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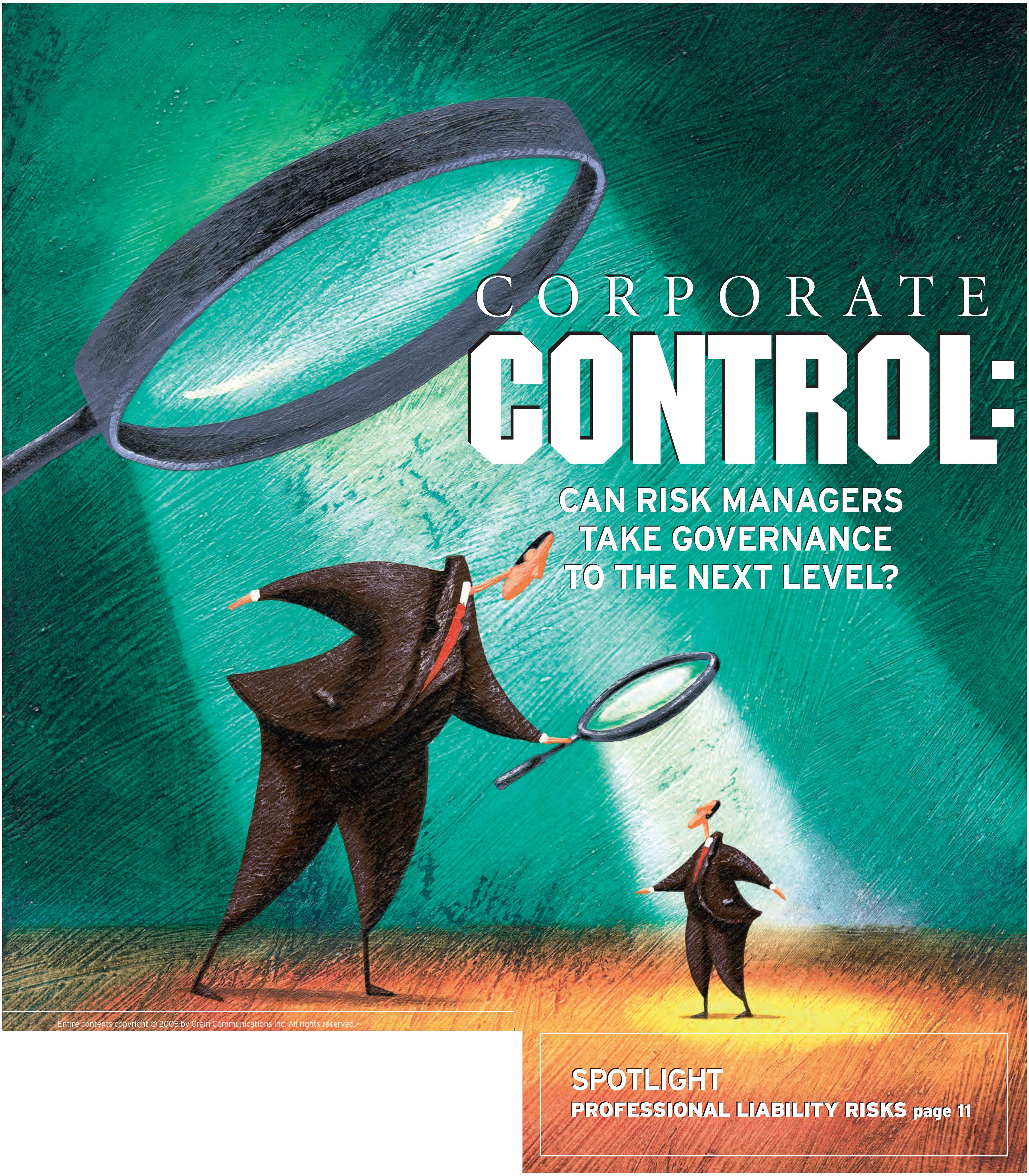

CORPORATE

# CONTROL:

## CAN RISK MANAGERS TAKE GOVERNANCE TO THE NEXT LEVEL?



SPOTLIGHT

**PROFESSIONAL LIABILITY RISKS** page 11

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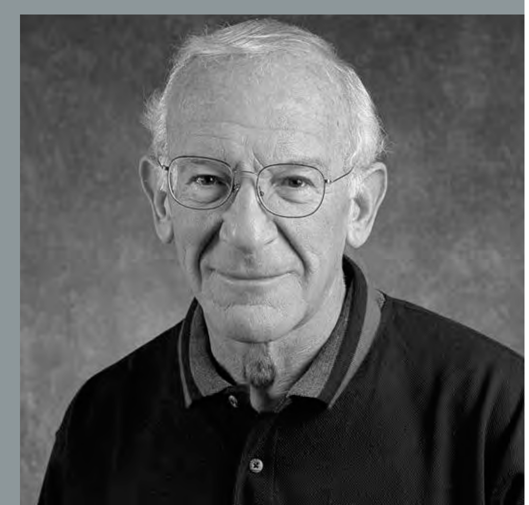
# 11TH ANNUAL AWARD DINNER

*The Board of Overseers honors*



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*Many of the environmental risks in brownfield real estate transactions can be effectively and efficiently managed.*

NOVEMBER 14, 2005

# Innovative insurance solutions now make brownfield transactions possible

*David W. Bennink is a director of Aon Environmental. He develops and implements integrated environmental risk management programs and advises corporations about the impact of environmental liabilities on balance sheets and market capitalizations. Dave can be reached at dave_bennink@aon.com.*

Many buildings across the country are haunted by environmental liabilities. In the past, many in real estate have shied away from the purchase of industrial or commercial sites for fear of unforeseen remediation expenses or extensive litigation.

Over the past 10 years, however, the federal and state governments have passed many brownfield acts to encourage the redevelopment of "brownfields." A brownfield is generally defined as any commercial or industrial site that is known or thought to be contaminated. Thus, across the country, there is an increasing trend to redevelop such sites.

The challenge in approaching possible brownfield transactions is that, while some potential liabilities may be mitigated by government legislation, there are often several other significant risks. Chief among them is the chance that the anticipated remediation expense is not well defined. In response to this and other risks, the insurance industry has designed an array of products specifically for facilitating brownfield transactions. These solutions include a growing number of environmental insurance policies that can effectively limit and transfer unique risk exposures.

Unlike most other lines of insurance coverage, there is no standard environmental insurance policy. Since each policy form is separate, great care must be taken in the drafting of policy language to ensure that the coverages offered by the insurance carrier are representative of the exposures at the site as well as of the redevelopment plans.

The first and most frequently used, environmental insurance coverage is a fixed-site pollution liability policy, which typically covers remediation of any new conditions discovered on-site, remediation of any unknown pre-existing environmental conditions, liability coverage for any bodily injury claims alleged to have resulted from exposure to environmental conditions on-site or migrating from the site, and liability coverage for any property damage claims to a third party, stemming from environmental conditions at the covered location and legal defense.

The second coverage is remediation cost cap coverage. This policy is typically bound separately from the first policy and carries a distinct limit of liability and retention. The coverage is granted for most cost overruns stemming from a planned remediation at the site. Underwriters typically require a copy of the proposed "scope of work," as well as confirmation that the proposed remediation has been approved by the governing regulatory agency.

There are unlimited opportunities for economic gain associated with the redevelopment of brownfield sites. The growing number of solutions offered by environmental insurance carriers is allowing the risks associated with known and unknown environmental conditions to be effectively and efficiently managed. As a result, insurance-based solutions are now increasingly being used in many real estate transactions that otherwise would have stalled or been deemed not economically viable. Companies that are expanding or redeploying operations where real estate plays a role should take a look at brownfields as a new horizon of business opportunity.

## Businesses use employment process outsourcing to facilitate effective recruiting

Recruiting and talent management are challenging aspects of human resources management. Even when an organization is not experiencing rapid growth, the time-to-hire and associated costs of recruiting impact the organization in many ways, from service-delivery capability to shareholder value. An integrated employment processing system can help facilitate sourcing, assessment, selecting and hiring of qualified candidates. Before choosing an employment process outsourcing provider, businesses should explore several key points, such as whether contracting processes allow for a collaborative work environment and if service levels and fee expectations have been articulated. For further insights, read the complete report at **www.aon.com/focus**.

## Strategic compensation and benefits programs help organizations defray costs, reward talent

Executive compensation and benefits programs can have a significant impact on an organization's bottom line. To design effective programs, it is critical to understand the current trends that are shaping annual incentive plan practices and board of directors' pay, as well as practical innovations in executive benefits programs, and legislative and regulatory issues that may impact these programs. To learn more about how to implement strategies to reduce benefits costs, remain competitive and reward talent, view a web cast on this topic at **www.aon.com/focus**.

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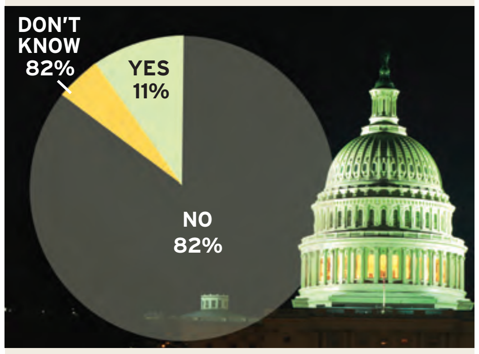
# Inside



**Online poll - [ 11/7 - 11/11 ]**

Do you think Congress will pass comprehensive pension funding reform legislation this year?

