMANN**

WASHINGTON—Congressional patience with the pace of state insurance regulatory reform appears to be wearing thinner.

In fact, a senior member of the House Financial Services Committee said last week that if significant progress on regulatory reform isn't made within the "next year to 18 months," Congress may consider reform legislation of its own. Rep. Paul Kanjorski, D-Pa., offered that assessment as the Financial Services Committee's Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises held its second hearing into the state of insurance regulation last week.

For their part, witnesses representing state insurance regulators



'I do not believe, at this point, that we need to consider a federal option.'

*Mike Pickens
National Assn. of
Insurance Commissioners*

and lawmakers said that they welcomed the federal interest in insurance regulation. For example, New York state Sen. Neil Breslin, a Democrat who serves as chairman of the National Conference of In-

surance Legislators' State-Federal Relations Committee, said his organization

was "grateful for the ongoing dialogue with this committee on efforts to improve the state-based system of insurance regulation." But Mr. Breslin stressed that his organization remains opposed to creating optional federal charters for insurers.

"I do not believe, at this point, that we need to consider a federal option," agreed Mike Pickens, president of the National Assn. of Insur-

See **REGULATION**/page 47



Xerox Chief Executive Officer Paul A. Allaire is one of the defendants in a suit that seeks to rescind part of the company's D&O coverage.

National Union seeks to rescind Xerox D&O cover

NEW YORK—An American International Group Inc. unit is suing to rescind \$25 million in excess directors and officers liability coverage it wrote for Xerox Corp., charging that Xerox misrepresented its financial condition in applying for the policy.

AIG's National Union Fire Insurance Co. of Pittsburgh, Pa., filed the suit in New York State Supreme Court in Manhattan, naming Stamford, Conn.-based Xerox and several current and former Xerox officials, the document imaging company reported in its third-quarter 10-Q report filed with the Securities and Exchange Commission.

Charging that it relied on the allegedly false Xerox financial data, National Union seeks a court order voiding the policy from inception or, alternatively, barring coverage of claims related to misconduct of Xerox or its officials. The \$25 million excess policy was part of Xerox's \$135 million D&O liability and corporate reimbursement program, which also included a potentially unrecoverable \$10 million layer written by the insolvent Reliance Insurance Co., a Xerox spokeswoman confirmed.

Xerox and its officials "deny

any wrongdoing and intend to vigorously defend the action," the 10-Q states.

Six former Xerox executives—including former Chief Executive Officers Paul A. Allaire and G. Richard Thoman—agreed in June to pay a total of \$22 million to settle SEC charges that they used accounting gimmicks to accelerate the company's recognition of about \$3 billion in equipment revenues. The actions inflated Xerox's earnings by about \$1.4 billion between 1997 and 2000, the SEC charged.

The six former officials are among the defendants named in National Union's rescision suit.

Xerox itself agreed in April 2002 to pay \$10 million to settle SEC charges over the alleged accounting fraud. The company continues to face a number of securities class action and shareholder derivative lawsuits, and its financial reporting is the subject of a criminal investigation by federal prosecutors in Bridgeport, Conn., according to the 10-Q. Xerox has denied wrongdoing in the securities litigation and is cooperating with the federal grand jury probe, the filing notes.

—By Douglas McLeod

Inside Business Insurance

Return to fundamentals seen as key to success

Insurers must get back to basics if they are to be profitable over the long haul, a panel says. **Page 4**

Ailing work comp system to bring more hikes

Employers should expect more workers compensation rate hikes as insurers deal with various challenges, one insurance exec says. **Page 4**

Managing the most valuable asset: Brand

Paul Winston examines the brand risk management lessons related to allegations of improper trading at Putnam. **Page 6**

Judicial hall of shame a helpful public service

The American Tort Reform Assn.'s list of 'judicial hellholes' serves as a catalyst for improvements. **Page 8**



Cedents, reinsurers working together

Reinsurance renewals will be characterized by pragmatism and professionalism, say executives meeting in Baden-Baden. **Page 41**

Online

- The **Datebook** calendar lists upcoming industry seminars and meetings and allows you to add info on your own event.
- Searchable **directories** of all the listings of industry vendors found in *BI's* Market Sourcebook.
- New **Opinion Poll** for readers: Do you think that the federal terrorism insurance backstop will be extended beyond 2005?

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What's needed for insurers to regain profitability?

RODD ZOLKOS

CHICAGO—For many insurers and reinsurers, the effort to restore profitability centers on a back-to-basics approach.

Of course, in a cyclical industry such as the insurance business, "back to basics is something you have to do every year in one way or another," said Joseph A. Gilles, president and chief operating officer of Wausau Insurance Cos. in Wausau, Wis.

Adding to the insurance industry's challenge in seeking profitability, "one of the things that continually happens is the environment changes on us," said Richard H.

Napier, senior vp of General Reinsurance Corp. in Stamford, Conn. Consequently, he said, what constitutes "the basics" is constantly shifting.

Messrs. Gilles and Napier were among a group of insurance industry experts offering their views on the industry's quest for profitability at the 13th Annual Executive Forum, which was sponsored by the Katie School of Insurance and Financial Services of Illinois State University and held Oct. 29 in Chicago.

As they attempt to get back to basics, insurers and reinsurers are seeking more information from clients, Mr. Gilles said.

Companies also are exhibiting a degree of underwriting discipline that wasn't always demonstrated during the recent soft market.

"I do think there has been a change in emphasis, that we're more bottom-line focused than top-line focused," said Susan Rivera, president of ACE INA Holdings Inc. in Philadelphia.

Looking at the issue from an insurance buyer's perspective, Mary C. Gardner, director of risk management for Sears, Roebuck & Co. in Hoffman Estates, Ill., said, "Profitability to me relates back to risk assessment and prioritizing the risks of my corporation from a frequency standpoint but also from a severity

standpoint."

If the buyer has done a good job with that risk assessment, it will have an impact on the insurer's profitability, Ms. Gardner said. So, risk managers can help their insurers stay financially strong by providing as much exposure information as they can in as straightforward a fashion as possible, she said.

"The key is, everyone wants the insurers to be profitable," added Nancy Aque, managing director at Marsh USA Inc. in Chicago. "I think what insurers want is not to have surprises."

Michael Weinstein, director of research at Conning Research & Consulting Inc. in New York, said he

thinks investors have a very negative view of the insurance industry. "And I think they approach it in a very simplistic fashion," he said, by trying to work the market cycle by buying insurance company stock when they think things can't get any worse for insurers and selling when times are good.

Still, he thinks investors would be eager to find a company that can demonstrate it can build a sustainable competitive advantage in the insurance market and thrive financially despite changing economic conditions.

Several of the panelists emphasized the importance of quality un-

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High court to review ERISA pre-emption of state lawsuits

WASHINGTON—The Supreme Court last week again agreed to consider how broadly the Employee Retirement Income Security Act pre-empts state law in regard to state patient protection laws.

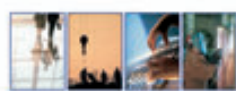
The cases, *Aetna Health Inc. vs. Davila* and *CIGNA Healthcare of Texas Inc. vs. Calad*, both involve the scope of the Texas Health Care Liability Act. Ruby Calad sued the CIGNA health maintenance organization to which she belonged through her husband's employer-provided health care plan, after she suffered complications from a hysterectomy. She claimed CIGNA had forced her to leave the hospital earlier than its own plan physician had recommended. Juan Davila, who also received health benefits through an employer-provided HMO, claimed that the HMO—Aetna Health Inc.—forced him to use a lower-priced drug than the

one his physician had prescribed, which nearly killed him and left him unable to take any sort of painkillers.

Both sued their HMOs under Texas law, claiming the health plans had failed to use ordinary care in making their medical necessity decisions. In both cases, the HMOs, citing ERISA pre-emption of state laws that relate to employee benefits, had the cases moved to federal district court. Neither plaintiff would agree to pursue ERISA—rather than state tort law—remedies, and the courts dismissed the cases. ERISA bans the payment of monetary damages for denied benefits.

In an opinion published Oct. 31, 2002, the 5th U.S. Circuit Court of Appeals reinstated the suits. The Supreme Court agreed to review the cases.

—Mark A. Hofmann



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11th Annual WORKERS COMPENSATION and Disability Management Conference

Keynoter tells how to cure ills in workers comp system

By GAVIN SOUTER

BOSTON—The workers compensation system is ailing, and employers should expect to see further rate increases as workers comp insurers struggle with a variety of challenges, according to Edmund F. Kelly, chairman, president and chief executive officer at Liberty Mutual Group in Boston.

Climbing medical costs, lower interest rates and low premiums have knocked the system out of balance so that insurers are shouldering a disproportionate amount of the costs of the system, Mr. Kelly said.

Furthermore, he said, if Congress fails to renew the feder-

al backstop for terrorism losses when it expires in 2005, workers comp insurers could face insurmountable problems.



Mr. Kelly

"Right now, I would describe the workers compensation system as a sick person," Mr. Kelly said in the keynote address at the *Business Insurance* Workers Compensation and Disability Management conference in Boston last month.

For the system to recover, employers are going to have to pay more for their coverage than they have over the past several years, he said. In 1997, 1998 and 1999, employers were paying about 80% of what they paid 10 years previously, Mr. Kelly said.

While benefits have not kept pace with needs and insurers have not made sufficient returns on capital, employers have seen

See KEYNOTE/page 44

Growing medical costs seen as No. 1 workers comp trend

By MEG FLETCHER

BOSTON—The most important nationwide trend affecting workers compensation this year has been increases in medical costs, according to panelists speaking during the recent *Business Insurance's* Workers Compensation and Disability Management Conference.

This "most critical" trend means that the cost of caring for injured workers' medical needs is now a larger part of each workers compensation claim dollar, said Nancy Schroeder, assistant vp-workers compensation for the National Assn. of Independent Insurers in Des Plaines, Ill., who addressed the conference late last

month in Boston.

According to data from the National Council on Compensation Insurance, "medical claim costs are alarming, with double-digit increases the last two years. In 2002, medical severity increased by 12%, even greater than the 2001 increase of 10.7%."

Yet it is important to remember that comp care "represents only 3% to 4% of total health care expenditures," said Keith Bateman, vp and director of the Alliance of American Insurers in

Downers Grove, Ill.

Several factors contribute to the increasing health care costs of workers comp claims, Mr. Bateman said.

While costs are up for inpatient hospital stays and specialists' fees, the increased cost and utilization of prescription drugs makes that the key contributor, he said.

What's particularly troublesome for workers comp insurers is that many of the tools available to control drug spending in group health plans, such as worker co-payments and the ability to direct an employee to a particular pharmacy, are not available to them (*BI*, Oct. 20).

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Continued coverage
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Forum: In search of profitability

Continued from page 4

derwriting to their companies' brand value.

"Relative to brand value and being an insurance company, I don't think we have any choice," Mr. Gilles said. "Underwriting is the foundation of our business."

"As far as the brand value and the underwriting, we've bet everything on it," added Mr. Napier.

And, while Ms. Aque said she thinks underwriters rarely have an understanding of the companies' bigger balance sheet goals—"I've always thought of them as like the bag boy in the grocery store"—others said they believe underwriters are increasingly making the connection.

"I think one of the challenges we have as an industry is the way we think about underwriting," Mr. Napier said. "I don't think we intend to think of it this way, but it's kind of at the end of the chain of things."

"One of the things we're investing very heavily in is trying to help

people make better decisions," he said.

Several panelists said the industry needs to do business more efficiently as it seeks to regain profitability.

"Obviously, we need to attack the expense ratio as well as the loss ratio," Ms. Rivera said. And, the time and the cost of information technology might both be right for companies to take steps to improve business efficiency, she said.

Data and "being able to slice and dice your book of business" and recognize and manage accumulations are essential to future insurance company profitability, she added.

Mr. Gilles said he thinks that in the insurance industry, the business side has abdicated responsibility for technology to the information technology people. "And we have inherited some really great useless systems or some really terrible useless systems, whichever way you want to look at it," he said.

"I think the brokerage community also needs to be more efficient," said Ms. Aque. "Although we've

made strides, we're not where we need to be." She suggested that part of the improvement might be in brokers relying more on regional offices around the country rather than offices in all 50 states.

In terms of pricing, "I think there's a sense that we're kind of at the edge of the hard market," Ms. Aque said. "I think it's questionable whether we continue on the plateau we're on now or whether it goes down again."

Ms. Rivera said that on the casualty side, further rate increases are needed. "I think we feel that casualty rates have reached a point that's more commensurate with loss costs, but now they need to keep pace with loss costs," she said.

And Mr. Napier said that in terms of excess casualty coverage, "reducing rates is irrational because all you have to do is stand still and loss costs will catch up to you."

Donna Galer, executive vp of Zurich Financial Services Group in Schaumburg, Ill., moderated the panel.

Paul Winston

Marsh's expertise could aid Putnam

Companies today must be more wary of the risks associated with public perceptions of inappropriate behavior, self-dealing or, worse, covering up any such activities.

For management who didn't learn that lesson in the wake of Arthur Andersen L.L.P.'s implosion after the Enron scandal a few years ago, we now might have the example of Putnam Investments Inc.

Last month, Putnam, a unit of Marsh & McLennan Cos. Inc., was hit with securities fraud charges because two mutual fund managers in 2000 allegedly engaged in improper market timing for their personal accounts, in violation of company policy and controls.

Putnam reportedly discovered the alleged wrongdoing and halted it but has been faulted for not taking stronger steps, including not firing the managers, not preventing them from pocketing the profits from their actions and not disclosing the missteps to the public when they occurred.

Now, it might be too late to make amends.

Never mind that timing the market, while not widely condoned, has long been a widespread practice in the investment community and at other mutual fund companies. Never mind that Putnam itself was not enriched by these trades. Never mind that it has since fired the managers and that even its long-term chief executive officer has stepped down.

Many clients of the company simply are unwilling to give Putnam a second chance. Public and corporate investors began to flee Putnam soon after the charges were leveled, and billions of dollars moved away from Putnam funds last week alone. Lawyers are already trolling for clients to sue Putnam. And so we now wait to see if another venerable American company will be trapped in a death spiral, à la Andersen.

The irony of Putnam's situation is that it is owned by one of the world's largest risk management companies. Just as virtually any risk manager can tell an anecdote of a corporate loss that could have been averted had management sought or heeded his or her advice, so, too, must many Marsh risk experts feel about Putnam's unraveling.

One of the best and most lucid presentations I ever heard on the arcane subject of brand and reputational risk was delivered by a Marsh executive a few years ago.

David Abrahams, who is practice leader of brand risk at Marsh Risk Consulting in London, spoke at the Federation of European Risk Management Assns.' 1999 conference in Berlin. His remarks

bear repeating here.

Mr. Abrahams presented a framework for performing a risk analysis of demand for a company's brand. He identified three components of brand risk:

- Qualifiers, which are "norms" often taken for granted or assumed by the public, such as trust, honesty and competency.

"When you reflect on all the crises of reputation, usually they are in this area," said Mr. Abrahams at the time, citing examples of train derailments, plane crashes or bank embezzlement. Today, he would probably add the examples of accounting fraud, ferry crashes and market timing.

- Macro-market, or nonfinancial influences. These include such influences on demand as regulatory, social and usage factors, Mr. Abrahams said. An example of this relevant to Putnam's situation might be changing social attitudes toward or tolerance of corporate practices that, while not illegal, could be seen as unethical.

- Brand equity, which encompasses individual differentiators of a company. Mr. Abrahams explained that brand equity includes those elements of a brand's image that have the ability to shift economic demand for a brand. These include the product or service represented by a brand, its authority as a brand, the approval conferred on the consumer of the brand and how the consumer identifies with the brand. "Damage to a brand is increased by its link to brand-equity elements," Mr. Abrahams noted.

In Putnam's case, its brand equity probably included its stature as one of the largest investment companies in the world, a successful track record in growth stocks and a reputation for integrity and high service.

Corporate management has to recognize that the rules of conduct have changed, as has public tolerance for unfair or shady dealings. This creates a much greater exposure to brands and reputations today compared with even a decade ago. That, in turn, means organizations—and their leaders—have to better manage the risks that can give rise to the destruction of a reputation or brand.

Marsh, Putnam's corporate sibling, knew this; but the investment management company learned it the hard way.

Editor Paul Winston can be reached at pwinston@crain.com



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Editorial

RRGs deserve NAIC study

DOES IT MAKE SENSE to take a position on an issue before studying it?

Obviously not. We are glad to see that the National Assn. of Insurance Commissioners concurs.

As we reported recently, the NAIC is setting up a working group of commissioners from several states to decide what position, if any, the NAIC should take if legislation to expand the federal Risk Retention Act is introduced.

That common-sense approach is decidedly different from the one the NAIC initially headed toward. One of its committees was reviewing a draft resolution—which we think could be fairly described as error-filled—opposing expansion of the federal law that would enable risk retention groups to cover property risks.

Whether the groups, which now can only fund commercial casualty risks for policyholder owners, should be allowed to expand is an issue on which the NAIC has every right to take a position. After all, its members are those who regulate RRGs.

But to stake out a position before hearing from a wide

range of groups, including risk managers, regulators and service providers, seems to be a classic case of putting the cart before the horse.

Maybe allowing RRGs to write property risks is ill-advised. But, if so, the facts should be there to support that position.

As the NAIC begins its research, it should be aware of a basic fact: for a broad cross-section of employers and professionals, including hospitals, educational institutions and physicians, RRGs have provided a long-term stable source of coverage where none was available or affordable in the traditional market.

Given the vital need RRGs are filling, it would seem logical to expand the book of business RRGs can write. If there are shortcomings in the regulation of the RRGs that have contributed to the failure of the groups, the NAIC should identify them so they can be fixed.

As the working group begins its project, we hope it does so with an open mind and offers recommendations that can further strengthen the groups as a safe alternative market option for buyers.

ATRA list fosters reform

IT'S A LIST UPON which no self-respecting judicial district should want to appear, much less take top honors—or in this case—dishonors.

The list in question? The second annual tally of “judicial hellholes,” which the American Tort Reform Assn. released last week. By hellholes, ATRA means jurisdictions where the legal deck is so stacked against civil defendants that justice rarely prevails.

This year's list is longer than last year's—13 jurisdictions compared to last year's 11—with a few “dishonorable mentions” on both lists. And, unlike last year's list, the 2003 version actually ranks the jurisdictions in terms of their unfairness to defendants. Perhaps not surprisingly, Madison County, Ill.—which has gained deserved notoriety as the venue of choice for plaintiffs' attorneys seeking the friendliest possible court in which to file national class-action suits—topped the list.

That's not a distinction a district should seek. ATRA is providing a real public service by pointing out where

the problems are, because it's not only corporate defendants who can suffer unjustly as a result of the kinds of practices that give judicial hellholes their very name.

The courts can only handle so much, so what happens to the local citizen with a garden-variety slip-and-fall claim? According to ATRA General Counsel Victor Schwartz, that citizen may get his or her day in court, but only after having to wait years as massive national class actions wend their way through what's supposed to be a local court.

But the list doesn't contain all bad news. Three jurisdictions on last year's list aren't on this year's because of reforms undertaken by lawmakers and judges alike. Therein lies the true value of the list—it can shine such a bright light on abuses that local authorities are shamed into taking corrective action. We can only hope this year's tally of judicial hellholes will encourage other local leaders to follow suit so they can expunge their names from the list and in the process improve the nation's civil justice system.

Schillerstrom



Letters to the Editor

Claims handling nothing to toy with

To the editor: Your Oct. 27 article, “Massachusetts Raises Standards for Claims-Handling by Self-Insurers,” underscores to self-insureds like Toys-R-U's and others who purport to handle claims that claims-handling is nothing to “toy” with.

Intuitively, there is no reason why “self-handlers” should not be held to the same standards of good faith claims handling and consumer protection as insurance entities. It also highlights the fact that the job of claims-handling always looks easier from afar than it does when one walks a mile in the adjuster's shoes.

Are you willing to assume the burdens of good faith claims handling, market conduct compliance, adjuster licensing and reserving? If so, self-handle away! If not, consider letting professionals discharge this function.

Without adherence to market conduct and good faith claim practice niceties toward claimants and consumers, self-handling claims can become more like self-abuse.

Kevin M. Quinley
 Senior Vp, Risk Services
 MEDMARC Insurance Co.
 Chantilly, Va.

State regulations make unprecedented progress

To the editor: For the last three years as a National Assn. of Insurance Commissioners officer and now president, I have sought to understand why a relatively small but vocal segment of the insurance industry is calling on Congress to create a federal regulator.

I had always heard the primary reason was insurers' concerns about competition from banks, and the problem in a handful of states in getting useful products approved and available to consumers. This argument made little sense: The states regulate bank sales of insurance products, too.

The fact is, state regulators have made a great deal of unprecedented progress in recent years in the areas of producer licensing, protection of consumers' private information and speed to market. We have a one-stop filing system for all multi-state insurance products, the System for Electronic Rate and Form Filing. Through September 2003, nearly 70,000 filings were made through SERFF, with about 40% of those for life insurance products. State regulators continue to make significant progress in these and other areas. Our unanimous passage of “A Reinforced Commitment: Insurance Regulatory Modernization Action Plan” at the NAIC's fall meeting makes clear our strong commitment to consumer protection and regulatory modernization.

So what is the real reason some are pushing for federal regulation? Having made excellent progress,

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Business Insurance welcomes letters to the editor. The 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; fax: 312-280-3174; e-mail: pwinston@crain.com

REINSURANCE: TRENDS & ISSUES

Spotlight Editor: Judy Greenwald



Reinsurance market remains firm into 2004

By JUDY GREENWALD

Risk managers and primary insurers can expect reinsurers' pricing discipline—and higher reinsurance rates—to continue at least through next year, despite a softening in certain lines, particularly property business.

But despite their improved financial outlook, reinsurers continue to look nervously over their shoulders,

largely because of the question of reserve adequacy for previous years' business.

Less likely to be a problem, observers agree, are the limited terrorism coverage assumed by reinsurers, which has been carefully underwritten, and the California wildfires, which are not expected to deeply pierce reinsurance layers.

Most observers also note that the trend toward cedents retaining

more business has slowed although they are generally not cutting back on retentions they already have.

Meanwhile, reinsurance security has become a major concern of primary insurers in light of the recent downgrades (see related story). Most observers say, though, that few insurers have followed American International Group Inc. in pushing reinsurers for additional se-

See MARKET/page 16

Face of market is changing as companies exit, enter

By DOUGLAS McLEOD

"Theatrical" is not a description usually applied to the reinsurance market, but the regular appearance of new players and exits from the industry stage over the last 18 months may make it apt.

A steady stream of established companies has sold off or curtailed reinsurance operations or simply withdrawn from the market since 2002 for reasons ranging from poor underwriting performance to a need to focus resources on core lines of business.

In the most recent examples of this trend, CNA Financial Corp. of Chicago and Hartford Financial Ser-

vices Group Inc. of Hartford, Conn., divested their reinsurance operations to competitors.

Last week, Philadelphia-based PMA Capital Corp. announced it is "exploring strategic alternatives" for its reinsurance operations after a \$150 million reinsurance reserve charge led A.M. Best Co. to downgrade its ratings to B++ from A-. While PMA officials declined to comment on possible strategic options, A.M. Best Analyst Robert Farnam observed that sale or runoff of the reinsurance operations are among the options PMA will face in light of the downgrade.

At the same time, the occasional newly capitalized reinsurer has ap-

peared, with the most notable recent formation being Bermuda-based Quanta Capital Holdings Ltd. in September. The pace of new formations has slowed markedly since the rush of post-Sept. 11, 2001, incorporations, though, and several market observers say they expect little startup activity in coming months.

Several of the post-Sept. 11 startups, meanwhile, have been busy launching initial public offerings, in many cases to supplement startup capital raised in private placements and to allow initial investors to sell portions of their stakes.

See EXITS/page 22

Cedents focused on security due to reinsurer downgrades

By JUDY GREENWALD

Property/casualty insurers are putting renewed emphasis on security when shopping for reinsurance, in reaction to widespread ratings downgrades in the reinsurance sector.

Insurers are either reducing the amount of business they place with particular reinsurers as a result of significant downgrades, or eliminating them from their programs altogether.

But insurers and intermediaries note that insurers are mostly pruning, not slashing, their reinsurance programs. Reinsurers that retain relatively high ratings—even if they have suffered a downgrade—have been relatively unaffected, if at all, by this trend.

Rating agencies generally receive high marks for fair and conscientious rating actions, even though

some market observers criticize the agencies for being too reactive, rather than proactive, in their downgrades.

In their defense, others note that rating agencies are obliged to wait until financial results are released before making any rating changes, while others in the market, including reinsurance brokers and cedents, are free to act immediately based on whatever they hear through the grapevine. This, perhaps unfairly, can convey the impression that the rating agencies are too slow.

A survey by Standard & Poor's Corp. shows how severely the downgrades have affected the industry. Of 20 major global reinsurers, 14 have been downgraded since mid-2001, and eight of these have had their ratings lowered more than once.

Of the five reinsurers that held

S&P's AAA ratings in mid-2001, only one—Berkshire Hathaway Reinsurance Group—still retains that rating (see sidebar).

Cedent reactions

Michael J. Stone, president and chief operating officer of RLI Insurance Co. and Mount Hawley Insurance Cos., two units of Peoria, Ill.-based RLI Corp., said that the insurer has always carefully evaluated its reinsurers' security.

But the recent spate of downgrades has led it to take a closer look at "how we go about managing that, and it's anywhere from (asking), 'Do we raise our retentions, i.e., buy less reinsurance,' to 'Do we reduce the number of reinsurers that we work with?' The answer to all those questions is 'yes,'" Mr. Stone said.

See SECURITY/page 26

BI's annual ranking of the world's largest reinsurance intermediaries page 14

Are long-term relationships between ceding insurers and their reinsurers obsolete? page 20

With so many downgrades of multiline reinsurers, some are debating the importance of the AAA rating page 30

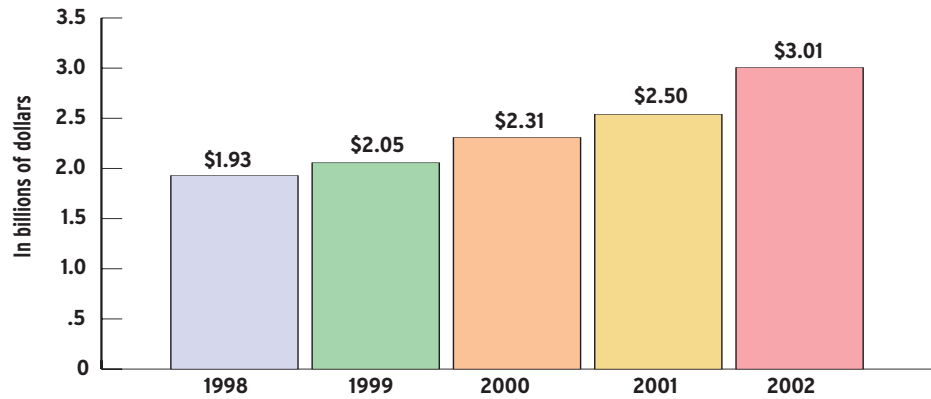
Ever-evolving catastrophe modeling tools are figuring prominently in reinsurers' underwriting decisions page 32

The market for medical malpractice liability reinsurance still has not stabilized, observers say page 36

Some ceding companies are exploring alternative forms of coverage, including finite risk programs page 38

GROWTH IN REINSURANCE BROKERAGE REVENUES

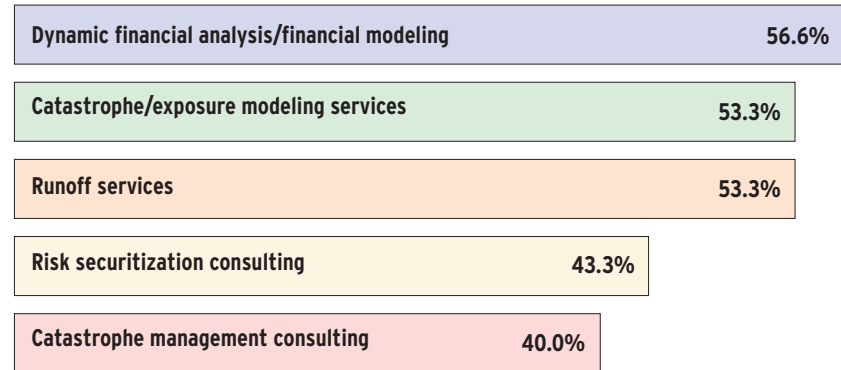
As a group, the world's 10 largest reinsurance brokers had a steady gain in brokerage revenues since 1998.



Source: BI survey

SERVICES PROVIDED BY REINSURANCE BROKERS

Based on percentage of companies offering services other than reinsurance brokering for all companies listed.



Source: BI survey

World's largest reinsurance brokers

Ranked by 2002 gross revenues from reinsurance brokerage and related services

Rank	Company/Address	Phone/Fax/Web site	Reinsurance gross revenues 2002	Reinsurance gross revenues 2001	% change	Employees 2002	Principal officer
1	Aon Re Global Aon Center, 200 E. Randolph St., Chicago, Ill. 60601	312-381-3040 Fax: 312-381-3045 www.aon.com	\$833,000,000 ¹	\$720,000,000 ¹	15.7%	2,900	Dennis Mahoney, executive chairman
2	Guy Carpenter & Co. Inc. 1 Madison Ave. New York, N.Y. 10010	917-937-3000 www.guycarp.com	\$740,000,000	\$625,000,000	18.4%	2,273	Salvatore Zaffino, chairman/CEO
3	Willis Re 10 Trinity Square London, EC3P 3AX, England	44-207-488-8111 Fax: 44-207-488-8976 www.willisre.com	\$462,000,000	\$383,000,000	20.6%	949	John Pelly, chairman/ chief executive-Willis Re
4	Benfield Group Ltd. 55 Bishopsgate London, EC2N 3BD, England	44-207-578-7000 Fax: 44-207-578-7001 www.benfieldgroup.com	\$449,635,145 ²	\$401,648,400 ³	11.9%	1,685	Grahame Chilton, group CEO
5	JLT Risk Solutions Ltd. 6 Crutched Friars London, EC3N 2PH, England	44-207-528-4000 Fax: 44-207-528-4500 www.jltgroup.com	\$140,175,738 ²	\$122,095,355 ³	14.8%	NA	Dominic Collins, chairman/CEO
6	HLF Group P.L.C. Friary Court, Crutched Friars London, EC3N 2NP, England	44-207-560-3000 Fax: 44-207-560-3504 www.heathlambert.com	\$110,657,623 ^{2,4}	\$98,039,016 ⁵	12.9%	581	D.B. Margrett, chief executive
7	Towers Perrin Reinsurance Mellon Bank Center, 1735 Market St. Philadelphia, Pa. 19103	215-963-7700 Fax: 215-963-7873 www.towers.com	\$110,000,000 ⁶	\$66,500,000	65.4%	425	William H. Eyre Jr., CEO
8	Arthur J. Gallagher & Co. Inc. ⁷ The Gallagher Centre, 2 Pierce Place Itasca, Ill. 60143-3141	630-285-3805 Fax: 630-285-4025 www.ajg.com	\$77,355,000	\$56,687,000	36.5%	357	David E. McGurn, president-specialty marketing and international division
9	BMS Group Latham House, 16 Minories London, EC3N 1AX, England	44-207-480-7288 Fax: 44-207-374-5928 www.bmsgroup.com	\$43,873,000 ²	\$34,118,520 ³	28.6%	248	John Spencer, group chief executive
10	John B. Collins Associates Inc. 8300 Norman Center Drive Minneapolis, Minn. 55437	952-820-0012 Fax: 952-820-2700 www.jbcollins.com	\$38,500,000	\$31,125,000	23.7%	140	John B. Collins, chairman/co-CEO

NA=Not available 1 BI estimate 2 Fiscal year ending 12/31/02 (British pound=\$1.5025) 3 Fiscal year ending 12/31/01 (British pound=\$1.4396) 4 2002 numbers are 12-month pro forma from 12/31/01 to 12/31/02 5 Fiscal year ending 3/31/02 (British pound=\$1.4320) 6 Pro forma numbers to include Denis M. Clayton & Co. Ltd. 7 Includes Arthur J. Gallagher Intermediaries (Bermuda) Ltd., Arthur J. Gallagher Intermediaries, Arthur J. Gallagher (UK) Ltd. and John P. Woods Co. Inc.
Source: BI survey

The full Directory of Reinsurance Brokers is available online in the Directories area of www.businessinsurance.com. The searchable directory allows users to locate reinsurance brokers by company name, gross revenues and number of employees, among other information. PDF copies of the directory can be purchased by calling the Crain Information Center at 312-649-5476.

Market: Remains firm into '04

Continued from page 10

curity, nor have those that have done so met with significant success.

Outlook mixed

Most observers say the financial outlook for the reinsurance industry is generally positive, though they may have some reservations.

"The ongoing business, I think, is good," said John Berger, president and chief executive officer of Chubb Re Inc. in Bernardsville, N.J. "I think what we continue to see is

the...weight of the past," including asbestos and losses from past accident years. "But I think the business that has been done since 2001 forward looks really good," he said.

The outlook is "mixed," said David Priebe, managing director for intermediary Guy Carpenter & Co. Inc.'s specialty practice group in New York. There are a number of "significant issues, which I think the market is going to come out of and manage well," he said. These include the impact of the terrorist attacks of Sept. 11, 2001; terrorism exposure; issues related to corporate

governance; the increased impact of asbestos; and the impact of the poor equities market, particularly on European reinsurers.

John Ward, chairman of the Cincinnati-based Ward Group, said that while there was a large influx of fresh new capital that came into the market after Sept. 11, the industry has lost as much in existing capital because of adverse reserve developments and the declining equity markets. "There have also been some fairly prominent ratings downgrades of major reinsurance companies," he said.

As a result, "there's increasing pressure to maintain and demonstrate financial strength...and so that may end up prolonging the hard market cycle," said Mr. Ward.

The industry is well capitalized, though, and it looks like rates will continue to be firm. Furthermore, although investment returns have "been well off the mark...all things considered, it looks like a very positive outlook," said Mr. Ward.

Brian Meredith, senior property/casualty insurance analyst with Banc of America Securities L.L.C. in New York, said, "The stronger, better-capitalized companies, particularly some of the broker market reinsurers, are going to do very well, the reason being you continue to

have capacity leaving the marketplace." Mr. Meredith pointed, in particular, to SCOR Reinsurance Co. as well as CNA Financial Corp.'s sale of renewal rights for most of CNA Re's treaty business to Folsamerica Reinsurance Co. This "leaves companies that are much better capitalized to gain market share," he said.

"The reinsurance industry is continuing to put a lot of focus on the fundamentals of good underwriting," said Mark P. Lescault, head of the divisional underwriting office at Swiss Re America Corp. in Armonk, N.Y.

The business Swiss Re America has underwritten and priced the last several years is "obviously significantly improved from the past, and I see no reason why we're not going to continue on the discipline we need to produce good results on an underwriting basis," he said.

Roderick P. Thaler, executive vp and national director at reinsurance intermediary Willis Re in New York, said he is cautiously optimistic about the reinsurance industry's prospects. "The ongoing results should be very good as the changes in the reinsurance terms over the last couple of years, coupled with the adequate underlying insurance terms and conditions, both rates and deductible levels, on original business, should position reinsurers to generate meaningful returns in 2004," he said.

Pricing discipline

Pricing discipline is expected to continue.

Steven Bolland, president of reinsurance intermediary Gill & Roeser Inc. in New York, said, "We've probably seen the peak, and we'll probably see a little bit of pullback at Jan. 1, but it's a pullback of a minor nature" in certain areas where the experience may justify it. "I think it's still a super market for reinsurers, and 2004 should be a great year for them," he said.