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REPORTING ON CORPORATE RISK AND EMPLOYEE BENEFIT MANAGEMENT NEWS

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# AIG discovery of new account errors prompts latest earnings restatement

By RUPAL PAREKH


**NEW YORK**—American International Group Inc. announced last week that it will have to restate its earnings once again, boosting the insurer's profits by nearly $500 million.

The latest accounting errors—which AIG discovered during an internal review—stem mostly from "previously disclosed material weakness in internal controls surrounding accounting for derivatives and related assets and liabilities" and "reconciliation for certain balance sheet accounts and income tax accounting," AIG said in a statement.

As a result of the mistakes, the insurer understated consolidated retained earnings reported on June 30 by approximately $500 million.

New York-based AIG will correct its financials for 2002 through 2004, along with certain data for 2000 and 2001, and quarterly earnings statements for 2004 and the first two quarters of 2005. "AIG's prior financial statements for those periods should therefore no longer be relied upon," the company said in its statement.

The insurer's longtime auditor, PricewaterhouseCoopers L.L.P., consulted AIG on the latest restatement move, a spokesman for AIG said.

As part of its announcement, AIG last week also provided an estimate of its third-quarter results, the filing of which has been delayed until Nov. 14 to give the company time to incorporate its upcoming restatement.

Net income for the first nine months of the year was estimated to be approximately $10.1 billion. The company estimated its total after-tax catastrophe losses, net of

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The Radisson SAS Hotel Amman was one of three hotels struck simultaneously by suicide bombers in Jordan's capital on Nov. 10. The other hotels were the Grand Hyatt Amman and a Days Inn. The blasts killed at least 60 people and injured scores more.

# Jordan tightens security after suicide bombings

By MICHAEL BRADFORD

**AMMAN, Jordan**—Hotels hit in last week's bombings in Amman, Jordan, are operating under tightened security as they sort out damages and make repairs.

Suicide bombers attacked three hotels at around the same time—the Grand Hyatt Amman, the Radisson SAS Hotel Amman and a Days Inn. There were about 60 deaths and 100 injuries in the attacks, which have been linked to the terrorist organization Al Qaeda.

Investigators late last week were looking over a banquet hall on the Radisson property where a wedding reception was taking place when a bomber struck. The hall, another banquet room and the lobby of the hotel were damaged in the blast.

"Security was already extremely tight but has been tightened even more," said Bassam Banna, assistant general manager of the hotel. The hotel is "fully operating," he said. "The area that was damaged is semi-attached to the hotel. The guest rooms were not damaged."

Mr. Banna could not provide specific insurance details but said coverage is expected to pay for repairs. It was unclear whether a policy written for the Nazzal family, which owns the hotel, or insurance held by Radisson Hotels & Resorts would apply, he said.

Property damage at the Days Inn is expected to amount to around $200,000, according to Khaled Abu Ghoush, general manager of the property. He said lost revenue is expected to total around $50,000 and that loss also is covered.

Mr. Ghoush said coverage for the hotel is written by Arab Europe Insurance Co. in Amman.

"We are fully operational," Mr.

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# Ontario rejects pension plan disclosure duty

## *Overturning of onerous rule a relief to plan sponsors*

By GLORIA GONZALEZ

Canadian pension experts are breathing a collective sigh of relief after the Ontario Court of Appeal overturned a lower court decision that would have significantly expanded disclosure requirements for plan administrators.

The trial court ruling would have required that plan administrators inform members of any potential changes under consideration, a new mandate that pension experts called "onerous."

In *Hembruff vs. Ontario Municipal Employees Retirement Board*, the Ontario Court of Appeal ruled that the plan administrator had no duty to advise plan members that it was contemplating making benefit improvements to the pension plan.

The decision removed a major obligation imposed by a lower court ruling that would have forced plan administrators to disclose any changes that they were considering making to the pension plan.

"I think plan sponsors that I've spoken to so far have expressed great relief," said Stephen Pibworth, legal consultant for Hewitt Associates Canada in Toronto. "It would have been very troubling if the Court of Appeal had affirmed the earlier decision."

Faced with a significant surplus in the late 1990s, the Ontario Municipal Employees Retirement Board began considering various surplus management measures, including benefit enhancements, in 1998. The board made several surplus management recommendations to the government, which must enact any changes to the pension plan via amendment. The government eventually accepted the board's recommendations and passed an amendment in May 1999 that provided limited increased pension benefits to members. The amendment was passed with a Jan. 1, 1999, effective date.

Eight former pension plan members who retired prior to the Jan. 1, 1999, effective date later sued the board, claiming that the board failed to inform them in advance of the potential changes to the board's pension plan. They alleged that this failure constituted both negligent misrepresentation and a breach of fiduciary duty.

In a March 2004 decision, the trial judge ruled that the

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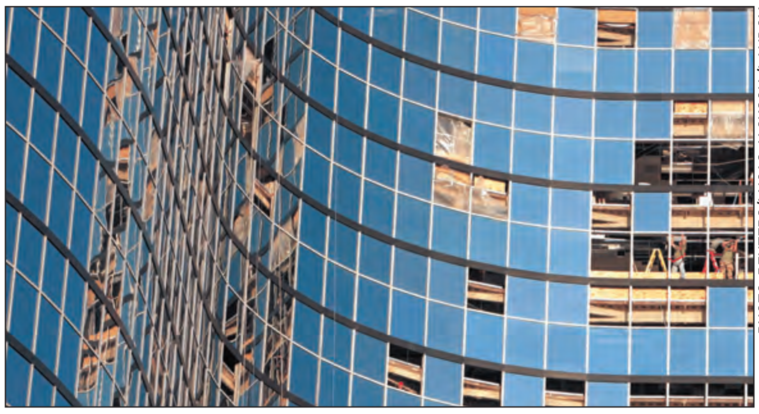

PHOTO: REUTERS/LUCAS JACKSON /LANDOV

**Contractors repair damage at The Galleria, an office building in New Orleans that was damaged when Hurricane Katrina struck the city.**

# Liability shield sought by Katrina contractors

**By MARK A. HOFMANN**

**WASHINGTON**—Congress should move swiftly to pass legislation that would shield private contractors doing government reconstruction work in the area ravaged by Hurricane Katrina from some private lawsuits relating to that work, several witnesses told a Senate panel last week.

However, the Gulf Coast Recovery Act—S.1761—would not protect those who engaged in reckless behavior or willful misconduct, the measure's chief sponsor—Sen. John Thune, R-S.D.—stressed during a hearing on the bill before the Senate Environmental and Public Works Subcommittee on Superfund and Waste Management.

"Because of the ongoing multibillion-dollar class action cases filed against the contractors who assisted the government in the cleanup of the World Trade Center, I have concerns that other major disaster cleanups—including Hurricane Kat-

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# Voters reject measures on benefits, insurance

**By MEG FLETCHER**

Voters in California and Washington soundly rejected four insurance-related measures in balloting last week, with the only one approved being an expansion of a smoking ban in Washington state.

The measures were all citizen initiatives that were brought to the polls through petitions, rather than by legislative referral. Nationally, voters in eight states considered 41 measures, 44% of which were citizen initiatives.

California voters rejected two competing measures—propositions 78 and 79—that both would have created discount prescription drug plans for eligible low- and moderate-income residents through state-negotiated rebates with drug manufacturers.

Proposition 78, which had a slightly lower threshold for eligibility, would have relied more on voluntary participation by drugmakers and could be terminated under specified conditions.

Proposition 79, which required federal approval, would have prohibited state Medicaid contracts with manufacturers that do not provide the best price under that program, except for drugs without therapeutic equivalent. The measure would have outlawed "profiteering," though that was only generally defined.

"When voters are confused, they vote 'no,'" said Dick Castner, executive director of the U.S. Chamber of Commerce's western region office in Los Angeles. In addition, negative publicity was directed at Gov. Arnold Schwarzenegger, who called the special election to further four other—ultimately unsuccessful—initiatives that he supported, Mr. Castner said.

In Washington state, voters rejected Initiative 330, a comprehensive package of tort reform measures that would have significantly reduced malpractice liability for health care facilities and practitioners.

They also rejected Initiative 336, which would have established a private supplemental program for health care facilities and providers to purchase excess malpractice insurance above private insurance.

Medical malpractice reform is "very complex and hard to communicate in sound bites," said Renee Sinclair, executive director of the chamber's northwest region in Lynnwood, Wash. In addition, "what overtook the message was the animosity between the two groups"—physicians and trial attorneys—she said.

Washington state voters did approve expanding a smoking ban to include common areas in places of employment, 75% of hotel or motel rooms and all bars, bowling alleys and casinos. It also prohibits smoking within 25 feet of entrances, exits, windows and ventilation intakes.

# Integro's Property Insurance Practice is Open for Business

**In the aftermath of the costliest series of natural disasters in U.S. history, the Property Insurance Market is in a state of turmoil.** The wide swaths cut throughout the Southeast by Hurricanes Katrina, Rita and Wilma assured that virtually no insurer of major risks in the U.S. was unscathed by the storms. The uncertainty over the severity of each insurer's losses is reflected in the wide disparity of underwriting postures now evident among property insurers.

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**Let's get together.** In the coming weeks one of our associates may call to find out how Integro can help preserve the reliability and efficiency of your insurance program in this market in turmoil. To hasten the conversation, contact Gary Marchitello, leader of Integro's Property Insurance Practice at gary.marchitello@integroltd.com or 212-295-5495. Visit us online at **www.integroltd.com**

## Editorial

# ‘Play or pay’ not the answer for covering the uninsured

SHOULD EMPLOYERS BE HIT with financial penalties if they don’t provide health insurance to employees and pay a big share of the premium?

That is the issue a Massachusetts legislative conference committee will be debating in the coming weeks as they consider whether or not to accept a measure passed earlier this month by the state Senate that would impose a “play or pay” health care mandate.

As we reported, all employers—except very small ones—with employees in Massachusetts would be assessed a tax equal to a percentage of payroll. For employers with between 11 and 99 employees, the tax would be equal to 5% of payroll, while employers with 100 or more employees would be liable for a tax equal to 7% of payroll. Revenues generated by the new tax would be used to help fund expansion of state programs to cover the uninsured.

However, this tax—imposed to encourage employers to offer health care coverage—would be directly offset by how much an employer spends on its health care plans.

The idea of such a health care tax mandate on employers is not a new one. Indeed, Massachusetts legislators in 1988 passed legislation quite similar to the current proposal.

More recently, California lawmakers in 2003 passed legislation to require all but the smallest employers to either pay 80% of employees’ health insurance premiums or contribute to a state fund.

But neither the earlier Massachusetts health care initiative nor California’s ever were implemented. The Massachusetts law, whose effective date was delayed several times, ultimately was repealed, while California voters last year approved a ballot initiative to scrap the health care law.

We think the previous actions by Massachusetts lawmakers and California voters can be attributed to a recognition of basic financial reality. Imposing such a mandate would have resulted ultimately in a loss of jobs. Financially pressed firms that could not afford to pay new taxes or premiums would have taken a variety of steps—moved out of state, laid off employees, not hired new employees—that would have been detrimental to job preservation, let alone job creation.

Massachusetts legislators before and California voters both recognized that the price of a health care plan mandate on employers would have exceeded the benefits. Reducing the ranks of the uninsured is a role that the states as well as Congress must take on. But achieving that goal should not result in job losses.

Government can and must do more to reduce the number of the uninsured. Lowering eligibility requirements for Medicaid, providing tax credits to individuals to offset part of the cost of health insurance premiums and expanding state-subsidized programs for those having problems getting coverage in the commercial market are ideas worth trying.

## Schillerstrom


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# TRIA revision appears to be reasonable 11th hour solution

THIS MUCH IS CERTAIN—unless Congress acts by Dec. 31—the Terrorism Risk Insurance Act will expire with nothing to take its place.

What’s not certain is whether Congress will be able to meet that deadline. But fortunately, the odds of action now seem better than they have in some time, courtesy of the House Financial Services Committee, notably its chairman, Mike Oxley, R-Ohio, and Rep. Richard Baker, R-La.

After months of consideration, the committee’s leadership has devised a proposal to extend TRIA by at least two years. The proposal would increase the size of the loss wrought by a terrorist attack needed to trigger the federal financial backstop and would make other changes that would increase the private insurance market’s portion of risk under the program.

The proposal also addresses the issue of nuclear, biological, chemical and radiological attacks, which was not conclusively addressed in the initial version of TRIA.

We haven’t seen the legislative language of the Terrorism Risk Insurance Revision Act of 2005, and thus will refrain from endorsing it right now. But as outlined, the measure appears to address many of the Bush administration’s stipulations that the private market assume an ever-increasing share of the terrorism exposure.

The House bill is a first but significant step toward assuring that the terrorism insurance marketplace remains stable. The Senate will also have to move on the issue, and any bill that can pass muster with both houses will still have to please the White House as well. We have no illusions that doing so will be easy.

In a perfect world, the private insurance market would be able to respond to all risks, but the very fact that terrorism insurance has to be discussed underscores that the world is far from perfect.

In an imperfect world, we have to settle for a reasonable response, and from what we’ve seen, the TRIA extension bill offered by the House Financial Services Committee’s leaders is probably the most reasonable response we can expect as the TRIA deadline looms.

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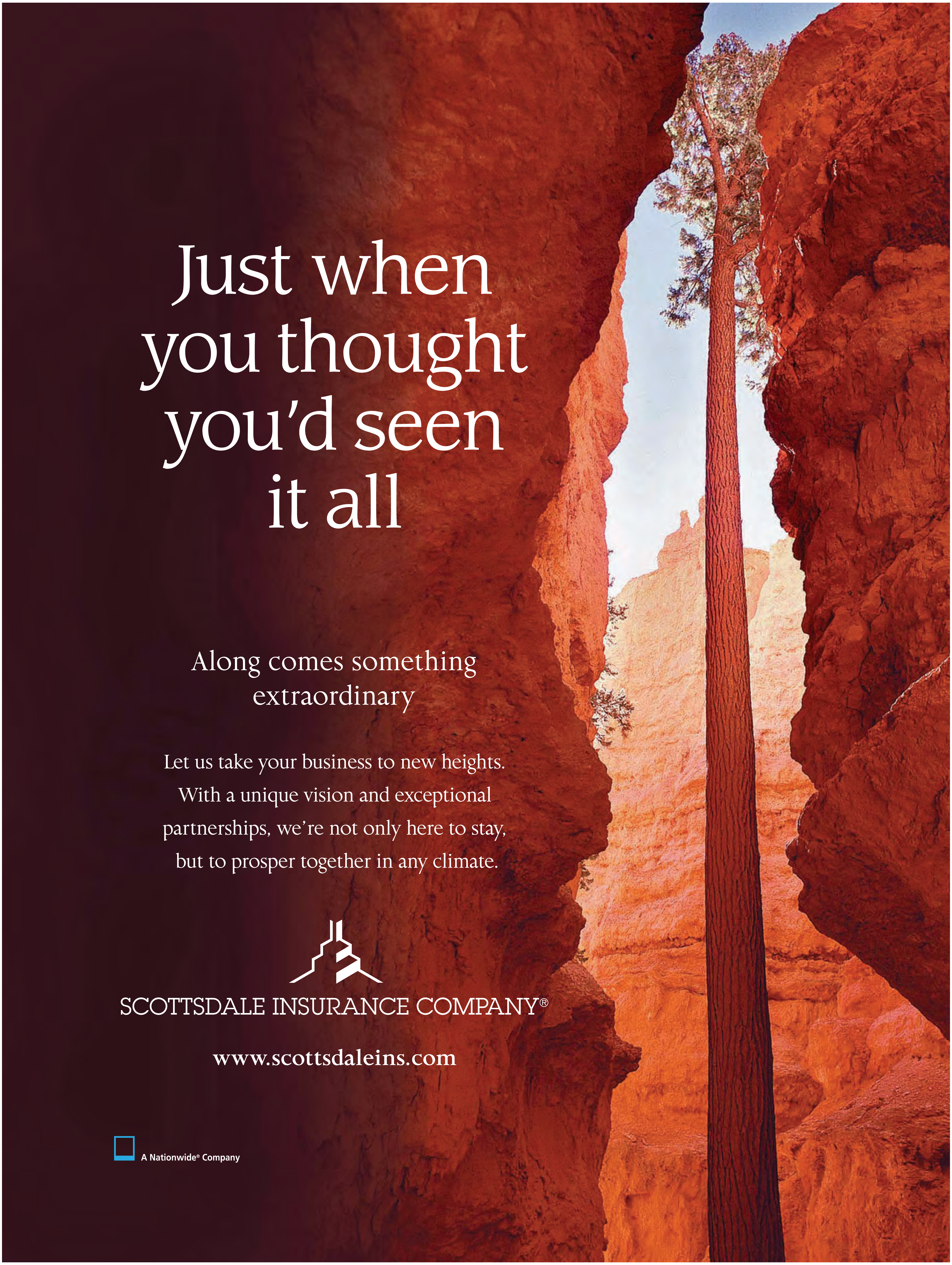
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# Spotlight

## Professional liability risks



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# Risk managers urged to help shape governance

## Scandals show need for influence over internal controls

By DAVE LENCKUS

From the infamous meltdowns of Enron Corp. and WorldCom Inc. to the recent legal troubles at restaurant holding companies Buca Inc. and Red Robin Gourmet Burgers Inc., the integrity of corporate executives has been a major issue for shareholders.

But neither securities class action lawsuits nor drops in share price triggered by executives' alleged acts of self-dealing are stimulating a concerted reaction in the risk management community over the adequacy of internal controls in preventing malfeasance, according to experts.

Many risk managers, consultants and insurance market executives say few risk managers have the background to weigh in meaningfully on corporate internal controls.

The idea of moving into that arena is not entertained even among many who support or practice enterprise risk management—the concept of managing risks beyond the traditional hazards.

But even without a background in finance, risk managers should attempt to have some input on internal controls, some experts say.

Ultimately, the goal should be to satisfy corporate investors and di-

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# Problems: D&O insurers look for assurance that best controls are in place

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rectors and officers liability insurers that the best controls possible are in place to prevent the kinds of management malfeasance that have grabbed headlines in recent years, experts say.

"Wall Street quantifies a problem as long as it is known; it will multiply a fear," said Cory Meiners, second vp of financial and professional services and corporate management professional liability practice leader at St. Paul Travelers Cos. Inc. of St. Paul, Minn.