Robert DeRose, senior financial analyst with A.M. Best Co. in Oldwick, N.J., also predicted that next year would be a good one for the reinsurance market.

While property rates are certainly leveling off, "casualty rate increases, while not as robust as they were in 2002 and 2003, are still going to have a good level of rate increases, especially for specialty classes," such as medical malpractice and directors and officers liability, he said.

"In general, we still are optimistic" about the January renewals, said Rick Smith, president and CEO of global property and casualty reinsurance at Overland Park, Kan.-based GE Employers Reinsurance Corp. "My view is that casualty will still have a lot of legs in it. It's been underpriced for so many years that there's still a number of years left of price increases, and...if you look at property, this has been a pretty tough property cat year."

Investment returns

Poor investment returns are likely to help keep the market hard.

"I don't believe anybody can look at 2004 and say they're going to make a lot of money on their in-

See MARKET/page 18



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Market: Remains firm into '04

Continued from page 16

vestment portfolio," Mr. Bolland said. "This is one of the strongest reasons why we aren't going into a soft market any time soon."

"We won't see yields improving significantly for the foreseeable future, we won't see the equity markets improving significantly, so the impact is, if we all face reality, that the investment environment is going to be a rather difficult one," said Mr. Smith. As a result, he said, "we've all got to be a little smarter, or wiser, on how we price deals."

Jack Snyder, chief marketing officer for Princeton, N.J.-based American Re-Insurance Corp, said the investment environment is "tempering the competitiveness of the marketplace because it gives you so little room for error when you work with fixed income yields that are at these historical lows."

Reserve worries

Meanwhile, reserves remain a nagging worry.

Gill & Roeser's Mr. Bolland said, "We've all seen reinsurers putting

up their reserves over the last few years, but whether or not they're adequate and can be maintained, who knows?" It is no secret that when actuaries evaluate reserves, they suggest a range, but it is confidential as to whether a reinsurer ultimately boosts its reserves at the bottom or top of that range, said Mr. Bolland.

Mickey Brookman, chairman of London-based reinsurance intermediary JLT Risk Solutions Ltd., said, though, "It's very difficult to make a general statement about the level of reserves." He added, "You just

have to really understand the nature of the company to make that judgment call."

American Re's Mr. Snyder predicted, though, that "you will continue to see some reserve surprises, and, in our opinion, a fair number of companies, both primary and reinsurer, have yet to fully address the entire potential loss emergence" from the soft market years.

Terry Van Gilder, CEO of the Morristown, N.J.-based Toa Reinsurance Co. of America, said, "I think, generally, reinsurer reserves are probably low still, which is why I think it's important for the industry that the pricing discipline be maintained for some period of time."

Steve Dreyer, managing director

at Standard & Poor's Corp., said S&P had anticipated that there would no longer be reserve additions "of any consequence" this year and that the rating agency would "really start to see the numbers improve, with the better-priced business overtaking the bad news of the past."

But the reserve increases continue, while S&P hears more and more anecdotally about less firmness in the market, said Mr. Dreyer. As a result, "these days, we're feeling like that may have been a very brief" period of opportunity and that "maybe we're not ever going to see real tangible benefits to the companies' ratings as a result of this hard market."

Long-term relationships now getting short shrift?

By JUDY GREENWALD

Although the days when reinsurance deals were settled with a handshake are long gone, opinions differ as to whether long-term relationships between insurers and reinsurers have become obsolete.

For many insurers and reinsurers, a trusted, long-term relationship is still highly valued. Some though, perhaps driven by the need to satisfy shareholders and report profits, prefer their insurer-reinsurer relationships to work on more of a transactional—rather than a relationship—basis, say observers.

Long-term relationships, with minor exceptions, are "clearly a thing of the past," said John Berger, president and CEO of Chubb Re in Bernardville, N.J. "Companies have changed strategies," he said, adding that insurer and reinsurer senior managements have changed, and some companies no longer exist.

"The new capital coming in is clearly transaction-oriented," said Mr. Berger. "I think the old, long-term, gentlemanly, 'everything is going to be OK' attitude is 'effectively dead.'"

Randall S. Jensen, president of New York-based Arthur J. Gallagher Intermediaries Inc., said, "I do think the business has changed." This is not to say long-term relationships do not matter, but "they certainly don't seem to matter like they once did," he said.

However, David Priebe, managing director for reinsurance intermediary Guy Carpenter & Co. Inc.'s specialty practice group in New York, views the situation differently.

"Long-term relationships, particularly in the reinsurance business, are extremely important and are highly valued by both the reinsurers and the ceding companies, so I don't see that changing to any de-

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Deals: Long-term relationships getting short shrift?

Continued from page 18

gree," he said. "In a sense I think there might be a desire to try to find ways to try to improve those."

But, Mr. Priebe said he is also seeing a greater reliance on "the technical and contractual aspects of the relationship, and given the significant liabilities and financial positions involved in these, there is going to continue to be an increased focus" on each party's contractual obligations.

Michael J. Stone, president and chief operating officer of RLI Insurance Co. and Mount Hawley Insur-

ance Cos.—two units of Peoria, Ill.-based RLI Corp.—said if there is a continuum running from long-term relationship to security, "it's probably pushed more to security than it used to be from the standpoint of what's being watched and observed." But, "there's still something to be said for long-term relationships," as long as they remain profitable for both parties, he said.

Roderick P. Thaler, executive vp and national director at reinsurance intermediary Willis Re in New York, said long-term relationships remain

important.

"Oftentimes, cynics talk about how the business is simply a commodity," said Mr. Thaler. "However, an astute buyer still wants to know that when they do hit bumps in the road, that they can rely upon their reinsurers—particularly some mutual companies that don't have ready access to capital."

"I think that, at the end of the day, (the importance of relationships) varies by customer," said Rick Smith, president and CEO of global property and casualty reinsurance at Overland Park, Kan.-

based GE Employers Reinsurance Corp. "There are customers who view reinsurers as opportunistic, and there are other customers that view reinsurers as a strategic partner."

ERC responds to its customers' attitude, said Mr. Smith. "Where customers view us as opportunistic, we must, in turn, view ourselves as opportunistic." However, "we add value to (clients) where there is a partnership mentality, where they want that relationship over many, many years and there's a view that both of us should make a reason-

able return over many years." That accounts for the core of ERC's business, said Mr. Smith.

A balance must be achieved, said Kerry Spaven, vp-ceded reinsurance for The St. Paul Cos. Inc. in St. Paul, Minn. Reinsurers "don't expect just because we're good, long-term players that we're going to pay them extraordinary prices on renewals, and we don't expect them to deeply discount the cost, either. It's a negotiated approach, like every transaction has to be."

'There are customers who view reinsurers as opportunistic, and there are other customers that view reinsurers as a strategic partner.'

*Rick Smith
GE Employers Reinsurance Corp.*

Bill Adamson, chief executive officer of Norwalk, Conn.-based reinsurance intermediary Carvill America Inc., said, "I think many clients are looking for a suitable supply of reinsurance," which requires development of relationships where there is "open communication and (where) the needs of the clients are openly discussed."

Some assert that cedent-reinsurer relationships have never been more important.

John Ward, chairman of the Cincinnati-based Ward Group, said: "I see the relationship between the cedent and the reinsurer to be more important than ever. When we go through tough times and when, especially in times like this, there's more focus on financial strength, I think that a good relationship can ease those types of concerns," said Mr. Ward. "I think a good, trustworthy relationship that's long term and based on mutual respect will continue to be an important ingredient in the segment."



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Exits: Face of reinsurance market is changing

Continued from page 10

Bermuda-based Montpelier Re Holdings Ltd., Endurance Specialty Holdings Ltd. and AXIS Capital Holdings Ltd. have all completed IPOs in the last year. Alea Group Ltd. recently disclosed plans for a \$275 million IPO, while Aspen Insurance Holdings Ltd. announced plans for an IPO last month but has not yet determined a date for the offering or the amount it hopes to raise.

For now, capital market interest in reinsurance share issues appears high enough to support the contin-

uing IPO activity, market observers say. That could change on fairly short notice, though.

"The appetite is there, but (for) a finite period of time," noted Gary Ransom, a managing director with Fox-Pitt, Kelton Inc. in Hartford, Conn. "The appetite is there until it's not there any more."

The newer players have been able to attract capital based on the expected high returns on investment to be made writing business in a tight reinsurance market. The reinsurers' capital structure could change in the future, though, if the

rapid growth of the past two years slows and competitive market conditions return.

Some reinsurers could begin to return capital to their investors in the form of dividends or share repurchases. Dwindling rates of return on capital could also lead to more mergers and acquisitions among today's players.

The reinsurance market of the last 18 months has been marked in part by the number of established players heading for the exits.

In many cases, the departures have involved large, diversified

property/casualty groups that have decided to divest their reinsurance units to concentrate on core insurance businesses.

The St. Paul Cos. Inc. of St. Paul, Minn., was among the first to act during this period, spinning off its reinsurance operations into the newly formed, Bermuda-based Platinum Underwriters Holdings Ltd. Platinum then launched the largest reinsurance IPO of the last couple of years, raising \$966 million in simultaneous public and private share offerings.

More recently, Hartford followed

suit, selling off its HartRe unit in May to Bermuda-based Endurance Specialty Holdings Ltd. A few months later, CNA sold off its treaty reinsurance operations to the Folsamerica Reinsurance Co. unit of Bermuda-based White Mountains Insurance Group Ltd.

"The overriding strategic issue appears to be sticking to the knitting," Sean F. Mooney, senior vp and chief economist with Guy Carpenter & Co. Inc., said of the spate of divestitures. "Companies increasingly want to have a very clear message to shareholders as to what business they are in."

"Quite a lot of organizations are trying to concentrate their capital and other resources on their core business," agreed Kenneth J. LeStrange, Endurance's chief executive officer.

Established property/casualty insurers facing reserving and other problems—and leery of the volatility of reinsurance results—"are stripping the deck chairs to save the ship" by getting rid of reinsurance operations, observed Roderick P. Thaler, executive vp with Willis Re in New York.

European reinsurers stung by losses, meanwhile, made their own series of moves: Gerling-Konzern Allgemeine Versicherungs A.G.—the seventh-largest reinsurer in the world based on 2001 net premium volume—withdrawed from the market late last year, while SCOR S.A. and AXA S.A., both of Paris, dramatically cut back underwriting operations in the United States and Bermuda at the beginning of this year.

Financially troubled Trenwick Group Ltd. of Bermuda also sold off the business of its LaSalle Re Holdings Ltd. unit to Endurance last year before halting underwriting in its other units and earlier this year and declaring bankruptcy.

At the same time, the last year has seen a slowdown in the formation of new reinsurers after a burst of new formations following the Sept. 11 terrorist attacks. At least nine companies were set up between November 2001 and June 2002, ranging from AXIS Specialty with \$1.65 billion in initial capital and Allied World Assurance Co. Ltd. with \$1.5 billion in initial capital, to Olympus Reinsurance Ltd., with \$500 million in initial capital.

That activity had largely died down until the September 2003 announcement that Quanta had raised \$550 million in a private equity offering and planned to begin writing specialty insurance and reinsurance. Quanta is headed by Tobey J. Russ, former president and chief executive officer of Chubb Financial Solutions Inc.

Several market observers said that Quanta's formation was an exception in a climate that for now has probably seen the end of highly capitalized startups.

Many of the sources of private funding for those startups have already established stakes in existing companies, Mr. LeStrange noted. "The supply of capital, if it has not

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Company	Date	Amount raised (\$millions)
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Aspen Insurance Holdings ²	TBD	TBD
AXIS Capital Holdings	7/03	473.0
Endurance Specialty Holdings	2/03	201.6
Platinum Underwriters Holdings	10/02	966.03 ³
Montpelier Re Holdings	10/02	190.5
Arch Capital Group ⁴	4/02	180.0

¹ Offering planned for late November. ² Offering announced 10/03; date and amount to be determined. ³ Includes \$207 million raised in simultaneous private placement. ⁴ First public offering since company restructured in 2000-2001; predecessor Risk Capital Holdings conducted IPO in 1995.

Exits: Face of market changing

Continued from page 22

dried up completely, has diminished significantly," he said.

"I don't think there will be many more startups of any significance," agreed Fox-Pitt's Mr. Ransom. "That hand has already been dealt."

The number of large reinsurance merger-and-acquisition deals may also shrink.

After the St. Paul, Hartford and CNA divestitures, "there aren't that many insurance companies that have assumed reinsurance operations left," Mr. Thaler noted.

Instead, the last year has seen sev-

eral of the newer, privately capitalized players in the reinsurance market launch IPOs, both bolstering their existing capital and allowing initial investors to cash out portions of their holdings.

For example, AXIS—initially capitalized by units of Marsh & McLennan Cos. Inc., J.P. Morgan & Co. and other investors—completed a \$473 million IPO in July. The IPO included sales of stock by AXIS itself—which used the proceeds to bolster capital and for general corporate needs—but also sales by about 60 of the reinsurer's existing

private shareholders, all of which continued to hold sizable stakes in AXIS after the IPO, according to Securities and Exchange Commission filings.

Since then, London-based Aspen Insurance Holdings—formed in 2002 as Wellington Re—announced plans for an IPO in an amount and at a date to be determined, while Bermuda-based Alea Group said it would launch a \$275 million IPO in London.

Going public is the logical next phase for these reinsurers after successful privately financed startups, noted Mr. Ransom.

What capital management moves the reinsurers may next make remain to be seen.

The newer companies are generally expected to perform well, with high levels of policyholder surplus, no reserve legacy issues, strong management and underwriting staffs and a market that remains tight for many lines of coverage.

Reinsurers may react in various ways, though, once their initial spurt of premium growth levels off or if market conditions begin to soften to the point that rates of return fall, observers say.

"The natural next step is (that) once they are no longer in high premium-growth mode, they will start to think of themselves as having excess capital," said Jim Bartie, vp at Moody's Investors Service in New York.

Reinsurers may then start looking for ways to return capital to shareholders, possibly by issuing dividends or by repurchasing shares, Mr. Bartie said.



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REINSURER RETRENCHMENT

Sales, spinoffs and shutdowns
in the reinsurance market,
2002-03

CNA – Sells treaty reinsurance
business to Folksamerica
Reinsurance Co. 10/03

Hartford – Sells HartRe
business to Endurance
Specialty Holdings 5/03

AXA S.A. – Halts underwriting
through U.S.-based AXA
Corporate Solutions
units 1/03

SCOR S.A. – Places Bermuda-
based Commercial Risk
Partners into runoff; curtails
U.S. underwriting 1/03

Gerling Konzern – Withdraws
from reinsurance
market 10/02

St. Paul Cos. – Spins off
reinsurance business to
Platinum Underwriters
Holdings 4/02

Trenwick Group – Sells LaSalle
Re business to Endurance;
Trenwick declares bankruptcy
in 2003 4/02

Overseas Partners – Shuts
down to return capital to
shareholders 2/02

Sirius International – Shuts
down Bermuda-based unit
Scandinavian Re after large
losses 2/02

Security: Cedents focusing on quality

Continued from page 10

But the insurer's response also depends upon the downgrade. A downgrade from a AAA rating to AA or to AA+ has less of an impact than a downgrade from a AA to an A-, or from an A+ to an A-, Mr. Stone noted. "So there's a whole series of questions that are variable, that have to be evaluated on a one-by-one basis," he said.

Barbara Bufkin, corporate vp, business development, for San Antonio-based Argonaut Group Inc., said that reinsurer downgrades have had a "significant impact" on the

insurer's programs.

"We're further evaluating our reinsurance security approved list with particular emphasis on long-tail liability, and we're taking much greater time in discussing the downgrades with our reinsurance partners," Ms. Bufkin said.

Kerry Spaven, vp-ceded reinsurance at The St. Paul Cos. Inc. in St. Paul, Minn., said that the insurer has a formal process, including a credit risk committee, for choosing its reinsurance partners.

"Certainly, the ratings of companies, along with various other criteria,

are explicitly taken into account as we make decisions every day about whom we do business with," he said. Depending upon the level of the downgrade, "it absolutely has a direct impact," he added.

"Generally, we take each downgrade and look at it on its own individual merits," Mr. Spaven said. For instance, "if we think the downgrade is first in a series" and the company is on a "slippery slope," then "yes, we do take aggressive actions," even if there has been only a slight downgrade, he said. Mr. Spaven noted also that St. Paul

looks at each individual entity with which it does business, not just the parent company.

Placement changes

Reinsurance brokers report that cedents are more carefully scrutinizing their reinsurers.

"There's a continued heightened awareness of credit," said Paul Karon, president of reinsurance intermediary Benfield Blanch Inc. in Minneapolis. "We have customers who are accepting fewer reinsurers than they did before. It's

definitely trending to a flight to quality."

David Priebe, managing director for reinsurance intermediary Guy Carpenter & Co. Inc.'s specialty practice group in New York, said, "Each and every insurance company is going to be thinking very carefully through who they're trading with, how much exposure they have, what's the value they're getting out of that transaction."

"People are recognizing that no one counterparty is totally secure, and therefore they need to think more carefully in terms of their overall risk management strategy and probably look at introducing greater diversification," Mr. Priebe said. "I think the real shift that we've seen is many companies thinking twice about putting 100% of their liabilities with reinsurers."

Instead, he said, they are distributing their business over five to a dozen quality reinsurers, "and not necessarily exposing themselves to one single entity."

However, Bryon Ehrhart, president of Chicago-based Aon Re Services, said, "the impact of the downgrades has been to put clients on more cautious footing as they make decisions about treaty allocations, but not substantially more cautious than they were before 9/11 or before the most recent spate" of downgrades.

Ratings trend

Because downgrades have occurred as part of an overall reinsurance industry trend, affected companies do not look as bad as if a downgrade occurred in isolation, analysts note. Furthermore, they say, even companies that have been downgraded still retain relatively high ratings.