The number of allegations that corporations lack adequate internal controls is significant but always has been, and it is no worse of a problem than it has been for years, according to attorneys.

> "Wall Street quantifies a problem as long as it is known; it will multiply a fear."
>
> **Cory Meiners**
> **St. Paul Travelers Cos. Inc.**

"Not to minimize that the allegations are in there, but they've always been there on a fairly common and frequent basis" in securities class action lawsuits, said insurer attorney Dan A. Bailey, a partner with Bailey Cavalieri L.L.C. of Columbus, Ohio.

The number of claims has not changed measurably even though many corporations have not met the deadline that the Sarbanes-Oxley Act set for companies to certify that they have adequate controls.

Mr. Bailey suggested that investors are not too concerned because they "know that the SOX requirements are pretty comprehensive and that companies couldn't comply within the period required."

But the frequency of claims that corporations lack solid internal controls does not suggest this is a problem that risk managers should tackle, many experts say.

And, to a large extent, risk managers aren't.

The primary reason is that few risk managers have the expertise to offer meaningful input, experts say.

Gary Dubois, chief underwriting officer at New York-based Liberty International Underwriters, a unit of Liberty Mutual Group Inc. that writes executive management coverage, said he does not look for risk managers to become more involved in drafting internal controls.

That role typically has been given to individuals with financial backgrounds, Mr. Dubois said. "Many risk managers' experience is more focused in the insurance arena."

The duty for overseeing internal controls has been "pretty much relegated" to financial departments, particularly internal auditors, since Sarbanes-Oxley was enacted, explained Roger Siefert, national practice leader of the financial advisory services group with New York-based risk consultant Kroll Inc., a subsidiary of Marsh & McLennan Cos. Inc.

James D. Hinton, the *Business Insurance* 2005 Risk Manager of the Year, has an accounting background and says he probably could handle some responsibilities for evaluating internal controls at HCA Inc. But Mr. Hinton has no such responsibilities at the Nashville, Tenn.-based hospital group, where he is vp-risk and insurance.

Mr. Hinton said his "personal view" is that risk management cannot be involved in managing internal controls for two main reasons: They typically do not have the necessary skills, and they usually have not risen to the requisite level of seniority in management.

Mr. Hinton said, though, that he could see risk managers with enterprise risk programs—especially in the financial services industry—having some input on internal controls.

Kroll's Mr. Siefert said that, for most risk managers, developing the ability to assess whether internal controls are effective would be "extremely time-consuming."

One risk manager who has an ERM program noted that the program does not touch on internal controls.

"My job is to do a road show for underwriters," explained the risk manager, who asked not to be identified. "I don't dwell on the controls" with underwriters.

There are risk managers, though, who have some level of input on internal controls.

And the more input risk managers have, the better the risk their organizations typically become, experts say.

Chief risk officers are beginning to realize that a risk manager's knowledge of internal controls likely would help improve or solidify that organization's relationship with its D&O insurers, according to Liberty International's Mr. Dubois.

Internal controls are "a huge point for underwriters," he said. While Sarbanes-Oxley requires the controls, "underwriters often don't have the ability to visit with internal auditors," who typically implement and test the controls, he said. "So risk managers' expertise would be a tremendous value to us," Mr. Dubois said.

Mr. Hinton agreed that D&O underwriters want information about internal controls, but he said that CFOs often accompany risk managers to policyholder meetings with insurers to present that informa-

**Continued from previous page**

tion.

Other experts foresee an even bigger role for risk managers.

"Anecdotally, I'd be able to say pretty strongly that, in corporations where the risk manager is viewed as part of the process, they have better controls—period," observed Steve Shappell, director of the legal and claims practice of Denver-based Aon Financial Services Group, a unit of Aon Corp.

Those companies faced fewer lawsuits and fared relatively well in those they did face, he said.

While few—if any—risk managers will become involved in developing internal controls, they can prod management to ensure that effective controls are in place, experts say.

"I don't think it's reasonable for them to fix the problem, but, certainly, they have a role in fixing a spotlight on the problem, if it exists," by prodding management to evaluate internal controls and elevate the importance of the issue, said Mr. Bailey, the insurer attorney.

St. Paul Travelers' Mr. Meiners said risk managers' involvement in internal controls is "something we believe" is a "primary function of their job."

Risk managers are responsible for managing the risk of theft and crime against their organizations, he noted. But "too often," financial malfeasance exposures—such as embezzlement through abusing expense accounts or setting up phony vendor accounts—are left to only the accounting department to handle, he said.

In discussions with CFOs, risk managers should ascertain their organizations' policies and controls on issues that, if left unchecked, could result in significant losses and give the investing community the impression that company controls are lacking, Mr. Meiners said.

In coordinating the ERM function at Kansas City, Mo.-based GE Insurance Solutions, Samira Barakat has input on the company's governance and compliance issues. That includes whether the D&O reinsurer is following its internal and external rules.

Regarding internal controls, Ms. Barakat, GE Insurance's chief risk officer, works with the reinsurer's compliance officer and finance department.

Ms. Barakat said her involvement in the company's internal controls functions has been eased by "the softer part of governance," which is the reinsurer's "very strong" culture of compliance with corporate governance. Ms. Barakat noted that all GE Insurance employees receive some level of compliance training—depending on their positions in the company.

The risk manager with the ERM program agreed that risk managers should at least determine whether the effort is being made to enforce controls.

Still, that would not "preclude what happened at Enron," he said.

Enron had controls, "but they were overruled by people who had the power," he said.

"The CEO, in some sense, is your biggest risk. Your CFO is your next biggest risk," because those corporate officials have the power to overrule controls, the risk manager said.

When senior management suffers a "crisis of integrity," the risk manager said, "all of the controls in the world aren't going to stop them."

A risk manager's involvement in the process likely would not prevent a loss when senior management is corrupt, but it could help facilitate "a better control environment," he said.

# Who's in control of financial controls anyway?

## Getting the risk manager side heard doesn't have to devolve into a turf war

By DAVE LENCKUS

Risk managers who decide they want some say in their organizations' internal financial controls should expect to hear some dissent, according to experts.

But the risk of setting off a turf war can be minimized if risk managers signal from the outset that they have no intention of seizing ownership of the controls, experts said.

The goal should be ensuring that internal controls are "being addressed properly," said insurer attorney Dan A. Bailey, a partner with Bailey Cavalieri L.L.C. of Columbus, Ohio. "Who's addressing it is secondary."

If internal controls are inadequate, the risk manager has to "figure out how to get to someone with sufficient authority" who would be willing to investigate the problem or ask the risk manager for assistance in driving the effort to fix the controls, Mr. Bailey said.

"Risk managers rarely win turf battles when it's a one-on-one fight," Mr. Bailey said. "They need to recruit other support within the company."

A risk manager with an enterprise risk management program agreed. He suggested that risk managers "build a relationship and get in line with the internal audit folks," whom he said often view internal controls and their effectiveness as the auditors' domain.

Risk managers then could evaluate whether auditors are examining the effectiveness of controls and whether auditors are reporting on them "at a risk ownership level," said the risk manager, who did not want to be identified.

But building that relationship with internal auditors "is easier said than done," because auditors "believe they have the right to own risk management," the risk manager said.

Samira Barakat, chief risk officer for Kansas City, Mo.-based GE Insurance Solutions, observed that a risk manager's life is filled with turf battles.

But risk managers—especially those with ERM programs—"need to understand all the risk facing a corporation or organization," she said.

"This is part of the risk that cannot be ignored."

An organization's reporting structure also likely would significantly impact how smoothly a risk manager would fit into the internal controls area, noted James D. Hinton, vp-risk and insurance at Nashville, Tenn.-based hospital group HCA Inc.

> Risk managers "need to understand all the risk facing a corporation or organization."
>
> **Samira Barakat**
> **GE Insurance Solutions**

Risk managers who report to chief financial officers would face less resistance, he predicted.

But because internal auditors often report to chief executive officers and many risk managers report to general counsels, battles with the CFO function should be expected, "because you're getting into financial reporting," Mr. Hinton said.

Another problem that many risk managers likely will have to overcome is their lack of background in finance, experts said.

The turf war problem, though, will be "highly dependent upon the philosophy of a particular company," said Steve Shappell, director of the legal and claims practice of Denver-based Aon Financial Services Group, a unit of Aon Corp.

Other experts agreed.

"An organization that takes internal controls seriously—I don't think they'd be offended" if risk managers offered their input, said Roger Siefert, national practice leader of the financial advisory services group with New York-based risk consultant Kroll Inc., a subsidiary of Marsh & McLennan Cos. Inc.

Mr. Siefert added, though, that the CFO likely would want to know what the risk manager could contribute to the process.

Other experts agreed that the value-added issue would be the first hurdle risk managers would have to clear.

"It always helps to have another set of eyes, but you have to know the right questions to ask" about internal controls if the risk manager is going to have any input on them, Mr. Hinton said.

Administrative errors can cause a law firm's liability rates to rise.

# Third-party liability threat to lawyers grows

## More malpractice claims are surviving summary judgment

**By ROBERTO CENICEROS**

The cost of defending attorneys against malpractice lawsuits continues to rise, while certain law firms face a growing threat from third-party claims with potentially costly outcomes, according to insurers.

Yet pricing for lawyers professional liability insurance has remained stable over the past year or so—a far different scenario from the post-Sept. 11, 2001, market, when rates shot up suddenly and drastically as deductibles increased significantly.