"In some respects, the relative ratings haven't really changed that much," said Jim Bartie, a vp at rating agency Moody's Investors Service Inc. in New York. "They have to some degree, but in essence, the entire industry has gotten downgraded, just about," though this trend has affected the European reinsurers' ratings more than those of the Bermuda companies, he said.

"Generally, the rating actions that occurred have been a lowering within the superior range, and those companies are still very strong," said Robert DeRose, senior financial analyst with A.M. Best Co. in Oldwick, N.J.

"They still maintain a very viable business franchise," and are still viewed by ceding companies as long-term players and partners going forward, he said. "The balance sheets of these companies are not as robust as they have been in the past, but they're still financially secure," said Mr. DeRose.

In contrast, he noted, reinsurers that were hit with more significant downgrades—including Gerling Global Reinsurance Group, Trenwick Group Ltd. and Scandinavian Reinsurance Ltd.—are "actually out of the market now, so they're really not ongoing concerns."

Reinsurer impact

Mark P. Lescault, head of the division
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Security: Focus on quality seen

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visional underwriting office at Swiss Re America Corp. in Armonk, N.Y., said he does not believe Swiss Re, which now has an AA rating from S&P, has lost business as a result of its downgrade from AAA. "Swiss Re is one of the strongest and best capitalized reinsurers in the business, so we're in a relatively advantageous position," he said.

"In our case, it's had virtually no impact," said Jack Snyder, chief marketing officer for American Re-Insurance Co., a Princeton, N.J.-based unit of Munich Reinsurance

Co., which also lost its AAA rating and now has an S&P rating of A+.

Rick Smith, president and CEO of global property and casualty reinsurance at Overland Park, Kan.-based GE Employers Reinsurance Corp., which now has an A+ rating from S&P, said its downgrade from an AAA "has had no impact of any significance, nor do I see this having an impact of any significance going through. We're literally as strong as we have been in our 89-year history, and that feels pretty good."

"Customers have told us they

have been with us in the past and will be with us tomorrow," Mr. Smith said.

"As long as a reinsurer can maintain an AA rating or better, there's typically business available to it, but that seems to be the break point," said Terry Van Gilder, CEO of Morristown, N.J.-based Toa Reinsurance Co. of America.

American Re's Mr. Snyder agreed. Once a reinsurer drops into the lower ratings levels, "some companies start to question how much of their long-tail casualty business they are willing to place" with them. As

companies drop in to the "B" categories, they are "almost taken completely out of the market" with the exception of some property lines, he said.

While some reinsurers have been taken off approved lists, most companies receiving downgrades "are solid, professional reinsurers, and will therefore for the most part" remain on the lists, said Richard DiClemente, president of New York-based THB Intermediaries Inc.

"We don't think this is going to be a case of an escalating situation, where we find reinsurers are more and more downgraded" and taken off insurers' approved lists, he said. "I think at this point core reinsurers are still in a fairly good situation."

Value of AAA rating debated

By JUDY GREENWALD

Are the days of several AAA-rated multiline reinsurers largely a thing of the past?

They may well be, say some observers. Reinsurers who have lost their top ratings from the rating agencies may not even be interested in regaining them because the additional business the rating would attract does not justify the cost of the additional capital they would be required to keep on hand.

And, with almost all multiline reinsurers having lost their AAA or A++ ratings, all are pretty much in the same boat, so there is no particular disadvantage to having the lower rating, observers say.

Others, though, believe that reinsurers may want to regain the prestige of the AAA.

At this point, only units of the Berkshire Hathaway Group have the top ratings of Standard & Poor's Corp., Moody's Investors Service and A.M. Best Co. Transatlantic Holdings Inc., which is partially owned by American International Group Inc., also has Best's top A++ rating.

Several other reinsurers have been downgraded recently. The reinsurers that have lost their S&P AAA rating since mid-2001 include Munich Reinsurance Co., Swiss Reinsurance Co., GE Employers Reinsurance Corp. and Allianz A.G. Holding.

Observers note the situation is similar to that in the banking industry, where the number of AAA-rated banks has recently diminished considerably. "Our industry is going the same way," said John Berger, president and chief executive officer of Chubb Re Inc. in Bernardsville, N.J.

Having an AAA rating is no longer all that desirable, say observers. Rick Smith, president and CEO of global property and casualty reinsurance at Overland Park, Kan.-based Employers Re, which now has an S&P A+ rating, said, "I do not see the value of an AAA."

"There's better places to deploy (the) capital that AAA requires, and customers have told us they don't pay more for AAAs," said Mr. Smith. He said he would like to see ERC get back to AA.

Jack Snyder, chief marketing officer for American Re-Insurance Co., a unit of Munich Re, which now has a Best A+ rating, said, "I think the desire to be AAA-rated has greatly diminished" because it is very difficult to generate an adequate return on the capital required to maintain it.

"The companies have a much more acute understanding of the cost of being at AAA, and that means maintaining redundant—

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Rating: AAA debate

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very highly redundant—levels of capital," said Steve Dreyer, managing director at S&P.

Furthermore, for some companies, the cost of maintaining the levels of capital required is "just too high, and they don't perceive the additional business benefit. In other words, they'd be just as happy being a AA," Mr. Dreyer said.

Robert DeRose, senior financial analyst with Best in Oldwick, N.J., said publicly traded companies, in particular, "have to generate returns for their shareholders, and so it may not be economically feasible to maintain the triple A rating."

Bryon Ehrhart, president of Chicago-based Aon Re Services Inc., said: "I think that reinsurers have figured out that the reinsurance treaty business is a subscription business, and that the optimal level of capital to hold, given that it's subscription pricing, is not AAA. I'm not saying that AAA reinsurers don't have some level of advantages," but clients have not shown they are willing to pay for it, he said.

Some disagree, though, about the likelihood of additional AAAs in the future. Jim Bartie, vp at Moody's, said that while it may be a while before the ranks of top-rated reinsurers grow, "it certainly could. I don't

think it's a foregone conclusion there won't be any AAA companies anywhere, but I think it will take quite a number of years" for it to become feasible, he said.

There will always be AAA-rated reinsurers, said Gary Ransom, senior vp at Hartford, Conn.-based Conning Research & Consulting Inc. "It's not a thing of the past," he said.

Patrick J. Denzer, president and co-CEO of reinsurance intermediary John B. Collins Associates in Minneapolis, agreed. Some of the downgraded companies "will, at some point in the future...seek to regain AAA status," he said.

"I think there's a chance they will come back," but not until the business has had a chance to accumulate more capital, said Paul Wilson, a vp with the consulting firm of Bain & Co. in London. "It may be a matter of pride for many of the larger businesses to have that sort of rating," even though having less capital "is obviously a more-profitable way to go."

"I think, on balance, companies would like to achieve that status," said John Ward, chairman of the Cincinnati-based Ward Group. "It's viewed as having importance to the marketplace, and companies would work hard to achieve that accomplishment."

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Cat modeling evolving as risks, technology change

By SALLY ROBERTS

As the technology and data continue to evolve, insurers and reinsurers more than ever are integrating catastrophe modeling tools into their everyday underwriting and business decision-making.

This is a far cry from 15 years ago, when the modeling software was first introduced to a leery insurance industry that had yet to experience a multibillion-dollar catastrophic loss, observers say. At that time, only a handful of companies used cat models, which were limited in scope, and they were seen mainly as probable maximum loss benchmarking tools.

As interest in the models evolved, though, so did the technology and data. Today, reinsurers and insurers are modeling PML scenarios across all lines of business, not only for a host of natural perils across the globe, but also for man-made perils, including terrorist attacks.

Indeed, while Hurricane Andrew in 1992 might have been the catalyst behind the widespread acceptance and use of cat models for property exposures, the terrorist attacks of Sept. 11, 2001, raised awareness of terrorism as a real exposure and the need to expand the models into casualty lines.

Since the attacks, the major cat modelers have developed new terrorism models and are incorporating such casualty exposures as workers compensation into these and other existing models, they say.

But while insurers and reinsurers are using the terrorism models today, the tools have been met with some skepticism and are therefore not being incorporated as widely into the companies' day-to-day business decision-making, observers say.

However, insurers and reinsurers are more often using the natural peril cat models to help make key decisions in such areas as capitalization, reinsurance coverage levels, primary pricing structures and risk selection, observers say.

"It's understood now that, in the catastrophe business...you can't run it without a cat model," said Steven Jakubowski, a senior vp of Impact Forecasting L.L.C., the catastrophe modeling unit of Aon Re Worldwide in Chicago. "The traditional approach of running a trend through historical losses is not good enough for underwriting purposes" any more, Mr. Jakubowski said.

"I think, 10 years ago, (cat models) were kind of nice to have to benchmark what you thought your loss exposure was," said Julie Ser-

akos, a senior vp with Willis Re Inc. in Minneapolis. "Now, it's become very integrated in assisting companies in making business decisions—whether that's on the reinsurance side in determining what an individual account exposure is and how it might correlate with their portfolio,

'We've come from an initial focus on earthquake to a focus on earthquakes, hurricanes, typhoons, cyclones, winter storms, tornadoes, hail storms, flood, fire and, recently, man-made catastrophes such as terrorism.'

Hemant Shah

Risk Management Solutions Inc.

lio, or on the primary side, using them to not only set reinsurance limits but also primary rates and underwriting strategies."

Indeed, cat models have come a long way from the late 1980s, when the tools were first introduced commercially.

"We've come from an initial focus on earthquake to a focus on

earthquakes, hurricanes, typhoons, cyclones, winter storms, tornadoes, hail storms, flood, fire and, recently, man-made catastrophes such as terrorism and industrial accidents," said Hemant Shah, president and chief executive officer of Risk Management Solutions Inc. in Newark, Calif.

Another dimension of the cat model evolution has been geographic, Mr. Shah said. This is a reflection not only of the global nature of the risks but also of the globalization of the insurance industry.

A large commercial insurance or reinsurance company operating in 20 countries with multiple perils can now have a consistent view of its aggregate risk accumulation around the world, Mr. Shah said.

At the same time, better data collection by primary insurers is resulting in more detailed models, allowing companies to not only look at their exposure on an aggregate level but also from an account-specific level.

"When we first started, it was hard to find an insurance company that had the data that we could use to do the modeling," said Richard Clinton, president of Oakland, Calif.-based EQECAT, the cat modeling subsidiary of EQE International. "A lot of that has gone by. Pri-

mary companies have gone through the process of collecting all kinds of detailed information because they want to use the detailed models" on an account-specific basis.

"The reinsurers, for a long time, delayed doing this because the aggregate models were quick and easy to use," Mr. Clinton said. "Now they are seeing that, to take full advantage of what they want to do, they need the detailed models, and they are finding they can get the detailed information from the primary companies or the brokers."

For example, "10 years ago, most insurance companies may not have been able to give you information by ZIP code. Now many can give you actual geo-coded locations," said Karen Clark, president and CEO of AIR Worldwide Inc. in Boston, referring to the latitude and longitude of individual locations.

Armed with this information, more reinsurers and insurers are making pricing and underwriting decisions on individual accounts.

Most of the major reinsurers use multiple cat models and are tying in proprietary pricing mechanisms around those models, EQECAT's Mr. Clinton said. Primary insurers now are moving in the same direc-

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Models: Tools evolve with changes to risks

Continued from page 32
tion, he said.

"You can manage your total PML all you want but, ultimately, that PML is driven by what you write," Mr. Clinton said. "To optimize your use of capital, you have to start to look at better underwriting and risk selection and taking into account catastrophe exposure as well."

"That's one of the areas we, as modeling companies, have as a challenge," he said. "How do we enable these companies to effectively and efficiently bring catastrophe modeling into their day-to-day un-

derwriting?"

While reinsurers may be using the models as an underwriting tool to help price accounts, not all ceding companies are comfortable with such practices.

"Some are, and some aren't," said Ryan Ogaard, managing director of Instrat, Guy Carpenter Inc.'s quantitative risk and financial analysis arm based in Seattle. He noted that there is a growing level of transparency, especially in the property catastrophe excess lines. In such lines, "everyone is seeing the same results, the same data in the same

format, and they can understand each other's modeling results and point of view," he said. Some companies feel "it's less about a business story someone is telling you and more about data and exposure—very cut-and-dry things," he said. "Some companies are a little frustrated by that. They don't feel as though they are getting credit sometimes for changing their book of business."

While natural peril cat models may figure into most reinsurers' and insurers' business decisions these days, the same cannot be said

for the newer terrorism models.

"The scenarios themselves are fairly well accepted; it's the probability around those events where there is still a high level of skepticism," Willis Re's Ms. Serakos said.

"These are just fledgling sort of models," Mr. Ogaard said. "They're not accepted as well as the property models are, but everyone knows you can't ignore these, and they want to have some stakes in the ground in terms of all the same things—levels of capitalization and levels of protection."

"Obviously, there was a lot of skepticism about the terrorism models because they are different," AIR's Ms. Clark said. "With the natural catastrophes, you're studying nature; you have scientists and they understand how earthquakes happen. But with terrorism, you're dealing with the human element, more irrational human behavior, so it's really hard to build a model," she said.

Ms. Clark noted, though, that "the terrorism model is being accepted faster than the natural hazards were after Andrew. Companies are much more used to the whole concept of the catastrophe model; therefore, they are fairly accepting of a terrorism model," she said.

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Med mal market unlikely to stabilize soon

By **ROBERTO CENICEROS**

Don't expect the market for medical malpractice reinsurance to ease any time soon, say risk managers, intermediaries and insurers.

"Everything I hear from our brokers and other people in the business is that the market has still not stabilized," said Michael Seitz, vp of risk management for Fairview Health Systems in Minneapolis. "It's still going to be another year or two before it stabilizes."

Fairview is an integrated health system with seven hospitals, 40 physician clinics and 275 doctors. Mr. Seitz purchases reinsurance for

medical malpractice coverage provided by Fairview's Bermuda-based captive.

Factors driving medical malpractice reinsurance price increases include rising litigation costs, a dwindling number of reinsurers and difficulty predicting long-tail losses, several sources say.

Those main cost drivers for the medical malpractice market don't seem to be easing, said Bob Peduto. Mr. Peduto is chief risk and underwriting officer in Overland Park, Kan., for GE Commercial Insurance and its Medical Protective unit.

"As we look at it right now, all we can say is we don't see things abating," Mr. Peduto said.

Affordability is an issue for many ceding companies, while the availability of desirable limits often depends on how reinsurers view a ceding company's book of business.

Nursing homes and long-term care facilities, start-up operations and managed care organizations face the toughest price increases and conditions.

Managed care organizations, for example, can purchase coverage, but they must often do so with retentions and premium increases that are multiples of their current levels, said Stephen Underdal, managing director and health care practice leader for Guy Carpenter & Co. Inc. in Minneapolis.

"There is ample reinsurance capacity for companies that are established, that are financially sound with strong Best ratings, that operate in favorable jurisdictions, that have been conservative in establishing primary rates and loss reserves and have stuck to their knitting," Mr. Underdal said.

But that is little comfort to some purchasers. Medical malpractice pricing and a lack of availability of desirable limits have driven them to take alternative measures.

Fairview Health's captive, for ex-

ample, has retained an additional \$2 million per claim over the past two years because of rising reinsurance costs. Reinsurers typically will renew existing limits, Mr. Seitz said, but they are willing to do so only at a significantly higher price.

Reinsurers also demand that captives retain more in aggregate limits, Mr. Seitz said.

"Not only do you pay more for your reinsurance but you are also taking on significantly more of your primary insurance through your captive," Mr. Seitz pointed out.

Alamo, Calif.-based Beta Healthcare Group has an A.M. Best rating of A- and has not filed a reinsurance claim in 15 years. Yet its reinsurance costs rose 93% in 2002 and 35% this year, noted Thomas J. Wander, chief executive officer of Beta Healthcare.

Still, those reinsurance rate increases are much better than some insurers experienced, he said. Mr. Wander purchases reinsurance for a hospital and doctor pool managed by Beta Healthcare. He also purchases reinsurance for Beta Healthcare's Hawaii-based risk retention group for emergency room physicians and other doctors.

He already is preparing for a July 1 renewal because his current rein-

surer, GE Employers Reinsurance Corp., stopped writing medical malpractice, Mr. Wander said.

A spokesman for Overland Park, Kan.-based ERC said, though, that the reinsurer still provides a "very modest" amount of medical malpractice reinsurance to certain markets. But the spokesman confirmed the ERC has largely moved out of the medical malpractice market.

While ERC currently provides Beta Healthcare with a \$25 million treaty, "we will probably have to have a number of players on the slip or have multiple treaties at different layers and a restriction in terms," Mr. Wander said. "I haven't heard anybody say that they want to throw \$25 million into a treaty."

The pool has traditionally provided its hospital members' coverage with an occurrence trigger. But, beginning in July, the pool is going to provide coverage only on a claims-made basis, Mr. Wander said.

He hopes the change will get more reinsurers to bid on his business.

Beta Healthcare already has passed on its price increases to its hospital members.

"Some hospitals, because reinsurance prices have gone up and we have had to pass along those increases, are buying lower limits," Mr. Wander said. "Fortunately, we haven't had any losses higher than what people are buying right now."

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Some seek alternatives to traditional reinsurance

By **RODD ZOLKOS**

Whether to cope with or take advantage of hard market conditions, ceding companies increasingly are turning to various alternatives to traditional reinsurance to meet their risk financing goals.

Finite risk programs, surplus notes, derivatives and catastrophe bonds are among the tools companies are using as they look to increase their ability to write business or transfer difficult-to-place exposures.

While for a time it appeared the fallout from corporate scandals at Enron Corp. and elsewhere were driving companies away from structured financings, finite risk continues to

have a place in many companies' programs, according to Mike Leybov, senior vp and practice leader for finite and financial reinsurance at Willis Re Inc. in New York.

"There is a lot of interest on the buyer side in finite transactions," Mr. Leybov said.

"On the buying side, we see two major driving forces behind people looking to buy finite products," he said. One is companies trying to satisfy leverage and surplus requirements; the other is "getting coverage on the finite side for risks where the insurance market is hard," Mr. Leybov said.