The post-Sept. 11 increases were preceded by the entrance of a wave of insurers into the lawyers professional liability market in the latter half of the 1990s. Back then, casualty lines, with their longer tails, attracted insurers intending to gain mostly from investing premium dollars, according to Stephen S. van Wert, program manager for Lawyer's Protection Plan, a Tampa, Fla.-based managing general agent representing Greenwich Insurance Co. of Greenwich, Conn., a unit of XL Capital Ltd.

The entrance in the late '90s of several insurers into the market for lawyers professional liability coverage depressed prices to an unsustainable level, say brokers and insurers.

Coverage for large law firms was especially underpriced, more so than coverage for small firms, said Mike Murphy, executive vp of professional liability for Arch Insurance Group in New York. Rates didn't move upward for seven or eight years while the exposure worsened, he noted.

But after Sept. 11, when interest rates turned south and the stock market soured, a correction commenced in the market for attorney coverage, just as it did for other professional liability lines, Mr. van Wert said.

Many insurers fled the market. Prices instantly shot up as capacity constricted, explained Karen Samuels, senior vp specializing in law firm risk management at USI Southeast, a unit of USI Holdings Corp. in Boca Raton, Fla. "It was just such a dramatic spike," Ms. Samuels recalled. "It was rapid and it was significant all at the same time."

As rates rose, coverage was also scaled back. Firms that previously had maintained a $250,000 per claim deductible subject to an aggregate suddenly had to renew coverage with million-dollar deductibles for each and every claim, Ms. Samuels said.

> The entrance in the late 1990s of several insurers into the market for lawyers professional liability coverage depressed prices to an unsustainable level, say brokers and insurers.

Insurers also eliminated coverages previously included in policies. For example, a law firm's professional liability policy might have included directors and officers coverage for firm partners who sat as outside members on corporate boards. But such "throw-ins" disappeared after 2001, Ms. Samuels explained.

While the early part of the decade gave rise to a hardening rate environment, the corporate scandals that emerged during the same time helped usher in greater demand for policies dedicated to protecting corporate counsel, said James Rhyner, worldwide lawyers professional liability product manger for Chubb Specialty Insurance in Warren, N.J.

Following the Enron Corp. and WorldCom Inc. debacles, corporate leaders wanted all limits deriving from directors and officers liability policies to protect them exclusively. They didn't want their coverage commingled with protections for their entities.

The same happened with coverage for in-house counsel, Mr. Rhyner said. Corporate attorneys also wanted policies with limits dedicated exclusively for their protection. That spurred a rise in the sale of policies just for employed attor-

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# Attorneys: Lawyers facing greater threat from third-party liability claims

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neys.

Such coverage had been available before but had remained mostly dormant until the corporate scandals, Mr. Rhyner said. It has since become "mainstream," he said.

Coverage for employed lawyers generally costs less than policies for attorneys working in law firms, several observers say. That's because employed lawyers typically face less loss potential than do those working in law firms, several insurers say.

When setting prices, underwriters and brokers say they weigh issues such as a law firm's type of practice, its geograpical location, its client selection and its administrative practices.

To date, attorneys professional liability policy prices have not retreated from their post-Sept. 11 rise, Ms. Samuels said. But increases have flattened, she noted.

Rates today remain about 40% to 60% higher they were than in 2001, according to Mr. van Wert. They are about where they should be, several insurers say.

Yet attorneys face greater threat from third-party liability claims, defense costs are increasing and more types of legal practice are likely to be targets.

Defense firms, for example, are now a bit more likely to get sued for legal malpractice, said Michael Furlong, business leader, lawyers professional liability, for GE Insurance Solutions in Overland Park, Kan. Lawsuits previously were uncommon in that area. "But, by and large, we are not anticipating or seeing any tremendous swings in the legal malpractice area, whether it be from a pricing standpoint or from a claims frequency or severity standpoint," Mr. Furlong said.

Nonetheless, more third-party liability claims appear to be surviving the summary judgment stage of litigation, Mr. Rhyner noted. Plaintiffs attorneys have improved their ability to bring claims that stick, he said.

That is happening, for example, with claims involving deepening insolvency. The claims stem from law firms that help raise capital for financially impaired companies. Should a company still face bankruptcy despite efforts to raise new capital, plaintiffs claim that, if not for the law firm's action, they would not be creditors. Plaintiffs claim that the law firm deepened the entity's insolvency by helping raise funding and that the firm should have known those funds would not be enough to get the troubled company back on track.

Because the lawsuits represent a new phenomenon, their loss potential is not yet well understood. But they have the potential to result in severe losses because "some of these rounds of financing were enormous," Mr. Rhyner said. "Just defense costs alone are a high-severity loss to a law firm and to a carrier," he said.

Meanwhile, defense cost inflation continues to climb, Mr. Rhyner said. Defense lawyers raise their rates annually, and discovery continues to grow more complex and expensive as electronic documents and e-mail communications must be delved into.

Because those costs are on a constant upward curve, some premium increases continue to be necessary, insurers say.

When setting prices, underwriters and brokers say they weigh issues such as the law firm's type of practice, its geographical location, its client selection and its administrative practices.

Any practice dealing with securities receives particular scrutiny because of regulatory issues swept in with the adoption of the 2002 Sarbanes-Oxley Act, Ms. Samuels noted.

Firms that do class action litigation and other practices steeped in representing plaintiffs also concern many underwriters, especially when big-dollar cases are involved. Those cases increase the potential for a high-severity loss. Additionally, litigious plaintiffs have been known to turn on their attorneys.

"If you can't get it for them, are you going to be the next named defendant?" Ms. Samuels asked rhetorically. "It doesn't happen in every case, but it has certainly happened."

That is why underwriters often consider a law firm's "client intake" habits, Ms. Samuels said. Potential clients who have previously experienced soured relations with reputable law firms should be given extra scrutiny, she advised.

But while a law firm's areas of practice offer an indication of potential severity, most claims against law firms stem from administrative errors, Chubb's Mr. Rhyner said. Therefore, insurers look not only at the type of practice but how a firm practices.

A firm lacking strong internal controls to ensure administrative policies and protocols are followed is more likely to get sued for administrative errors. An administrative error could stem, for example, from a firm missing a filing deadline when it was supposed to secure an inventor's worldwide patent rights. Such an oversight could lead the inventor to lose millions of dollars, Mr. Rhyner explained.

# State tort reform measures, loss control programs bring stabilization to medical malpractice market

By MEG FLETCHER

The marketplace for medical malpractice liability insurance is improving as rate increases level off, claim frequency drops, states pass tort reform measures and health care providers commit to loss-control programs.

As a result, buyers generally are finding more-flexible terms and conditions and more capacity.

But the long-troubled marketplace still faces overall increases in the severity of claims and a lack of effective tort reform in some states. Also, insurers are reluctant to write coverage in recently reformed states until the new laws have been tested and upheld.

For large hospitals, "the pricing is starting to get in the more-reasonable realm, but we are not there yet," said James D. Hinton, vp-risk and insurance for Nashville, Tenn.-based HCA Inc. Mr. Hinton was designated *Business Insurance*'s 2005 Risk Manager of the Year in part because of his efforts to control medical costs in the company's 190 hospitals in 25 states.

During the past four years, hospital systems such as HCA have greatly increased their retentions—in Mr. Hinton's case to $25 million from about $5.5 million—and are staying at that level for the time being, he said. Mr. Hinton said he would like to lower his retention by $10 million to $15 million, "but only if the price is right," he said.

Broker Marsh Inc., whose core business is large institutions, has seen rate changes nationally range from flat to down by 10%, said Anthony Mercurio, the managing director responsible for the broker's medical professional liability practice. "The greatest decrease has been in top-layer coverage," he said.

The situation for physicians also is improving nationally, with increases of 2% to 3% being offset by some decreases, Mr. Hinton said. Recent increases in physicians' premiums stemmed from their failure in the 1990s to keep pace with the 5% to 6% increase in annual claim costs, he explained.

"Rates have stabilized," although at high levels, said Larry Smarr, president of the Physician Insurers Assn. of America. "The average cost of a paid claim is increasing 6% annually," he said. The Rockville, Md.-based trade association, which represents about 60 insurers that are owned or operated by physicians, insures more than 300,000 physicians and about 1,400 hospitals.

> A "rapidly growing" alternative market has given health care facilities "a greater financial incentive to reduce their cost of risk."
>
> **Greg Larcher**
> **Aon Risk Consultants**

In addition, a "rapidly growing" alternative market has given health care facilities "a greater financial incentive to reduce their cost of risk," said Greg Larcher, assistant director and actuary in the Columbia, Md., office of Aon Risk Consultants, a unit of Chicago-based Aon Corp. The frequency of malpractice claims has decreased by 1% over the past year, although the severity of those claims continues to grow at a rate of 7.5% annually, he said in an analysis released last month.

A key factor in the leveling of rates has been the impact of some tort reform measures, sources say.

According to the National Conference of State Legislatures, 48 states introduced more than 420 bills in 2005, and 32 states have passed more than 60 bills that have been enacted in the past six months.

Particularly noteworthy are the six states that capped noneconomic damage awards: Alaska, Georgia, Illinois, Missouri, Montana and

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## Popular medical malpractice reforms adopted in 2005

2005 legislative sessions have passed a number of tort reform bills dealing with medical malpractice.

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|---|---|---|---|---|---|---|---|---|---|---|---|
| Ariz. | Conn. | Ga. | Ill. | La. | Maine | Mo. | Mont. | N.H. | S.D. | Va. | W. Va. |

Some immunity for doctors' apologies

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Cal. | Conn. | Del. | Fla. | Ga. | Mont. | Nev. | N.J. | S.C. | Va. | Wyo. |

Increased oversight of doctors

| | | | | | | |
|---|---|---|---|---|---|---|
| Conn. | Cal. | Ga. | Ill. | N.D. | S.C. | Va. |

Certification that claims have merit

| | | | | | |
|---|---|---|---|---|---|
| Alaska | Ga. | Ill. | Mo. | Mont. | S.C. |

Limitations on noneconomic damages

Data source: National Conference of State Legislatures

# Med mal: State tort reforms, loss controls stabilize market

Continued from previous page

South Carolina. The caps range from $250,000 in Alaska to $1.05 million in Georgia.

"Studies have shown that limits on noneconomic damages reduce the uncertainty of awards and provide more stability to underwriters, while discouraging litigation and promoting a more uniform and fair environment for pain and suffering awards," said Rita Nowak, assistant vp-commercial lines for the Property Casualty Insurers Assn. of America, in Des Plaines, Ill.

"Caps mean more for hospitals because they are the deep pocket," Mr. Hinton said.

Other popular 2005 reforms included passing "doctor apology" laws that provide some immunity for physicians, increasing oversight of physicians by beefing up medical or peer review requirements and stipulating that an affidavit or certificate of merit be issued before a lawsuit can be brought.

Texas and Mississippi are among the states now reaping the benefits of previous tort reforms, which are helping to drive down loss costs.

In Texas, "the recent spate of rate cuts—by the state's five-largest physician liability carriers—will produce $48.6 million in annualized premium reductions," according to Jon Opelt, executive director of the Austin, Texas-based Texas Alliance for Patient Access. Mr. Opelt noted that other promising developments include a reduction in hospital liability costs and a 50% reduction in the number of lawsuits filed in most Texas counties. In addition, he said, the state has seen access to health care improve,

"Studies have shown that limits on noneconomic damages reduce the uncertainty of awards and provide more stability to underwriters, while discouraging litigation and promoting a more-uniform environment for pain and suffering awards."

**Rita Nowak**
**Property Casualty Insurers Assn. of America**

with 3,000 more physicians coming into the state, and increased competition for their business due to growth in the number of insurers.

The largest med mal insurer in Mississippi also is reducing rates. The Medical Assurance Co. of Mississippi, which provides malpractice insurance to about 70% of the doctors in the state, announced a 5% decrease in premiums for 2006 due to a substantial reduction in incurred losses this year, said Mike Houpt, chief executive officer of the Ridgeland, Miss.-based insurer. Loss and loss-adjustment expenses, which had been $40 million in 2004, are expected to be only $25 million this year, he said.

In addition, the Mississippi insurer's board also voted in September to refund at least 10% of each policyholder's premium, Mr. Houpt noted.

Many Washington state physicians also had their premiums re-

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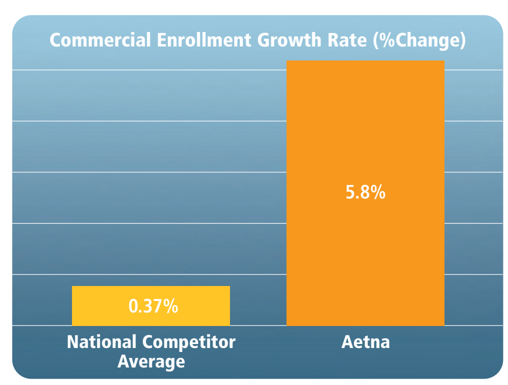


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-2005125

Implementing loss control methods such as the use of electronic patient record-keeping systems that provide online reminders about best practices and warnings about negative drug interactions may help hospitals keep rate increases for medical malpractice coverage to a minimum.

# Med mal: Market sees increasing stabilization

Continued from page 20

duced, but the state's insurance department had to mandate the reduction. Seattle-based Physicians Insurance and its affiliate, Western Professional Insurance Co., were ordered to stop using unfiled rates and to refund $2.2 million in 2003 premium overcharges, plus interest, to its physician policyholders. For 2005, though, the insurers announced a 7.7% rate reduction.

While most insurers are reluctant to reduce rates until a new tort reform measure is tested, Texas was an exception, because voters there approved the reforms as an amendment to the state constitution (*BI*, April 18). Such definitive action makes the legislation nearly challenge-proof, sources say.

Elsewhere, though, challenges to tort reforms are pending or expected.

In Georgia, a state superior court overturned the so-called "winner pays" provision of tort reform passed earlier this year. The measure required that a party prevailing in a lawsuit must obtain a judgment of more than 125% of a proposed settlement or face paying the opposing party's attorney fees.

Also, the Wisconsin Supreme Court issued a ruling that voided a noneconomic damage cap in a birth defect case. The court held that the $350,000 cap established in 1995—which had increased due to annual inflation adjustments to $445,775 in 2005—was unconstitutional on the grounds that it violated the equal protection of the state's constitution, according to a statement by the American Insurance Assn.

"That should cause everyone to pause," because Wisconsin is not known as a litigious state, said Daryl J. Douglas, hospital claims manager for GE Insurance Solutions in Overland Park, Kan. Mr. Douglas is now handling the runoff of large claims following the sale of Medical Protective Corp. in July.

Wisconsin's Legislature took steps last week to remedy the situation when it gave final approval to A.B. 766, which would cap noneconomic damages at $450,000 for adults and $550,000 for minors under 18 years of age.

> "As competition heats up, we are beginning to see a willingness on the part of underwriters to do creative things."
>
> **Anthony Mercurio**
> Marsh Inc.

While capacity in the market varies from state to state, there are indications that it may be expanding beyond the ongoing growth in alternative facilities, including risk retention groups.

For example, two Bermuda-based companies expressed an interest late last month in providing additional capacity for small nursing home chains and community hospitals with lower-than-usual attachment points of $2 million to $5 million, noted Corbette Doyle, executive vp of Aon Corp.'s national practice group and chairman of Aon Risk Services' health care industry practices. Ms. Doyle declined to identify the companies.

"As competition heats up, we are beginning to see a willingness on the part of underwriters to do creative things," Mr. Mercurio said. These include multiple-year deals, loss-sensitive policies and an enthusiasm to help hospitals secure coverage for their voluntary hospital staff.

While some underwriters are tightening guidelines for bariatric surgery, others are willing to consider health care practitioners' increasing commitment to loss control, he said. For example, underwriters like to see a hospital installing an electronic patient record-keeping system that also helps physicians by providing online reminders about best practices and warnings about negative drug interactions, Mr. Mercurio said.

In addition, "there is a tendency toward more choice in coverage

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# Med mal: State tort reform measures, loss control programs help stabilize market

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forms," so larger accounts have an easier time building layers of coverage, Ms. Doyle said.

Some observers, though, continue to focus on continuing uncertainties in the marketplace. Overall, A.M. Best Co. cautioned in a statistical study published in August that those improved 2004 results "should not be construed as an indication of restored pricing or an end to the medical malpractice crisis."

A specific concern is the impact of recent storms.

Mr. Mercurio said that property/casualty insurers might find medical malpractice coverage to be a more-attractive alternative than continuing to provide property coverage in storm-ravaged areas.

Ms. Doyle is concerned, though, that insurers may draw away from writing medical malpractice risks because the storms may produce an unexpectedly large hit to their aggregate surplus. In addition, she said, insurers might shy away from such risks because of questions that have been raised about the acceptability of financial reinsurance, which is used in writing med mal risks.

Another uncertainty is the impact of a controversial report on insurers' rating practices issued by several consumer groups in July. The report, "Falling Claims and Rising Premiums in the Medical Malpractice Insurance Industry," alleges that the industry has been significantly overcharging doctors despite a decline in claim payments. Jay Angoff, an attorney and the former director of the Missouri Insurance Department, wrote it for the New York-based Center for Justice & Democracy, a consumer group.

Several groups have criticized the report and its analysis, including the American Academy of Actuaries. Late last month, the group issued a statement saying that the report's analysis and conclusions should be questioned because the "report uses improper data comparisons, incomplete information and appears to misuse certain industry benchmarks."

In response, the Center for Justice issued a statement in which it urged that regulators study the extent to which actuaries have overstated projections. It also urged that regulators establish standards that actuaries must follow in calculating insurance rates.

The National Assn. of Insurance Commissioners is now reviewing the report.

# States succeed on malpractice damage caps but miss out on key cost-saving measure

Periodic payments are an underutilized tool in settlement compensation, a proponent says.

By MEG FLETCHER

Tort reform proponents have successfully expanded the scope of medical malpractice reforms in several states over the past year, but one of the key tools in reducing liability costs—periodic compensation payments—is still underutilized, experts say.

In large part, tort reformers have followed the model of the Medical Injury Compensation Reform Act of 1975 in California, which has four key requirements: a cap on noneconomic damages; awards that must be reduced by collateral sources of recovery; a limit on plaintiffs attorneys' fees; and the use of periodic payments to fund judgments such as ongoing medical care costs.

While other states have been successful in implementing the noneconomic damages reform, they have had less success in passing the other three MICRA reforms—and the failure to pass the periodic payment requirements, in particular, is often a block to significant savings, experts say.