"On the reinsurance side, it is a pretty mature, developed market-

place," Mr. Leybov said. All major reinsurers have finite operations that are integrated into the larger company and positioned to take advantage of the company's resources, he said. "It's quite a different position from what it was 10 years ago," when there were only a handful of companies engaging in finite risk transactions, Mr. Leybov noted.

The market for finite reinsurance is "fairly active," according to Andrew J. Barile, president and chief executive officer of Andrew Barile Consulting Corp. Inc. in Rancho Santa Fe, Calif.

"I'm working on one now where we're using the concept to explore a company getting out of a product line," the reinsurance consultant said. "I'm in the market now, and we've got about half a dozen players looking at the opportunity."

That market maturity and understanding of finite risk insurance helped reduce the impact of the series of well-publicized corporate accounting scandals, Mr. Leybov said. "I expected more of an impact of Enron and other accounting-related scandals on finite. It's kind of an easy target," he said. "Probably 10 years ago, the impact would have been greater."

In terms of the scandal's repercussions, "I think what you do see is accounting firms requiring a more substantial proof of risk transfer," Mr. Leybov said.

While there had been talk of raising risk transfer standards in finite risk contracts to achieve insurance accounting treatment, Mr. Leybov said that, instead, the change that has occurred in the market has been less formalized.

"Where a client or auditor looks at risk transfer, they may look at it more carefully, be a little more conservative in the assumptions that underlie the risk transfer," he said.

And, Mr. Leybov said, the shape of finite transactions has changed somewhat. "In general, finite becomes less finite, so to speak," he

said. "I think probably the right word would be 'structured' reinsurance."

Today's finite policies typically involve "pretty substantial risk transfer" combined with structural components of finite risk covers such as a significant financing component or a profit-sharing arrangement. That change is a "significant trend," Mr. Leybov said.

"As long as there is risk transfer, it's reinsurance," Mr. Leybov said. "I think what is more important is the intent of the cover. If it's meant to distort the results of the company, it should not be condoned."

"I think finite reinsurance is a legitimate tool," he said. "But, as any tool, it may be abused or misused. And it was probably misused in the past."

The finite risk market "is not as negative as some people think," Mr. Barile said. "Obviously, they're not going to get away with some of the things they have in the past when it looked like there was no risk to the reinsurer."

"It's not something that's talked about as much as it used to be because people realized there were a lot of misuses of finite risk reinsurance," Mr. Barile said. "There were too many instances in the past where a finite risk reinsurer kept a company afloat that should have gone under."

Another trend in the market is companies looking to address surplus issues through tools such as loss-portfolio transfers, quota-share reinsurance and surplus notes.

"The backdrop for our clients has been one of surplus strain vs. underlying premium growth," said Rob Darby, managing director and head of the structured risk specialty practice at Guy Carpenter & Co. Inc. in New York. That surplus strain, he said, generally stems from the effects of the prolonged soft market, and it is making it difficult for many companies to take advantage of the current hard market "to make hay."

"That's really been the backdrop of why surplus relief vehicles have been popular," he said. "If you look at the types of deals we did three years ago vs. what we do now, it's clearly shifted to surplus relief-type products."

With products coming from both reinsurers and the capital markets to help buyers address their surplus concerns, "we recognized our clients were saying, 'Which is better for me?'" Mr. Darby said. To help answer that question, Guy Carpenter developed an internal model for comparing the use of quota-share reinsurance with issuing surplus notes.

"They have a different effect, obviously," Mr. Darby said. "But they (both) have an effect on what the leverage ratio is going to be and how the company is going to look after you purchase these things."

Guy Carpenter's model overlays the impact of each approach on the client company's financial statement. Mr. Darby noted that the model is flexible and doesn't have to be used for comparison purposes. A ceding company can use it to determine the impact on its financial statement of each of the different approaches, or just to model different quota-share scenarios.

Also, the model has a module that

looks not just at the impact of the two approaches on a buyer's financial statements, but also at the costs of each approach.

The market for another reinsurance alternative, risk-linked securities, also continues to show slow but steady growth.

"2003 is shaping up to be the year with the greatest amount of issuance since the inception of the market in 1997," said John DeCaro, vp at investment bank Cochran, Caronia & Co. in Chicago. "There's been about \$1 billion of issuance through the end of September."

In addition to deals involving major players, such as Swiss Reinsurance Co., "We've really seen a number of first time issuers who hadn't been in the market before," Mr. DeCaro said. "We've also seen some risks come to market that hadn't previously been securitized."

Among the noteworthy deals were June's Phoenix Quake and Phoenix Quake Wind issues brought to market by Swiss Re for Zenkyoren, the Japanese National Mutual Insurance Federation of Agricultural Cooperatives. The \$470 million in securities represented the largest cat bond issuance since the USAA Group's 1997 Residential Re deal, Mr. DeCaro said.

Another significant deal in August was a \$100 million cat bond brought to market by Swiss Re on behalf of the Taiwan Residential Earthquake Insurance Program, Mr. DeCaro said. "It was the first time that Taiwan quake risk had ever been securitized," he said, adding that the deal was "extremely popular" with investors, as the Taiwan risk represented a diversifying exposure for their portfolios.

At present, there are about \$3.1 billion in outstanding risk-linked securities, Mr. DeCaro said, and "We're aware of a relatively robust pipeline for the next two months." In addition to growth in the number of issuers, there also is a continued influx of new investor capital to the market, he said.

"For us, a cat bond is an alternative that we discuss with clients," Willis Re's Mr. Leybov said. "I think this market also is becoming more mature. I think it's probably a very good niche way of transferring property cat risk." And, he agreed that "There's a lot of interest on the investor side in cat bonds."

Mr. Leybov said he sees a continuum of risk financing options developing, with traditional reinsurance and cat bonds at the two ends of the reinsurance spectrum, with the space between occupied by other instruments that might have some of the characteristics of each.

Some companies are using various forms of derivative contracts, for example, to cede risk, he said. In those cases, while "the ultimate risk taker is a capital markets player," the contract lacks the liquidity of a cat bond. "Sometimes it's funded, sometimes it's not," Mr. Leybov said. "Hedge funds are entering this area."

The development of that continuum of reinsurance alternatives, though, is still in its early stages, Mr. Leybov said. "It is developing. It's still a very young area," he said.

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Between the Lines

Compiled by Joanne Wojcik



Looking to U.S. for health care cost tips

At a time when the U.S. health care system is on life support, it's ironic that Great Britain would look to us for a cure for its own medical cost ills.

The cash-strapped National Health Service is consulting with Kaiser Permanente to help reduce hospital admissions. The NHS said Oakland, Calif.-based Kaiser's operating budget is comparable to the NHS' but more efficient. For example, a Kaiser patient having hip replacement surgery typically spends four days in the hospital, while the NHS average is 12.

"In many ways, Kaiser Permanente is like the NHS, providing a similar range of services for a population equivalent to that of a small country," according to an analysis comparing the two systems published by the British Medical Journal.

But is he faster than a speeding bullet?

He may not be Superman, but PremierLine Insurance's Customer Service Supervisor Clark Kent is a superhero to U.K. small businesses.



"Nobody running a small business is a superhuman, but sometimes it pays to flex your business muscles a bit when negotiating with your insurer," said Mr. Kent, who has developed 10 "Super Tips" as part of the Lancaster, England-based broker's marketing materials.

Among them: "Read Minds. Don't accept the first quote you're given no matter what the claims made by the seller." He also suggests clients "use your superpowers to swat aside minor attacks" by self-insuring small claims.

Rip cords and bodice rippers

Ever wonder what risk managers do to ease stress during the hard market?

"I jump out of airplanes," said Lance Ewing, president of the Risk & Insurance Management Society Inc. and executive director of risk management at Las Vegas-based Park Place Entertainment. Mr. Ewing said he's only made six jumps so far, but he plans on a lot more because he finds it to be a great stress reliever. "I get a huge adrenaline rush."

Stephanie Giancola, risk management specialist for the Massachusetts Department of Housing and Community Development, has chosen a more prosaic pastime. "I write racy romance novels in my spare time. They are most definitely politically incorrect in nature, and probably more risqué than risky," she said. "But this creative outlet does do the trick when it comes to stress relief!" Her first novel, "Between a Rock and a Mad Woman," published by St. Martin's Press under the pen name Stephanie Green, should be on store shelves soon.

Write on!

More fun with HIPAA

Lawmakers are racing to close a loophole in the 1996 Health Insurance Portability and Accountability Act that lets health plans deny coverage for injuries from common recreational activities, such as motorcycling.



HIPAA bars plans from excluding from group coverage or charging higher premiums to individuals who participate in activities some insurers may consider hazardous, but benefits for a particular injury can be excluded, say sponsors of the Health Care Parity for Legal Transportation and Recreational Activities Act.

The bill, introduced in the Senate by Sen. Susan Collins, R-Maine, and in the House by Rep. Scott McInnis, R-Colorado, would stipulate that benefits may not be denied for any injury "solely because such injury resulted from...an activity such as motorcycling, snowmobiling, all-terrain vehicle riding, horseback riding, skiing, or other similar legal activity."

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

Products & Services

Offshore outsourcing coverage offered

LONDON—Political risk coverage for offshore outsourcing is being offered by Miller Insurance Services Ltd. and Liberty Syndicates in London. The coverage is designed to pay for the business interruption and relocation costs that companies may sustain if their outsourced operations in overseas locations are forced to close due to sanctions, war, confiscation and other perils.

Traditional political risk coverage does not apply to outsourced operations, as the companies that contract with the overseas service providers do not own the overseas assets, said Matthew Moore, underwriter at Lloyd's of London syndicate 282, managed by Liberty Syndicates, which underwrites the coverage. The policy offers up to \$40 million in limits for relocation costs. The policy is marketed by Miller in London and is available through U.S. brokers.

For more information, contact john.eltham@miller-insurance.com.

NIA group launches consumer-driven plan

NEW YORK—NIA Group L.L.C. has developed a new consumer-driven health care plan for the

metropolitan New York market.

The plan, called The NIA Way, is designed to contain costs while providing employees with flexibility in how they pay for health care. Features include debit cards for access to flexible spending accounts and personal care accounts, discount programs, and Web tools that provide consumers with convenience and purchasing power. The plan includes provider relationships with Walgreen Co. drugstores and Town Sports International health clubs to provide wellness services.

More information is available from Marc Hudak at 212-850-0135.

Benefits tool provides real-time data access

TIMONIUM, Md.—Benelogic has introduced new software that gives benefit managers and consultants real-time access to benefits data, with a suite of management tools.

The company's Client Management Portal provides a single point of access to all eligibility and billing files, content and group statistics. Additional features include a year-by-year summary of specific benefit programs, monitoring of open enrollment status and tracking and verification of enrollment.

More information is available at

www.benelogic.com.

Claims litigation info available online

CHICAGO—Visibility Inc.'s newly redesigned Web site is a "one-stop shop" for information on claims litigation management.

The site, www.visibility.com, offers those interested in claims litigation several resources that will help them stay current on emerging trends and provides a forum for communicating with colleagues on ways to reduce claims costs through litigation practices. The site also contains research and articles on claims litigation topics.

Lawyer's liability policy available

NEW YORK—Navigators Pro, a division of Navigator Management Co., is offering a lawyer's professional liability policy.

The coverage, written by Navigators Insurance Co., offers limits of up to \$5 million under the LPL Magistrate policy. It is available to firms with up to 75 attorneys.

The policy has a broad definition of professional services, which include services rendered in an attorney/client relationship as well as duties performed as an arbitrator or mediator, notary, title agent, administrator of an estate, executor, guardian, trustee or similar fiduciary capacity.

More information is available from Navigators at 212-244-2333.

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Pragmatism marks Baden-Baden gathering, participants say

Ceding companies seek stability

By CAROLYN ALDRED

BADEN-BADEN, Germany—A pragmatic and professional approach to the reinsurance renewal season likely will prevail this year, attendees at the 2003 reinsurance meeting in the German spa town of Baden-Baden agreed.

In the midst of a hard market in which reinsurer security remains a major concern, cedents and their reinsurers are learning to work with one another, executives who attended the working meeting said.

"I have attended Baden-Baden since 1976, and I was impressed this year with the professional approach taken. There was no screaming, no crying, no 'gotcha' attitude. Every side is becoming aware of having to manage the risks together," said Michael Handler, chief executive of Guy Carpenter & Co. Inc.'s Zurich, Switzerland-based continental European operation.

"I was encouraged that the feedback this year was about stability," said Gary Head, U.K. underwriting manager of London-based Hiscox

Insurance Co. Ltd.

At this year's meeting, there was a somewhat relaxed atmosphere," compared with previous years, commented Frank Schaar, Cologne, Germany-based executive vp of Converium A.G.

"There is a greater understanding in the primary insurance sector that adequate risk pricing is necessary. Buyers want to see reinsurers who will be long-term partners," said Franz Hertl, executive manager for Germany with Munich Reinsurance Co. in Munich, Germany.

Buyers want to "stick with professional reinsurers who underwrite properly, even if they are more expensive," said Dietrich Schardt, reinsurance buyer for Cologne-based Gerling Group.

"We value long-term relationships with our clients, so we take the same approach to reinsurance. We should not do business with someone who cannot make a profit," Mr. Schardt said.

"Insurers and reinsurers have improved underwriting results this

See **BADEN-BADEN**/page 43



Reinsurers' security was one of the main topics at this year's reinsurance meeting in Baden Baden, Germany.

World Updates

Alea planning \$275 million IPO

Reinsurer Alea Group Holdings (Bermuda) Ltd. is planning to raise \$275 million in an initial public offering on the London Stock Exchange this month. Alea, which has operating units in the United States, Bermuda, the United Kingdom and other countries, will use the proceeds to expand underwriting capabilities and redeem \$50 million in subordinated preferred stock, sources say. A.M. Best Co. affirmed the group's A- rating after the announcement. Alea is owned by affiliates of the investment firm Kohlberg Kravis Roberts & Co.

SCOR posts loss, plans share issue

SCOR S.A. plans to raise 600 million euros (\$694.8 million) and to continue to overhaul its business. The announcement accompanied the reinsurer's nine-month earnings report, for which it posted a 349 million euro (\$404.1 million) loss, largely stemming from a reserve increase. That compares with 425 million euro (\$492.2 million) loss for the year-earlier period. In addition, SCOR plans to spin off its life reinsurance operations into a separate entity but maintain ownership of the unit. Previously, the reinsurer said it would seek other investors for the operation. SCOR also plans to continue focusing its U.S. operations on short-tail business with midsize cedents. SCOR U.S. wrote gross premiums of 444.5 million (\$514.7 million) in the first nine months, down 44% from the same period last year.

Chinese insurer IPO raises \$695 million

China's largest insurer raised \$5.40 billion Hong Kong (\$695.0 million) last week in its initial public offering. Shares of PICC Property & Casualty Co. Ltd. soared on the Hong Kong Stock Exchange on the day of the offering as investors eager to buy into China's emerging insurance market drove the price up to \$2.70 Hong Kong (35 cents) from its \$1.80 Hong Kong (23 cents) opening. The offering precedes IPOs in the works for China Life Insurance Co. and Ping An Insurance.

Storebrand posts nine-month profit

Norwegian insurer Storebrand Group reported profits of 633 million kroner (\$82.3 million) for the first nine months of 2003, compared with a loss of 1.73 billion kroner (\$224.9 million) in the same period last year. The improved earnings are mainly due the better investment returns, according to Storebrand.

German employers moving away from defined benefits

By BENJAMIN SEEDER

BERLIN—Several German companies are restructuring, or are considering restructuring, their pension plans into defined contribution schemes or cash balance plans, a move they hope will save millions in future contributions.

German companies have been converting their book-reserve plans to advance funded pension plans since the mid-1990s. That shift gained steam in the past year, especially after a decision last spring by the two major U.S. credit rating agencies to treat companies' pension obligations as corporate debt.

But now the trend—boosted by Robert Bosch GmbH, Siemens A.G. and Lufthansa A.G.—seems to be toward defined contribution plans, or in some cases cash balance plans, and away from traditional defined benefit plans.

Stuttgart-based Bosch plans to shift its book-reserve pension plan to a funded defined contribution scheme, one company source said. Bosch has 3.2 billion euros (\$3.71 billion) in pension liabilities for its German operations. The source said it will be awhile before any change is implemented.

"It is going to happen eventu-

ally, but we are waiting to see the platform we can use. It may be awhile off," said the source, who requested anonymity.

But Bosch is already well down the road in converting its pension plans in other parts of the world, including the United States and Japan.

According to Dave Davis, director of compensation and benefits at Bosch's U.S. subsidiary, Robert Bosch Corp. in Broadview, Ill., the company "has a proposal before the board" on converting the company's \$650 million traditional defined benefit plan to a cash balance plan.

Bernhard Wiesner, head of company pensions in Germany, said Bosch's schedule in the United States is being delayed because of a recent federal court decision that said IBM Corp.'s cash balance plan violated the age-discrimination provisions of the Employee Retirement Income Security Act of 1974.

Neither Mr. Wiesner nor Mr. Davis would say when they expect the U.S. effort to resume.

But Mr. Wiesner said a similar project in Japan would continue, whereby the company's defined benefit plan would be restructured into a cash balance plan.

Jurgen Radomski, chief per-

See **GERMANY**/next page

Indian regulator riles brokers over commission rules

By ELIZABETH FRY

NEW DELHI, India—Brokers in India are protesting changes in regulations that severely restrict their ability to charge commissions on commercial business and that reward policyholders that deal directly with insurers.

The Insurance Brokers Assn. of India is calling for the Insurance Regulatory and Development Authority to overturn the regulatory changes and has threatened to sue the regulator if it does not take action.

The brokers say that the changes, which took effect this summer, radically change the commission structures that were in place when they first applied for licenses.

"It violates the very basis on which brokers have injected capital into the country, bought licenses and started operating as brokers," said Mitul Vora, a partner with Mumbai-based Willis RB, a joint venture established by Willis

Group Holdings Ltd.

Bharat J. Boda, president of the Insurance Brokers Assn. of India, said the association would take legal action within two weeks if the situation were not resolved.