"The point of periodic payments is to match the payments to the needs of the client," said Randy Dyer, executive vp of the Washington-based National Structured Settlements Trade Assn. Many of the payments are funded through a structured settlement that requires the defendant to buy an annuity that guarantees a stream of payments to the claimant over his or her lifetime.

Periodic payments can also lead to more equitable settlements, said Jon Opelt, executive director of the Texas Alliance for Patient Access in Austin.

"The deliberative structured settlement process will also help jurors to more fairly compensate plaintiffs, rather than taking a hit-or-miss approach," he said.

Allowing for the periodic payment of future medical payments is "critical" to reducing the cost of claims but is "a piece that many people miss," said Daryl J. Douglas, hospital claims manager for GE Insurance Solutions in Overland Park, Kan. He is now handling the runoff of large claims following the sale of Medical Protective Corp. in July.

> "The point of periodic payments is to match the payments to the needs of the client."
>
> **Randy Dyer**
> **National Structured Settlements Trade Assn.**

For example, Mr. Douglas said an annuity to cover $10 million to $15 million in lifetime medical expenses for a severely injured child could be purchased for $1 million to $3 million. Annuity providers base their charges on a combination of investment and life expectancy actuarial projections.

In addition to reducing costs, "structured settlements are a good tool to get cases settled," said Michael Shalhoub, the immediate past chair of the Defense Research Institute's Medical Liability Committee. He is an attorney with New York-based Heidell, Pittoni, Murphy & Bach L.L.P.

"Most states attempting tort reform get the caps on noneconomic damages," but they do not get the other three MICRA reforms, said James D. Hinton, vp-risk and insurance for Nashville, Tenn.-based HCA Inc., a health care system consisting of 190 hospitals in 25 states.

Generally, the periodic payments measures have been successfully opposed by the trial bar, which has argued that the provisions lessen the accountability of defendants.

Some states have adopted the requirement, however. Texas, for example, adopted some periodic payment reform with its 2003 changes.

Texas' reform permits structured settlements if the present value of future medical expenses is at least $100,000, though it becomes mandatory if the defense requires it, said Mr. Opelt. "I do think that cost savings for periodic payment reform will be significant," although it is too soon to have data to evaluate that, he said.

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# Canadian securities law lowers bar for class actions

## Foes say bill will increase liability risks

By GLORIA GONZALEZ

An amendment to securities law in Ontario is raising concerns that Canada will become more vulnerable to a litigation culture like that in the United States.

A sharp rise in securities claims is expected because of the law, which is designed to facilitate investor lawsuits. The legislation has a number of safeguards in place, though, that some observers believe will prevent frivolous lawsuits and large claims from permeating the Canadian tort system.

The law has already led to careful examinations of policy wording and will likely lead to higher prices and deductibles for directors and officers liability coverage, insurance professionals say.

Bill 198 opens the door to new lawsuits by amending the Ontario Securities Act to impose civil liability for inaccurate or incomplete corporate disclosure in the secondary market. Secondary-market investors may sue for misrepresentations in documents and public oral statements and failures to make timely disclosure of material changes.

Prior to Bill 198, a shareholder could sue for misrepresentation only if he or she had participated in the initial offering of shares. "Coming into the 1990s, we had a widely perceived gap in legislative protection for investors," said Larry P. Lowenstein, Toronto-based chair of the national litigation department at Osler, Hoskin & Harcourt L.L.P.

The law will apply to all companies that trade on the Toronto Stock Exchange and any public company with substantial ties to the province of Ontario.

There is widespread agreement that Bill 198 will lead to a surge in the filings of new securities claims, partly due to the fact that the vast majority of investments are made in the secondary market. "We are anticipating that there will be an increase in the attempts for people to launch securities claims," said Mary Maloney, Toronto-based vp, Canadian products manager, for the executive protection practice of Chubb Specialty Insurance.

The key clause in Bill 198 that will facilitate class action securities lawsuits is its removal of the reliance barrier. In Canada, members of a class action have to have common grounds for the lawsuit to proceed, such as a common reliance on the information that was misrepresented, said Ian Rose, a lawyer with Lavery, de Billy L.L.P. in Montreal who practices in the D&O field. Bill 198, though, provides a deemed reliance for the purposes of a class action securities claim, so plaintiffs do not

Continued on next page

## Reforms: States ignore some MICRA tools

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Prior to 2003 in New York, there were problems with the application of the periodic payment statute, Mr. Shalhoub said.

For example, in one case a $50 million judgment for primarily future medical expenses was nearly tripled, after the courts strictly interpreted the statute. The New York Legislature changed the law in 2003, but it is too early to gauge the impact of those changes, Mr. Shalhoub said.

"The trial bar often actively opposes most medical malpractice tort reform, including periodic payment provisions for judgments," Mr. Dyer said. In some cases, they are justifiably concerned about the kind of security such legislative proposals provide to claimants, he said—for example, proposals that make a claimant dependent on the credit-worthiness of a hospital that is guaranteeing the stream of payments.

> "The use of structured settlements is a tactic for wrongdoers to... escape accountability, boost their bottom line and make more money."
>
> **Assn. of Trial Lawyers of America**

"Generally speaking, use of periodic payments does not impact plaintiffs attorneys fees," Mr. Dyer said.

A spokeswoman for the Washington-based Assn. of Trial Lawyers of America, which represents plaintiffs attorneys, said: "We don't support them unless plaintiffs do.... The use of structured settlements is a tactic for wrongdoers to use to escape accountability, boost their bottom line and make more money," she said.

Mr. Dyer would like to bring both sides together. "We think there is a way to construct a periodic payment element so both sides will stop fighting about it," he said.

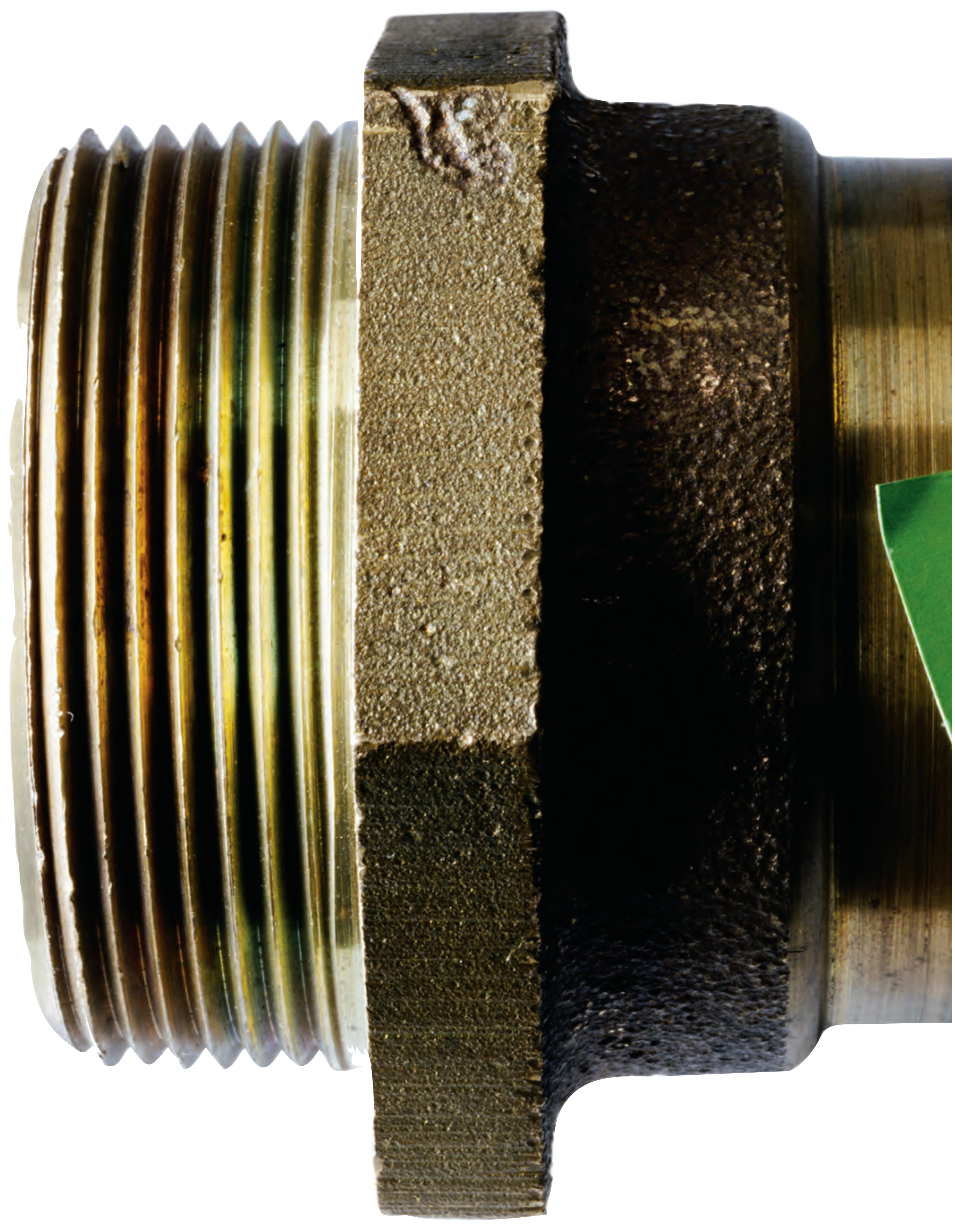


PHOTO: AP?WIDE WORLD

Canadian securities law Bill 198, designed to facilitate investor suits in Ontario, will apply to all companies trading on the Toronto Stock Exchange.