Brokers established in India after the Broking Act was passed in 2001. Under that legislation, brokers are entitled to charge commissions of between 10% and 17.5%, depending upon the type of nonlife business they place.

In June, though, the IRDA changed the regulations so that commissions could not be charged on commercial business for state-owned companies; many of the large industrial and commercial companies in India have some form of state ownership.

Also in June, the IRDA made a change that favored brokers by abolishing the 5% discount that insurers were permitted to offer non-state-owned companies that dealt directly with insurers rather than through a broker. A few weeks later, though, the IRDA reversed that change and reinstated the dis-

See **INDIA**/next page



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In re: Petition of Nigel Hall and Anthony Bamber, as Foreign Representatives of **MARLON INSURANCE COMPANY LIMITED** (formerly Skandia Marine Insurance Company (UK) Limited and Vesta (UK) Insurance Company Limited), Subject of a Foreign Proceeding.

In re: Petition of Nigel Hall and Anthony Bamber, as Foreign Representatives of **THE NATIONAL INSURANCE & GUARANTEE CORPORATION LIMITED** (formerly The National Insurance & Guarantee Corporation Plc), Subject of a Foreign Proceeding.

In re: Petition of Nigel Hall and Anthony Bamber, as Foreign Representatives of **RIVERSTONE (STOCKHOLM) INSURANCE CORPORATION (PUBL)** (formerly Odyssey Re (Stockholm) Insurance Corporation (publ), Skandia International Insurance Corporation (publ), Skandia Reinsurance Corporation, Amphion-Aequitas Reinsurance Corporation, Amphion Insurance Corporation and Amphion Reinsurance Corporation), Subject of a Foreign Proceeding.

NOTICE OF ENTRY OF ORDER GIVING FULL FORCE AND EFFECT TO SCHEMES OF ARRANGEMENT AND GRANTING RELATED INJUNCTIVE RELIEF

PLEASE TAKE NOTICE THAT on November 5, 2003, the Honorable Cornelius Blackshear, United States Bankruptcy Judge for the United States Bankruptcy Court for the Southern District of New York entered an Order giving full force and effect to Schemes of Arrangement under Section 304(b) of the Bankruptcy Code and granting related injunctive relief in the above-captioned cases. Parties in interest may obtain a copy of such Order and the referenced Schemes of Arrangement by making written request to the undersigned attorneys for the Petitioners.

Dated: New York, New York November 5, 2003

LOVELLS
 Attorneys for Petitioners
 By: /s/ Karen Ostad
 Karen Ostad (KO 5596)
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Germany: Shift away from old pensions

Continued from previous page

sonnel officer at Siemens in Munich, said the company will be converting its estimated 11 billion euros (\$12.74 billion) in defined benefit pension assets to a defined contribution pension plan, effective Oct. 1, 2004.

"For Siemens, the (new arrangements) will make the benefit cost considerably easier to calculate," Mr. Radomski said in a statement.

"It is primarily uncertainties arising from future interest rate developments, connected with the longer life expectancy of our employees, that have made this modification of our scheme necessary," he said.

Last year, the company was forced to cough up 2.6 billion euros (\$3.01 billion) in additional contributions to help plug a funding deficit that had grown to an estimated 4.5 billion euros (\$5.21 billion).

Lufthansa of Cologne, which has 4.2 billion euros (\$4.86 billion) in pension liabilities funded from corporate book reserves, is toying with the idea of shifting to a defined contribution-style scheme, said Andreas Noth Durft, vp-human resources.

"These liabilities are unfunded in Germany, but there is some thinking going on about how we can change this," Mr. Noth Durft said.

He declined to offer details on which path the company would take.

The move to funded defined contribution plans is a trend among German companies, according to

Ulrich Kamm, a consultant with Georg Seil Consulting GmbH in Wiesbaden.

"The German companies that do have funded defined benefit schemes have found out in the past few years, like the ones in the U.S. and Britain, that there are costs involved in running these schemes. I think that's the reason behind so many companies considering converting to DC-style," he said.

The companies that are considering switching to a funded plan might choose defined contribution schemes, among a number of options, he added.

"In Germany, there are any number of ways that companies can provide employee pensions. Setting up a (defined contribution) pension fund is one of them, but there are also insurance means—pension-skasse," Mr. Kamm said.

German companies are beginning to shift to funding pension liabilities and away from their long-held tradition of paying pensions on a "pay-as-you-go" basis from book reserves.

Analysts say the shift is taking place because of expected changes by 2005, when international accounting standards are scheduled to be adopted by European Union countries.

Another factor is the realization by German corporations that an approach more consistent with the rest of the world works better in attracting foreign investors.

Benjamin Seeder is a reporter for Pensions & Investments, a sister publication of Business Insurance.

India: Brokers riled by regulatory flip

Continued from previous page

count. Mr. Vora said the brokers were staggered by the sudden turnabout by the IRDA only 18 months after brokers were first permitted to apply for licenses. "This prevents brokers from approaching any other than minnow-sized companies, and our exclusion from the big companies will stifle the growth of the fledgling broking industry," he said.

Brokers will still be able to charge for risk management advisory and consultant work, but these areas do not normally generate high fees, he said.

"India has around 250 brokers that are holding capital based on the commissions and return on capital they were expecting to achieve," Mr. Vora said.

Neil Mathews, chief executive officer of Aon Global Insurance Services in Mumbai, blames the sudden backflip by the IRDA on mounting pressure from national

insurers. Mr. Vora agreed that insurers are feeling threatened by the entry of the brokers and the probability of intense competition, which will reduce the premium income and hurt their bottom line.

And the reintroduction of the 5% discount came shortly after a new chairman at the IRDA was appointed in July, bringing with him a change in regulatory view, said Mr. Mathews.

The IRDA has convened a special committee to investigate the issue of the 5% discount; the committee is expected to report within the next two weeks. The committee is also reviewing the issue of commissions and is expected to report on that by the end of the year.

A spokesman from IRDA would say only that it is deliberating on this issue and will report very soon. The spokesman said that he could not discuss the issue of pressure from insurers.

Baden Baden: Stability sought

Continued from page 41

year, and both sides admit they need more of this," he said.

"Long-term relationships based on profitability and stability are important" for cedents, said Mr. Head, who is responsible for buying reinsurance for Hiscox Insurance's U.K. and European personal and professional risks.

Casualty remains firm

As a result, the increased pricing of recent years likely will be maintained this renewal, particularly in the casualty market, where, because of the long-tail nature of the exposures, buyers need their reinsurers to be around for the long haul, attendees observed.

In Germany, large commercial risks, particularly those in the pharmaceutical sector, likely will see significant casualty rate increases again this year, executives noted. Lines such as directors and officers, in particular, will be marked by large increases, they said.

"There is still a need to increase prices for casualty risks, particularly in the industrial sector," said Mr. Hertl.

"Rate increases will vary from class to class and country to country, but there will be no softening" of casualty rates, said Mr. Handler.

Converium's Mr. Schaar said he expects casualty rates to increase from 10% to 15%, with large commercial portfolios facing bigger increases, higher retentions and reduced coverage.

Indeed, a continuing lack of excess capacity and higher pricing in

the casualty market likely will prompt many ceding companies to take higher retentions, particularly in certain areas such as the United States, said Michael Pickel, a director of Hannover Reinsurance Co. in Hannover, Germany. He is responsible for property/casualty reinsurance for Austria, Germany, Italy and Switzerland and for credit and surety worldwide.

Mr. Pickel also predicts a capacity crunch for D&O cover.

There also is continued talk about exclusions in casualty lines, a matter of heated debate last year, together with a greater focus on transparency and more-limited cover, Mr. Hertl said.

Mr. Pickel noted that there likely would be no relaxation in casualty exclusions this year and that some sectors, such as the pharmaceutical industry, could see exclusions for production risks such as product recall.

In addition, asbestos-related risks, which already are excluded for many geographical territories, also are being excluded in the German market, Mr. Hertl noted.

And some reinsurers are excluding risks related to electromagnetic-field exposure, such as that created by cellular phones. Although there is, as yet, no clear evidence that electromagnetic fields cause bodily injury, there is enough uncertainty to make reinsurers think twice, said Mr. Hertl.

As a result, an electromagnetic-field and electromagnetic-radiation exclusion clause is being introduced in reinsurance treaties in Germany with respect to the third-party lia-

bility of producers of cellular telephones and network operators, Mr. Hertl confirmed.

Mr. Pickel said he does not think, though, that there will be a total exclusion on electromagnetic-field risks this year. "There is no conclusive evidence that EMF is a risk. It will depend what policies cover," he said.

Mr. Handler of Guy Carpenter

'There is little certainty about reinsurance security, and we are certainly looking very carefully at allocating our exposure across a panel of strong reinsurers.'

Gary Head

Hiscox Insurance Co. Ltd.

agreed that "there is no clear consensus regarding EMF."

Credit and surety is another area where capacity still remains tight, with several European reinsurers having pulled out or reduced their capacity, noted Mr. Pickel.

Reinsurers are conscious of the huge accumulation risks in credit and surety business, and rates likely will continue to increase, he said.

With several companies moving away from credit and surety reinsurance, capacity will be short, said Mr. Schaar.

Meanwhile, "there is no problem with capacity for property," said Mr. Pickel. Although the losses from several storms that hit Germany last winter proved to be more

costly than anticipated, catastrophe rates likely will be stable this year, Mr. Pickel predicts.

More uncertainty surrounds the marine market, where continued competitive pricing in the direct market is forcing some reinsurers to reconsider how much marine reinsurance they want to write, said Mr. Schaar. He noted that Converium will be writing only a "limited" amount of international marine reinsurance for 2004.

"There still appears to be a considerable amount of capacity for plain-vanilla marine risks," although several marine reinsurers are exiting the market, said Robert Miller, director of London-based Miller Insurance Services Ltd.

Concerns over security

Buyers' willingness to pay higher prices for reinsurance protection stems largely from concerns over reinsurance security following a spate of rating downgrades across the reinsurance industry (see story, page 10).

"Reinsurance security is an imminent concern," said Mr. Schardt.

"Cedents are looking for financially strong reinsurance companies, and there are not many left," said Mr. Schaar, noting that concern over reinsurance security is forcing cedents to change their buying behavior.

"Clients do not want to put too many eggs in one or two baskets and are looking for a handful of companies to spread their risks. They are looking for diversification and to spread their risks among, say, five companies, none taking more than about 20%," he observed.

While considerable new capacity is available in Bermuda, the new companies are not tried and tested and often lack the experience of the European insurance markets, said Mr. Schaar.

Hiscox Insurance is typical of many buyers that are reviewing their reinsurance arrangements.

"There is little certainty about reinsurance security, and we are certainly looking very carefully at allocating our exposure across a panel of strong reinsurers," said Mr. Head.

Among the issues Hiscox looks at are reinsurers' ability to pay, willingness to pay and knowledge of their cedents' business, he said.

While the company takes into account the views of rating agencies, the investment community and brokers, it also relies on its own research, he said.

Gerling also is reviewing its reinsurers, said Mr. Schardt, pointing out that it will likely have some new companies and a more balanced group of reinsurers. It also is placing all its property/casualty reinsurance on a nonproportional basis.

Rating issues are important, but cedents also look closely at service, leadership and expertise from their reinsurers, said Mr. Hertl.

"They want to find partners who are there for the long term," he said.

Letters to the Editor

Continued from page 8

state regulators now hear from some of the proponents of federal regulation that their concern is not so much product competition from banks but competition for the customer—for the customer relationships and lists and information banks possess—and the one-stop financial services shopping a bank can provide. Another real concern is the inability of insurers to achieve the return on equity that banks enjoy, and statutory reserve requirements which tie up capital. Most insurers' capitalization far exceeds the requirements of state risk-based capital and other laws so they can keep their ratings high. Perhaps the concern about capitalization is more a concern with rating agencies than it is state regulation and consumer protection laws.

It just may be now is the time for American regulators to move from a relatively static financial solvency analysis to a more modern, dynamic risk-based approach, one which will both protect consumers and allow flexibility for insurers. The current federal charter proposals do nothing to help in this regard. Instead, the current proposals create a huge, new costly regulatory bureaucracy in Washington, which will inevitably mean the lowering of consumer protections, accountability and responsiveness; the loss of premium tax revenue for state governments and money for our guaranty funds; and dual or multiple layers of more costly regulation for producers and insurers.

The current corporate-owned life insurance debate in Washington and the proposed increased taxes on life insurance products during the Clinton administration, etc., are prime evidence that some in Congress see the insurance industry as a "cash cow"—a way to indirectly increase taxes for all of us who are insurance consumers to pay for a vast array of new government spending.

What I have learned about the state vs. federal regulation debate this year has made me more committed than ever to state regulation, to improving consumer protection and creating truly efficient regulation, through regulatory modernization.

I respectfully request the proponents of federal regulation to support our efforts and continue to help us identify needless costs and burdens that may exist in the current system. The consumer expectations, culture and history of the insurance business are much different from banking or securities. This is true all over the world. Regulators need to hear what the real concerns are and exactly what we should consider to address them. We can work from there. The prospect of success for consumers, state governments and the industry lies in improving our proven state-based system, not in the creation of a pie-in-the-sky federal regulator.

Mike Pickens
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Workers Compensation and Disability Management Conference

Preparation crucial to placing work comp coverage

By MEG FLETCHER

BOSTON—Employers seeking to buy workers compensation insurance in the current hard market should keep it both positive and personal when dealing with prospective insurers.

That was the advice of two brokers and a risk manager who participated in a panel discussion on "Winning in a Seller's Market: Making Your Program Shine" during *Business Insurance's* recent Workers Compensation and Disability Management Conference, held at the Fairmont Copley Plaza in Boston.

Broker Lorrie R. DeWerd, senior vp-risk management for Willis Group Holdings Ltd. in Boston, emphasized the need for an employer to first engage in "internal market-

ing," which includes discussing a business plan and agreeing on a renewal strategy, as well as managing expectations to avoid surprises.

The employer then needs to engage in "external marketing," which Ms. DeWerd describes as starting early to "tell a good story" that would put the employer's risk in the best possible light.

That presentation should include educating prospective insurers about your business and seeking to understand issues that concern your underwriter, she said. Employers should be prepared to demonstrate their company's loss and safety control programs and quantify the positive impact of loss-control programs, Ms. DeWerd said.

Given the uncertainties of today's markets, though, it is always neces-

sary to have an alternative Plan B available, she added, without providing details.

In addition, Stan Long, chairman of broker Marsh Inc.'s workers compensation practice, emphasized the need for employers to seek technical support when placing difficult risks.

"Avoid attempts to spin, argue platitudes or overstate competition for the placement," Mr. Long said in his presentation.

He also urged employers to break down negative numbers or results for the company and perhaps the jurisdiction. That, for example, may require reporting separately an unusually large loss or specific results in a sometimes-difficult state such as California, Mr. Long said.

In terms of predicting future loss-

es, he said it is important to be very specific. Mr. Long advised, for example, that the only law changes—such as those that may have the impact of reducing benefit or claims costs—that should be cited are those that have already gone into effect, never those that are merely proposed or pending.

Ann Barry, the risk manager for Boston-based Fidelity Investments, said her biggest challenge in finding insurance coverage was her company's concentration of risks in several "hot cities" that insurers perceive as potential terrorists targets—New York, Chicago, Los Angeles, Boston and Washington.

In marketing her company, she said it was "critical" to meet face to face with underwriters so she could explain to them the steps Fidelity has taken to reduce its exposures. For example, it split its New York workforce of about 1,000 people and moved about half of them to a building in New Jersey, she said.

In addition, Ms. Barry said underwriters responded favorably to presentations by Fidelity's internal experts in security, real estate and operations, who gave detailed explanations of the company's loss-control programs, training and practices. Coupled with favorable loss control data, such presentations help differentiate her company's safer-than-

average operations, she said.

Another important loss control practice her company follows is to keep a low profile through limited signage.

"We don't advertise our buildings," Ms. Barry said.

She also urged employers to develop good personal relationships with vendors, by lunching with them, for example, because "loyalty makes a difference." She credits such relationships with limiting rate increases last year to 100%, rather than the 200% to 300% that other companies experienced.

In addition, she urged buyers to seek long-term relationships with vendors.

While buyers may be suffering from the current hard market conditions, they are not alone in causing them, said John T. Leonard, president and chief executive officer of Portland, Me.-based MEMIC—the former Maine Employers' Mutual Insurance Co.—and its MEMIC Indemnity Co. affiliate.

Insurers contributed to the problem by discounting premiums for too long, he said. Insurers' financial situation then worsened when interest rates dropped and medical costs soared, he said.

Barry E. Thompson, president of Risk Acuity L.L.C. of Thomaston, Conn., moderated the panel.

Trends: Medical costs increase

Continued from page 4

In addition, employers and insurers are grappling to cope with the growing use of the painkiller OxyContin. The drug, which was originally intended for people suffering from severe long-term pain, has become one of the most popular drugs prescribed for workers comp claimants. The concern with the drug stems from its addictive nature and how some users are abusing it.

Some claimants who use it become addicted while recovering from their injuries and then must go through a detoxification program before they can return to work, Ms. Schroeder said.

In addition, the slow-release medication can produce a heroin-

like high when consumed after being ground up. It has a street value of 10 times its cost, which may entice some workers to make money by selling it, Ms. Schroeder said.

But rising medical costs are not the only national trends that have emerged this year, Ms. Schroeder said. Another trend concerns federal impingement on state workers comp programs, she said.

That "is an increasing and disturbing trend," said Bruce C. Wood, assistant general counsel with the Washington-based American Insurance Assn. One of the most serious examples of that is the federal Medicare program's "far more aggressive stance" in protecting its status as "the secondary payer" of benefits to previously injured workers, he said.

Consequently, Medicare is requiring employers to establish trust funds to pay the medical costs of older injured workers to help ensure that employers and their workers comp insurers primarily pay such costs, so that they are not left to Medicare, he said. The Medicare secondary-payer issue "has been increasingly disruptive" and is expected to continue because Medicare is going broke at the same time Congress is expanding the drug benefit Medicare offers under its program, Mr. Wood said.

Lobbying efforts heretofore have not resolved the problem, so the next step is to get Congress to step in and define Medicare's appropriate interest in a state-based workers comp system, he said.

Another example of federal impingement is a bill (H.R. 1562) approved by the House Veterans' Affairs Committee that could allow veterans to receive medical care for workers compensation claims through the U.S. Veterans' Administration. It also would permit that entity to recover full charges for any such medical care, which could increase workers comp costs, Mr. Wood said.

Despite those infringement issues, some progress has been report-

ed in resolving workers comp payers' concerns about their continued access to claimants' medical data, following enactment of the Health Insurance Portability and Accountability Act earlier this year.

Payers need access to such data to resolve claims and had been concerned that physicians might respond to the privacy requirements by denying information to them, although the law's preamble expressly excludes applying those provisions in the case of workers compensation claims, Mr. Wood said. While there have been pockets of problems, the education effort appears to be succeeding, Mr. Wood said.

Another national trend concerns various types of activity involving state-specific funds, which generally exist at least to provide a source of workers comp coverage, if none is available elsewhere.

Developments this year include concerns about the solvency of the competitive California state fund, which, if declared insolvent, could "take down" private insurers linked to it by guaranty funds, Mr. Bate-man said.

Meanwhile, the Arizona state fund is suing legislators who sought to use its accumulated assets for general expenses, he said.

In several states, though, there have been proposals to allow a fund to write others lines of insurance, such as medical malpractice insurance in Oregon, he said.

Finally, workers comp insurers continue to be concerned about state funds that seek to write workers comp insurance outside their borders while still maintaining their federal tax exemption, he said. That exemption reduces their cost of operation relative to their private insurers, who have complained that their entry into the marketplace constitutes unfair competition.

The session moderator was Wayne L. Salen, director of risk management for Home Quality Management Inc. in Palm Beach Gardens, Fla.

Keynote: Curing ills in work comp system

Continued from page 4

their costs decline, he said. "So it is inevitable that the group that will feel the most pain in the attempts to redress the balance is the employers."

But if the workers comp system is to offer a stable and effective way to deal with injured workers, it must remain in balance, Mr. Kelly said. "Over time, we must all share the cost in the workers comp system," he said.

One of the main problems affecting the workers comp system is medical inflation, Mr. Kelly said. Ten years ago, 35 cents to 40 cents of each dollar paid in workers comp claims was spent on medical expenses, but today 55 cents in every dollar paid is attributed to medical claims, he said.

Furthermore, the scope of workers comp claims appears to be expanding to cover illnesses that previously would have been covered by health insurance and the duration of workers comp-related illnesses is also increasing, he said.

Insurers are also facing problems associated with the general economy, Mr. Kelly said. With interest rates at historically low levels, insurers are seeing their investment income shrink, he said.

"With low discount rates and more of the claim subject to medi-

cal inflation, we are exposed to a spread far in excess of the discount value," Mr. Kelly said.

To try to deal with the problems in the system, risk managers must use every tool at their disposal and partner with good-quality insurers and other service providers, he said. And there must be public involvement in addressing changes in the health care system.

"When it comes to workers comp, I don't think anyone could, or should, be comfortable," Mr. Kelly said. There has to be a state-by-state effort to "get it back on track helping injured workers to get back to work," he said.

Also, the federal backstop for terrorism-related losses provided in the Terrorism Risk Insurance Act needs to be extended beyond its 2005 expiration, Mr. Kelly said.

Even with the backstop, insurers are exposed to huge losses, Mr. Kelly said. Under the sliding scale of protection provided by TRIA, Liberty Mutual, for example, would next year have to suffer a \$750 million loss before TRIA coverage kicked in, he said.

"Without the extension of TRIA...the workers comp system will be threatened," Mr. Kelly said. So risk managers as well as insurers should work to try to obtain an extension of TRIA, Mr. Kelly said.

138 attend conference

BOSTON—The 11th annual *Business Insurance* Workers Compensation and Disability Management Conference attracted 138 people to Boston Oct. 20-22.

The conference kicked off with roundtable discussions for employers and service providers, followed by one and one-half days of open sessions on a wide range of subjects, including innovative risk financing techniques, legislative developments and new strategies to cut lost-time injuries.

All of the presentations will shortly be available to be viewed through streaming video at www.businessinsurance.com.

The chairman of the advisory board for the conference was Jeffrey W. Pettegrew, vp of insurance and risk management at Westaff Inc. in Walnut Creek, Calif.



Workers Compensation and Disability Management Conference

Aggressive steps to combat fraud urged

By **GAVIN SOUTER**

BOSTON—Employers must take an aggressive approach if they want to reduce workers compensation fraud, a panel of experts says.

But knowing the signs of fraudulent claims and being prepared to deal with them are just part of the process. Preventing fraud before it starts is also key, the experts note.

However, employers must also be cautious and realize that valid claims can have the appearance of fraud, and those claims must be treated with added care, a consultant said.

"We are not going to stop workers comp fraud, but we can do things to control it," said Dennis Jay, executive director of the Coalition Against Insurance Fraud in Washington.

Mr. Jay was part of a panel discussion at the *Business Insurance* Workers Compensation and Disability Management conference held in Boston last month.

There are several red flags to watch out for in workers comp fraud, he said. They include:

- Monday morning injuries, when someone is injured over the weekend and tries to pass it off as a workplace injury.
- New employee injuries, when someone specifically looks for a new job in order to get workers comp coverage for an existing injury.
- Employee retaliation, when someone who has been disciplined seeks to "get back at the company" by filing a workers comp claim.
- Employee termination, when workers file claims after a plant closing has been announced.
- Late return to work, when the return to work date is incongruent with the injury.
- Prior workers comp history.
- No witnesses to the injury.

In addition to being more vigilant in looking for fraud, employers need to be more proactive in fighting fraud, Mr. Jay said.

Employers need to be prepared to take legal action against perpetrators of fraud when fraud occurs and discourage employees from attempting fraud, he said.

For example, employers should publicize that they have zero tolerance for fraud, Mr. Jay said.

Companies should also seek to sift out potential fraudsters before they even join a company, said Timothy E. Fargo, president of Omega Insurance Services Inc., a workers comp investigation and surveillance company in St. Petersburg, Fla.

"Human Resources is to risk management as underwriting is to the claims department," he said.

For example, about a third of job applicants are known to falsify information about their level of education, Mr. Fargo said. "So if they say they have a skill that they don't have, that's an issue."

So, companies should ensure that they have adequate pre-screening procedures for new hires, he said.

In addition to looking for fraud, employers also must remain aware that there are many workers comp claims "where it ain't that simple," said Peter Rousmaniere, president of Pain Disability Management L.L.C.,

a consultant in Somerville, Mass.

Some claims are complex and employers who take a simple approach to handling those claims end up hurting both the company and the injured employee, he said.

Mr. Rousmaniere cited the case of nurse who worked at psychiatric fa-

cility and was kicked in the abdomen while trying to restrain one of the patients.

The nurse, who related her story at the conference, said she had stomach and neck pains and during a two month recuperation period she was not contacted by the claims manager

of her company's workers comp insurer. She then asked for a release to return to work from her physician. However, she had to quit working after one shift on another psychiatric ward due to the trauma of dealing with violent patients, she said, and her abdominal pains returned.

The claims adjuster was dismissive of her claim. The nurse said she still has not received appropriate care several months after stopping work.

"This can look like a malingering case or the most screwed up claims organization on the face of the earth," said Mr. Rousmaniere.

Dan H. Kugler, director, corporate risk management at Snap-on Inc. in Pleasant Prairie, Wis., moderated the session.



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Drugs: Import debate intensifies

Continued from page 1

cities announced plans to buy drugs for their employees from that country, where prices are among the lowest in the world because of government price controls.

The pharmaceutical industry itself acknowledges that government price controls worldwide have led to higher pricing in the free-market United States. Drug makers use the higher U.S. revenues to offset losses from countries with price controls and to support product research, development and marketing.

According to a 2003 survey by Lincolnshire, Ill.-based Hewitt Associates Inc. of 500 large employers, 43% say the federal government should allow consumers to purchase prescription drugs from other countries. Just 27% say it should not be permitted, while 30% were unsure.

Canadian drug reimportation is "one of the subjects that has come up" in discussions among members of the Washington Business Group on Health, according to Steven Wojcik, vp of public policy for the Washington-based employer coalition.

"Our board chairman is from Minnesota, which is a border state," he pointed out.

Minnesota Gov. Tim Pawlenty plans to travel to Winnipeg, Manitoba, this week on a mission to further the state's plan for the reimportation of prescription drugs.

Legislation pending in Congress that would legalize drug imports from Canada and Europe also came

from Minnesota, introduced in February by Rep. Gil Gutknecht, R-Minn.

But the interest goes beyond states contiguous to Canada.

In Illinois, a recent report commissioned by Gov. Rod Blagojevich found that the state would save \$91 million annually if it were permitted to purchase prescription drugs from Canada. The state spent \$340 million on prescription drugs for its employees and retirees last year, up 15% from a year earlier.

Several cities in Massachusetts; the states of Iowa and Colorado; and even Montgomery County, Md., which borders the U.S. capital, also have announced they are considering reimportation.

But private employers have yet to join the rally cry of state and local governments.

"We've had some informal discussions about it," said Dr. Dennis Richling, president of the Midwest Business Group on Health, an employer coalition in Chicago. "Caution is the best way to describe what people are feeling."

"There was a lot of interest (among employers) before the FDA started cracking down," said Susan Nash, a partner in charge of the employee benefit department at the law firm of McDermott, Will & Emery in Chicago. "Since then, they're taking a wait-and-see approach as to what happens in Congress."

Under the Federal Food, Drug

and Cosmetic Act, it is illegal for anyone to reimport prescription drugs other than the original manufacturer. Furthermore, under federal tax law, an employer cannot reimburse its employees for drugs on a tax-free basis, either as part of a health insurance plan or a flexible spending account, unless they are "legally procured."

In response to the growing interest in reimportation, the FDA has stepped up its enforcement efforts, issuing warning letters to drug importers and testifying in Congress against the proposed legislation that would make the practice legal.

Drug makers also are fighting back.

Eli Lilly & Co. last week announced it would limit the amount of its drugs sold to Canada.

Spokesmen for Wyeth and AstraZeneca also acknowledged reducing exports to Canada in response to the surge in resales to Americans.

"AstraZeneca Canada sent a letter to all of its customers in April saying we had seen some unusually large orders for our most popular drugs," said a spokeswoman for the U.K.-based drug maker. "Because filling large orders would actually threaten the drug supply to Canadian patients, we had to put an allotment system in place."

In response to drug makers' moves, several members of Congress, including Rep. Gutknecht, have sent a letter to Attorney General John Ashcroft to in-

vestigate whether the pharmaceutical industry has violated antitrust laws by restricting sales to Canadian wholesalers and pharmacies that export to the United States.

But drug makers assert that what they are doing is legal and within their rights.

"Our contracts stipulate that the drugs are for Canadians only," explained a spokeswoman for Glaxo-SmithKline P.L.C., which was the first to limit supplies in January.

Throughout the debate, both the FDA and drug makers have expressed concerns that the products being repackaged and resold to U.S. citizens could have been tampered with or mishandled, thereby reducing their effectiveness, and that some may even be counterfeit.

In June, William K. Hubbard, associate commissioner for policy and planning at the FDA, testified before Congress that the "FDA cannot assure the American public that drugs imported from foreign countries are the same as products approved by the FDA."

"The problem, in a nutshell, is Canada's like a post office," said a spokesman for the Pharmaceutical Research and Manufacturers of America, a Washington-based trade group representing some 90 drug makers.

Medicines are routinely imported from nations such as Bulgaria, India, Pakistan and South Africa into Canada and then transhipped to unsuspecting American patients, the spokesman said, adding that many of these countries do not have the same safety standards as the United States.

"In fact, the government of South Africa has publicly acknowledged that one out of five medicines there is counterfeit," he said.

But a spokesman for Canada Health, the government-run health system, maintains that "Canada's regulatory requirements are among the best and most rigorous in the world," and that they apply both to drugs manufactured in the country and to those that are imported.

While the debate over reimportation continues, some industry experts are wary that such a tactic will really solve the problem of high prescription drug costs in the United States.

"I think that there's real short-term benefits if you import, because the lower cost is very appealing to a lot of us," said Dr. Richling of the MBGH. "But all you're going to do is take care of your immediate needs, and it doesn't help with the bigger problem of the pricing issue of pharmaceuticals and what's happening in the U.S. market and where we need to go."

"If we want to do something about drug prices, isn't there a more-direct way to do it?" queried Joe Martingale, national leader for health care strategy at Watson Wyatt Worldwide in New York.

"To go through that circuitous export-import in order to take advantage of another country's price controls just seems like half-assed public policy," Mr. Martingale said. "And it's an indication of how serious the problem is. It's an issue that Congress is reluctant to take head on and is more willing to address in this backwards way."

Workers Compensation and Disability Management Conference

Ergo programs, claims validation cut costs

By MEG FLETCHER

BOSTON—Implementing good ergonomics programs and ensuring the validity of claims are vital to restraining workers compensation costs, a panel of experts says.

An ergonomics program is an important component of an employer's comprehensive disability management program, said Alison Heller-Ono, president and chief executive officer of Monterey, Calif.-based Worksite International, an ergonomics consulting firm. Ms. Heller-Ono was part of a panel discussion at *Business Insurance's* recent Workers Compensation and Disability Management Conference in Boston.

Ergonomics programs can have "a significant impact" on an organization by driving change in its injury-prevention and disability-management programs, including return-to-work efforts, she said.

She noted that ergonomics-related injuries do not stem simply from repetitive tasks and can be linked to a variety of factors, including pressure on workers to meet goals, workers' perceived lack of control, short- and long-term stresses of various types, and the quality of the supervisor/employee relationship.

In these days of increased productivity monitoring, it is also important to consider the impact of job rules on workers' stress levels, she

said. Some workers find it difficult to function in highly structured environments, such as call centers that require a worker to signal when he or she wants to use the restroom, and she noted that this stress can contribute to ergonomics-related injury.

Typical strategies that employers use to reduce such injuries include: establishing a task force on ergonomics; developing integrated policies, procedures and activities; performing worksite analyses; providing training; responding quickly to a worker's symptoms of injury before he or she files a workers compensation claim; and tracking outcomes.

But to be successful, such programs must have the support and involvement of administrators; middle managers and supervisors, whom she considers "the weakest link" in ergonomics programs; and workers.

In addition, Ms. Heller-Ono recommended that employers analyze their loss experience by comparing it with data from the U.S. Department of Labor's Bureau of Labor Statistics.

She also urged employers to calculate their return on investment, noting that investments in workplace safety are generally cost-effective.

For example, Boston-based Liberty Mutual Insurance Co. reported in a 2001 survey of executives that two-thirds of respondents reported re-

ceiving a \$3 return for every \$1 invested in workplace safety.

Another panelist noted that psychological considerations can also complicate the return-to-work process.

"Sometimes, people are just not motivated to come back to work," said Dr. Alexander R. Lampone. Dr. Lampone is a physician and attorney who heads Work Comp Solutions, a medical and legal consulting firm in Pacific Palisades, Calif.

That reluctance may stem from a worker's interpersonal and family problems or the negative experiences he or she has had with an employer's bureaucratic or adversarial program, he said.

Indeed, a worker's sense of entitlement can frustrate return-to-work efforts, said panelist Jeffrey Pettegrew, who is vp of insurance and risk management for Westaff Inc., a temporary staffing company based in Walnut Creek, Calif.

The aging of the workforce also has implications for workers compensation, Mr. Pettegrew said. He noted that California's current 1% threshold for determining whether an injury is caused or exacerbated by work makes many conditions related to normal aging compensable workers comp claims.

Changing concepts about disability-related disease also complicate workers comp claims. For example, there are "ambiguous" back, soft-tis-

sue and neuropsychological disorders such as fibromyalgia, which are difficult both to diagnose and disprove, Dr. Lampone said.

In some states, including California, "the determination of disability is a medical, political and financial decision" in which the signature of an applicant-driven physician ordering medical treatment may result in unnecessary surgeries for claimants, he said.

"Medical control is the key," Dr. Lampone said. "We must put the pen back into the hand of a neutral, quality physician," not "an applicant physician or a 'company doctor,'" he said.

Especially in serious cases, Dr. Lampone recommends that employers consider having a physician actively intervene. Such intervention may include delaying authorization for treatment by pointing out where treatment recommendations are based on erroneous information.

In addition, the physician will likely have to prepare "contention-style interrogatories, based on evidence-based medical practice," Dr. Lampone said. If employers adopt this approach, they should be prepared to litigate, he said.

"As an employer, you need to decide which claims you are going to fight," said panel moderator Bernadette Melchionne, senior corporate insurance administrator with Mattel Inc. in El Segundo, Calif.

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Late News

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reflect the savings that the commissioner determines will result from the reforms, according to the California Insurance Department.

FM Global opens hazard research center

Johnston, R.I.-based Factory Mutual Insurance Co. has opened a research facility that includes a natural hazards laboratory that can replicate hurricane-force winds. The \$78 million research campus in Rhode Island also encompasses a fire testing facility that is more than twice the size of the insurer's original 1967 fire test center, as well as electrical hazards and hydrology labs. In addition to creating hurricane-force winds of up to 160 mph, the natural-hazards lab includes a debris cannon that can fire objects, such as lumber, at speeds of up to 90 mph.

Blues enrollment increases slightly

Total enrollment for the 41 Blue Cross & Blue Shield plans around the country reached 88.3 million as of June 30, up 1.2% from the end of 2002, according to the Blue Cross & Blue Shield Assn. Blues plans nationwide paid out \$77.6 billion in claims in the first half of 2003. In all of 2002, the plans paid out \$141 billion in claims. The plans reported total premiums of \$89.9 billion in the first half of 2003, a 13.4% increase over the same period in 2002.

Cash balance amendment comes under fire

Rep. John Boehner, R-Ohio, chairman of the Education and Workforce Committee, and Rep. Bill Thomas, R-Calif., chairman of the Ways and Means Committee are urging congressional conferees to



Rep. Boehner

strip an amendment from a Treasury Department appropriations bill that would restrict the ability of the department to develop cash balance plan regulations. That amendment, proposed by Rep. Bernard Sanders, I-Vt., and approved by the full House, would bar Treasury from producing rules that would have the effect of overturning a U.S. District Court ruling that found that IBM Corp.'s cash balance plan discriminates against older employees.



Ohio court limits liability for nonwork auto accidents

Ohio employers and insurers are hailing an Ohio Supreme Court ruling that significantly reduces an employer's liability under its commercial automobile policy for accidents that are not work related. In its decision in *Westfield Insurance Co. vs. Galatis*, the court made clear that an employer's auto policy covers a worker's injuries only if an employee is engaged in business travel, unless otherwise specifically agreed. The decision applies to the uninsured/underinsured motorist portion of commercial auto policies.

AXIS posts big gains in premiums, profits

AXIS Capital Holdings Ltd. has reported net income of nearly \$371.9 million for the first nine months of

the year, a 142% increase from the first three quarters of 2002. AXIS reported gross premiums written of more than \$1.79 billion during the first three quarters of 2003, an increase of more than 130% from the same period last year.

Rate hikes slow for many lines: RIMS survey

Rate hikes are slowing for many commercial insurance coverages, according to a survey from the Risk & Insurance Management Society Inc. Premiums for property, fiduciary liability and directors and officers insurance increased by between 3% and 32% on average in the third quarter, according to a survey of renewal information gathered by Advisen Ltd. for the benchmark survey produced by New York-based RIMS. Those coverages were renewing last spring at as much as 250% above prior-year rates, according to RIMS. Excess liability and workers compensation coverages, however, continue to see significant rate hikes, the society said in a statement announcing the survey results.



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Endurance profits up sharply

Bermuda-based Endurance Specialty Holdings Ltd.'s net income reached \$174.5 million for the first nine months of the year, up from \$63.5 million in 2002. Gross premiums written were \$1.3 billion, compared with \$623.5 million for the first nine months of last year. The gross written premiums include business acquired from HartRe Co. L.L.C. and LaSalle Re Ltd.

Aon's nine-month net income rises 43%

Aon Corp. reported net income of \$413 million for the first nine months of the year, up 43% from the first three quarters of 2002. Aon reported total risk and insurance brokerage services revenue of nearly \$4.17 billion for the first three quarters of 2003, up 15% from the

same period last year. Consulting revenue for the first three quarters was \$862



million, also up 15% from the first nine months of 2002. But in the third quarter, net income fell 10% from the same period last year to \$115 million. The company said comparisons with third quarter 2002 results were negatively affected by a \$25 million increase in pension costs, a \$22 million decline in investment income and a \$10 million decrease in claims services pre-tax income. Meanwhile, Aon also said it has reached a final settlement of approximately \$200 million for its World Trade Center property insurance claim.

Briefly noted

A bipartisan group of senators and their staffs met last week to discuss issues surrounding a proposed national trust fund to compensate victims of asbestos-related diseases. No stakeholders, such as insurers and defendant companies in asbestos-related lawsuits, were invited to participate...The Environmental Protection Agency announced that cleanup was completed at 40 high-priority Superfund sites across the country during the fiscal year that ended Sept. 30. That brings the total of sites cleaned up since the program's inception in the early 1980s to 886....The Pension Benefit Guaranty Corp. is taking over and terminating two underfunded pension plans sponsored by Slater Steel Inc., a bankrupt manufacturer in Fort Wayne, Ind. The two plans, which have about 1,100 participants, are underfunded by \$36 million, of which the PBGC estimates it will be liable for \$29 million.

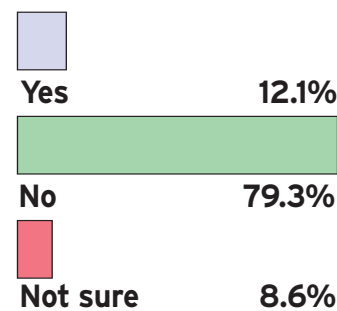
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Online Poll

[11/3-11/7]

Will the consolidation of large managed care organizations reduce group health care plan cost increases?



BI Stock Index

[11/3 - 11/7]

Up-to-the-minute data for all 87 companies that comprise the *BI* Stock Index can be found at www.businessinsurance.com

Percentage change of *BI* Stock Index vs. key indicators

BI Stock Index	2045.65	-0.23
Dow Jones	9809.79	0.09
S&P 500	1053.21	0.24

Largest gains

AXIS Capital Holdings Ltd.	8.98%
PXRE Corp.	8.33%
NYMagic Inc.	6.83%
American Financial Group	6.20%
Philadelphia Consolidated	5.75%

Largest losses

PMA Capital Corp.	-64.26%
SCOR	-31.03%
CNA Surety	-14.85%
CNA Financial	-11.96%
UNUM Corp.	-8.98%

Weekly change by market segment

Brokers	1.01%
Insurers/Reinsurers	0.89%
Managed Care Organizations	-0.60%

Source: CNET Investor (investor.cnet.com)

Regulation: Congress impatient for reform

Continued from page 3
ance Commissioners.

The NAIC is following an insurance regulatory modernization plan that it adopted in September, said Mr. Pickens, who is also Arkansas insurance commissioner.

That plan calls for implementing various reforms according to a specific schedule, with the final reform—the integration of multi-state regulatory procedures—slated for completion by the end of 2008.

Mr. Pickens said that “a vocal minority,” consisting mainly of big banks and big life insurers, spear-

heads the drive for optional federal chartering. Insurer lobbyists—and not consumers—want the change. Any federal regulator would be “less accountable” and “less responsible” than state regulators, said Mr. Pickens.

During a question-and-answer period, Sen. Breslin told the subcommittee's chairman—Rep. Richard Baker, R-La.—that he is “much more optimistic” that the states will be able to solve their own problems than he had been previously.

Rep. Baker then asked how long it was reasonable for Congress to

wait for state regulatory reform to bear fruit? “How long do we stay on the sidelines?” he asked.

Mr. Pickens called it an “excellent question” and noted that the final deadline for the NAIC's action plan is 2008.

But Rep. Kanjorski said that 2008 is too long to wait. “If we can't get something moved along at the state level within the next year to 18 months,” he said, Congress might act on its own to implement reform.

“I'm starting to get the impression” that the states want to retain regulatory authority over “all the is-

sues that are easy,” said Rep. Kanjorski.

Rep. Kanjorski said that the states were only too willing to hand off what he termed “difficult issues”—such as terrorism insurance, flood insurance and dealing with nuclear risks—to the federal government.

Not all members of the subcommittee seemed willing to consider the optional federal charter as a means to reform the regulatory system, though.

Indeed, Rep. Spencer Bachus, R-Ala., said that creating such a system is “almost undoable” in both practical and political terms.

Captive: Approvals fast-tracked

Continued from page 1

looking at the approach.

"This is something that can make a lot of sense," said Richard Insera, assistant treasurer and director of risk management for Praxair Inc., a supplier of specialized gases in Danbury, Conn. "In some lines, you can pretty much be guaranteed an actuarial profit, plus you can hold on to the cash and invest it," he said.

"We are actively considering this.

TIMELINE

Liberalizing the use of captives to fund benefits has been a decades-long process.

1979: The Labor Department rules that at least 50% of a captive's business must be third-party business in order for the captive to fund employee benefit risks for its parent. Numerous other restrictions imposed under PTE 79-41.

1992: Employer interest in funding benefit risks through captives grows amid an IRS ruling that benefits could be considered unrelated business, increasing likelihood of tax deductibility of property/casualty premiums paid to captives.

1993: With tax considerations at least a partial factor, CSX Corp. asks DOL for permission to fund group term life insurance coverage through its Vermont captive, which has only a small percentage of outside business.

1994: DOL rejects CSX Corp.'s application, noting its long-held position is that a captive must have a significant amount of outside business before it can fund its parent's benefit risks.

1999: In a sweeping change in position, DOL says employers no longer will automatically be required to satisfy the 50% premium test to fund benefit risks in their captives. A top official says the department will look at the quality of primary insurers used by a captive to write the business and whether the transaction truly benefits employees.

1999: In the first test of the DOL's flexibility, Columbia Energy Group asks for permission to use the Vermont branch of its Bermuda-domiciled captive to fund long-term disability risks. Columbia does not meet the 50% test but agrees to sweeten LTD benefits for employees and to use a top-rated insurer to issue the LTD policies.

2000: DOL approves Columbia Energy's application.

2002: Following Columbia Energy's lead, Archer Daniels Midland Co. asks for approval to reinsure group life insurance benefits through its Vermont captive. ADM agrees to improve benefits and to use a top-rated insurer to write the policies.

2003: DOL approves ADM's application.

2003: International Paper Co. seeks DOL approval to use its Vermont captive to reinsure group term life insurance benefits. Its application is the first filed under a fast-track review procedure, under which DOL must act on an application within 45 days of receipt.

2003: DOL approves International Paper application.

There can be some potential cost-savings," added David Crofts, vp-risk management, Americas, for Cadbury Schweppes P.L.C. in Dallas.

Towers Perrin's Mr. Cole pegs the potential cost savings of funding benefits through captives—compared with more-traditional programs—at 5% to 8% for group term life insurance risks, 10% to 15% for long-term disability and 5% to 9% for retiree medical.

Those cost savings come on top of other advantages offered by captives, including balancing a captive's more-volatile casualty exposures with more predictable employee benefit risks, Mr. Cole said.

"You get growth and diversification of risk," said Joseph Poplaski, senior vp and group actuary for Liberty Mutual Insurance Co. in Boston, which will write benefits risks reinsured through captives.

While the advantages of funding benefits through corporate captive programs have been discussed for years in risk management and employee benefit circles, the path for implementing such an approach has been largely blocked until recently.

One big obstacle was the Labor Department itself. For two decades, it clung to a 1979 rule that required that at least 50% of a captive's premium volume be generated by business unrelated to its parent in order for the captive to fund benefit risks for its parent. The department said a significant amount of third-party business was necessary to safeguard an employee benefit plan against less-than-arm's-length transactions.

Few employers, though, had or wanted to put that much outside business in their captives. As a result, the 50% premium test put the cost saving and other advantages of funding benefit risks through captives out of reach for all but a handful of employers.

Yet another potential advantage to funding benefits through captives emerged in the early 1990s: an increased likelihood for employers to take tax deductions for property/casualty premiums paid to their captives.

Such deductions might be possible, experts reasoned, in the wake of court rulings that a parent company can deduct premiums paid to a captive as long as the captive funds a significant amount—perhaps as little as 30%—of unrelated business.

At the same time, the Internal Revenue Service ruled in 1992 that employers can deduct group term life insurance premiums paid to their captives because those premiums represent unrelated business.

As a result, if a company funds benefit risks through a captive, the captive could be considered as writing a significant amount of outside business, increasing the likelihood that the parent would be able to deduct the property/casualty premiums it paid to the captive.

Reaping such tax breaks had significant appeal. Enhancing the tax deductibility of property/casualty premiums might not be the primary reason to fund benefits through a captive, but it could be a close second, said Liberty Mutual's Mr. Poplaski.

But that advantage, like other advantages of funding benefits through captives, could not be achieved by employers until the 50% test was liberalized.

That liberalization came in 1999, when a key Labor Department official, following years of discussions with captive attorneys, said the 50% test no longer would be an absolute prerequisite to winning departmental approval for funding benefits through captives.

Among other things, the department would consider the quality of the primary insurers used by the captive to write policies and whether plan participants would benefit from the arrangement.

Following up that pledge of new flexibility, the department in August 2000 approved Herndon, Va.-based Columbia Energy Group's application to use the Vermont branch of its Bermuda-domiciled captive to reinsure its long-term disability benefits program.

Earlier this year, the department approved the application of agribusiness giant Archer Daniels Midland Co. of Decatur, Ill., to use its Vermont captive to reinsure group life insurance benefits.

Both Columbia Energy, which has since been acquired, and ADM agreed to sweeten benefits, use top-rated insurers to issue the policies and hire an independent fiduciary to ensure all conditions of the exemption were met.

With the Columbia Energy and ADM applications approved, the stage was set for International Paper to take advantage of the expedited review procedure.

Like Columbia Energy and ADM, International Paper agreed to use a top-rated insurer—MetLife—to issue policies and to make several improvements to its group life insurance program once its reinsurance agreement with MetLife and Circle-Tree, which last year had earned premiums of more than \$24.7 million, was approved.

With the expedited review process now a reality, more employers will be following on the same path, though experts say the numbers of employers doing so will, at least initially, be small.

"You will see a few at a time," said Mr. Poplaski.

"One potential obstacle that employers will have to overcome, experts say, is getting corporate risk and employee benefit departments to work together.

"You can have two departments that don't have a connection to one another," Mr. Poplaski said.

In addition, while the Labor Department in 1999 eased the 50% test, other requirements it has imposed on captive benefit funding arrangements remain. For example, a captive must be licensed in a domestic state or be the domestic branch of an offshore captive.

"I don't think this approach may be for everyone, but where it works, it can work very well," Towers Perrin's Mr. Cole said.

"This could be the start of something big," said Gary Langsdale, International Paper's director of risk management in Memphis, Tenn.

Putnam: No impact

Continued from page 1

Late last month, in separate civil complaints, the U.S. Securities and Exchange Commission and Massachusetts securities regulators accused Putnam and two of its portfolio fund managers of violating corporate policies that bar improper trading practices made at the expense of long-term investors. Putnam, the fifth-largest U.S. mutual fund company, is one of a number of mutual fund companies whose trading practices are being investigated.

Although Putnam executives uncovered the improper trading several years ago, their attempts to stop the practices were unsuccessful, and the improper trading continued through this year, the civil suits allege.

After the allegations surfaced, several state pension plans pulled their assets out of Putnam, which had \$272 billion in assets under management at the end of September.

Those customer defections are what many believe led to Putnam Chief Executive Officer Lawrence J. Lasser's resignation last week. MMC quickly named Charles E. Haldean, a senior managing director and co-head of investments, as Putnam's new president and CEO. It also named Steven Spiegel, senior managing director and chief of global distribution, to the new position of vice chairman, while A.J.C. Smith, former chairman and CEO of MMC, was named Putnam's new chairman.

The company also hired Barry P. Barbash, a former SEC director, to conduct an independent review of Putnam's policies and controls.

"The kind of conduct that occurred has no place at Putnam," Jeffrey W. Greenberg, chairman and CEO of MMC, said in a statement. "We are taking measures to see that this does not happen again. We have previously stated that Putnam will make complete restitution to the Putnam funds for any losses suffered by Putnam shareholders as a result of any improper market-timing activities," he said.

An MMC spokesman said that the fund managers in question made \$770,000 in profits related to the improper transactions. The trading involved "market timing practices," or quick-paced buying and selling of shares to take advantage of stock market conditions. While not illegal in itself, such activity increases trading costs and is prohibited by Putnam.

Marsh quickly fired two fund managers involved in the improper trading after the regulators' suits were filed, and it assembled a new management team. Despite those moves, the law firm of Schiffrin & Barroway L.L.P. filed a shareholder suit against Putnam and Marsh in the U.S. District Court for the Southern District of New York last Tuesday.

The MMC spokesman declined to comment about the suit.

While the allegations of improper trading may have given Putnam a black eye, some Marsh clients and other observers say it is not a reflection of how MMC's other business operations are run.

"Being personally acquainted with many of the Marsh and MMC senior team, I can say without reservation that while the Putnam episode is unfortunate, I don't see that it is in any way likely to be a reflection of Marsh's general business practices or philosophy," said Christopher Mandel, a Marsh client who is assistant vp-enterprise risk management for USAA Group in San Antonio.

"The fact that they have moved quickly to deal with it in the way they have speaks volumes as to what's important to them in the way they run their business," he said.

Analysts who follow Marsh echoed that view.

"They have a separate board structure for Putnam and a separate management team for Putnam, so I think it would be more of a concern if you had the same management team running both," said Steven Ader, a credit analyst with Standard & Poor's Corp. in New York. S&P revised its outlook on Marsh to negative from stable last week, due to concerns that the legal actions might weaken Putnam's business position over the long term, affecting Marsh's diversified business profile.

Marsh & McLennan Cos. Inc. in 2002 reported \$10.44 billion in gross revenues, of which its insurance brokerage operations accounted for \$5.91 billion, or about 57%. Consulting operations contributed \$2.36 billion, or 23%, while Putnam accounted for \$2.17 billion, or almost 21%, of MMC's gross revenues.

Putnam's problems "will have essentially no impact from an operations or strategic standpoint" on Marsh Inc., said Jay Cohen, an analyst with Merrill Lynch & Co. Inc. in New York. "We see Putnam as a fairly separate operation vs. the insurance brokerage business. It has its own brand name. Marsh Inc...has not been accused of any wrongdoing, and you're talking about different buyers," he said.

Mark Lane, a principal and research analyst with William Blair & Co. in Chicago, noted that in addition to having no impact on Marsh Inc., the allegations Putnam faces also will not affect MMC's Mercer Human Resource Consulting practice.

"Mercer and Marsh work more closely together than Marsh and Putnam or Mercer and Putnam," Mr. Lane said.

While Putnam's problems may not affect any of MMC's other operating units, "it obviously has an effect on Marsh's corporate earnings," Mr. Cohen said. He noted that Merrill Lynch & Co. lowered its 2003 earnings per share estimates for Marsh by one cent and its 2004 estimate by 10 cents.

He added, however, that because Putnam will likely make up less than 20% of Marsh's overall earnings in 2004, compared with 45% in 2000, the impact will not be as great.

"It's simply not as large of a component of the earnings as it was, and therefore the shortfall at that unit doesn't impact the corporation financially as it would have," Mr. Cohen said.