Continued from previous page

have to prove reliance on the misrepresentation or failure to disclose. "The major hurdle to securities class actions has been eliminated," Mr. Rose said. "I think there's going to be a significant increase in the number of class actions."

The removal of the reliance barrier has created a risk in Canada similar to the fraud-on-the-market theory in the United States, which provides for a deemed reliance on information that causes a company's stock price to fall, lawyers say. "Legally, it sort of puts us on the same landscape as the United States," said Eric Dolden, an insurance lawyer with Vancouver-based Dolden Wallace Folick.

In addition, Bill 198 does not require the plaintiff to show that the defendant was negligent, intended to deceive or had knowledge if the misrepresentation or nondisclosure occurred in a core document such as an annual information form, noted Rossana DiLieto, associate general counsel for the Ontario Securities Commission. The burden shifts to the defendant to prove that he or she performed adequate due diligence, she explained.

These factors, combined with several others, have led to concerns that the legislation, in establishing a right of action for secondary-market investors, has made companies too vulnerable to class action lawsuits. "Has the playing field now been tilted too far in a pro-plaintiff sense?" Mr. Lowenstein asked.

But some observers believe fears that a wave of U.S.-style class actions will be launched in Canada are unfounded. They point out that Bill 198 also includes a number of safeguards designed to protect against "nuisance suits." (see story, page 32). "I think there are significant safeguards in there to prevent that from happening," said Jonathan Ashall, vp, financial services group of Aon Reed Stenhouse Inc. in Toronto. "We do expect there will be claims coming out of this. We think, from an industry standpoint, the impact would be minor, with the exception of defense costs."

In addition, there are features in the Canadian tort system that make it less conducive to class action lawsuits than is the U.S. system, observers say. For one, Canada does not have jury trials for commercial civil cases. Jury trials

"The major hurdle to securities class actions has been eliminated. ... I think there's going to be a significant increase in the number of class actions."

**Ian Rose**
**Lavery, de Billy L.L.P.**

are "one of the reasons you have these huge settlements in the United States," Mr. Rose said.

Canada also has a "loser pays costs" system, and punitive damages remain rare and lower than those awarded in the United States, removing a major incentive for class action lawsuits, lawyers say.

## Insurance market impact

The Canadian D&O market is already preparing for the new risks associated with Bill 198. "It presents liability to directors and officers that they never faced before, including possibly some very large-scale monetary damages that can be awarded," said Jay A.R. Cassidy, assistant vp, claims, Marsh Canada Ltd., who is based in Toronto.

Thus far, the primary impact appears to be in the area of policy wording, with brokers carefully examining policies to ensure that they provide sufficient coverage for insureds. Severability, in particular, is going to be an important issue, and brokers are reviewing policies to ensure they will allow coverage to continue for innocent parties. "There are variations in how strong the language is, and that's the real issue," Mr. Ashall said.

Chubb has already examined its policy to ensure that it responds to Bill 198 claims, Ms. Maloney said. "We're anticipating that our existing coverage will respond fully," she said.

Market observers have ruled out

See BILL 198 / next page

### Canadian law cause

The Ontario securities law change under Bill 198 removes the requirement that plaintiffs must show they relied on a defendant's misrepresentation or failure to disclose securities information.

### ...and effect

Removal of this barrier is likely to lead to higher costs and deductibles for directors and officers liability insurance, market sources say.

# Bill 198: Law change may bring surge in securities lawsuits

Continued from previous page

the possibility of a blanket Bill 198 exclusion in future D&O policies, with brokers saying they would not recommend a policy with such an exclusion and their clients would not accept one. "There's no thought at all to excluding coverage for Bill 198," Ms. Maloney said.

The legislation has not yet affected the D&O insurance market in terms of pricing, but observers believe that is only a matter of time. "I think it will throw cold water on what was anticipated to be a softening market," said Phillip Hoyt, managing director of Toronto-based XN Risk Insurance Services (Canada) Inc.

Insurers will also look to increase deductibles to respond to higher defense costs, Mr. Ashall said.

> "I think (Bill 198) will throw cold water on what was anticipated to be a softening market."
>
> **Philip Hoyt**
> **XN Risk Insurance Services (Canada) Inc.**

Chubb could write a policy that has a higher deductible for securities exposures and a lower deductible for other exposures, something the company has already done for Canadian companies with U.S. risks, Ms. Maloney noted.

Errors and omissions insurance is also likely to be affected by Bill 198, which creates liability for experts such as lawyers, accountants and actuaries who provide professional advice that contributes to a misrepresentation. As in the United States, these experts are likely to be named in lawsuits, observers say. "I think the E&O policies are going to be affected," Mr. Dolden said.

Canadian risk managers say they are aware of Bill 198 but declined to comment because it is not an issue for them from a coverage standpoint at this time. Large Canadian companies are generally aware of the new liability presented by Bill 198, although those that have U.S. exposures have already dealt with similar issues emanating from changes in U.S. law. All companies should undertake a thorough review of their corporate governance and disclosure policies in light of Bill 198, lawyers say.

In recent years, Chubb underwriters have increased their focus on the corporate governance and internal practices of their clients, and that will continue, particularly with regard to their disclosure policies, due to Bill 198, Ms. Maloney said. Having good corporate governance and disclosure policies does not prevent companies from being sued, she acknowledged, but it does make the claims much more defensible, she said.

Ultimately, the number of claims and their eventual level of success will depend largely on how the legislation is interpreted by the courts, including how high judges set the standard for approval of these lawsuits, observers say.

"Until there is actual testing and use of the bill, I don't think that anyone can predict the actual outcomes," Ms. Maloney said. "Time will just provide that clarity."

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# Change lets secondary-market investors sue firms over inadequate information

### Liability caps

Canadian Bill 198 does offer some limitations on liability for defendants named in securities lawsuits, including:

- Damages cannot exceed $1 million or 5% of company's market capitalization
- Damages against a director or officer cannot exceed $25,000 or 50% of his or her annual compensation, including the value of stock options.

**By GLORIA GONZALEZ**

An amendment to Ontario's securities laws, Bill 198, will give investors in the secondary market the right to sue a company or responsible individuals that provide misleading or inadequate information about a firm's operations.

The legislation will give secondary-market investors the right to seek compensation for damages suffered if the issuer or responsible individuals made a written or oral public disclosure that contained an untrue statement of a material fact or failed to make a timely disclosure. It applies to all filings made after Dec. 31 and those in existence and still effective after that date.

The law will apply to all companies that trade on the Toronto Stock Exchange and any public company with substantial ties to the province of Ontario. Although the legislation is applicable primarily in Ontario, British Columbia has adopted comparable legislation, and other provinces are exploring the possibility of adopting similar measures.

Bill 198 includes 10 defenses for parties accused of violating its provisions. For example, a party to a civil action would not be liable if the individual can prove that he or she conducted a reasonable investigation and had no grounds to believe that there was a misrepresentation or that a failure to make a timely disclosure would occur.

There is also no liability with respect to "forward-looking information" that is presented as either a forecast or a projection and contains cautionary language, identifies factors that could cause actual results to differ and states the relevant factors and assumptions in making the forecast or projection, according to Bill 198's provisions.

The legislation also contains several features designed to deter "nuisance suits." Before proceeding with a securities claim under Bill 198, a court must be satisfied the action is being brought in good faith and a reasonable possibility exists that it will be resolved in the plaintiff's favor. A judge must also approve any settlements, which would prevent plaintiffs from obtaining approval when it appears the lawsuit was frivolous, legal experts say.

> "The whole game in Canada is going to be 'How do we get around the caps?' "
>
> **Eric Dolden**
> **Dolden Wallace Folick**

Under Bill 198, several parties can be sued, including the company, directors, officers, experts and influential persons, but there are liability caps designed to prevent awards reaching the levels that are sometimes seen in the U.S. tort system. For example, the law limits the damages that a company could pay to the greater of $1 million or 5% of its market capitalization. For a director or officer, the cap would limit damages to the greater of $25,000 or 50% of his or her compensation for the year, including stock options.

Legal and insurance industry experts, though, question the effectiveness of the caps in deterring such lawsuits.

While the caps may prevent a $100 million company from being hit with a $100 million claim, it will not prevent a $100 million claim against a company with a market capitalization in the billions of dollars, noted Ian Rose, a lawyer with Lavery, de Billy L.L.P. in Montreal.

In addition, the liability caps do not apply to defendants other than the company if the person knowingly made or influenced the making of the misrepresentation or failure to disclose.

In those situations, "these damage caps are basically useless," said Jay A.R. Cassidy, assistant vp, claims, Marsh Canada Ltd., who is based in Toronto.

In order to circumvent the caps, plaintiff lawyers will allege that the misrepresentation or failure to disclose was done with knowledge, although the onus is on them to prove knowledge under Bill 198, lawyers say.

"The whole game in Canada is going to be 'How do we get around the caps?'" said Eric Dolden, an insurance lawyer with Vancouver-based Dolden Wallace Folick.

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# Time to control comp drug utilization

By Joseph Paduda

For years, risk managers paid scant attention to prescription drug costs in workers compensation—and why would they? Drugs amounted to a few cents of the medical dollar and were not a big driver of medical expenses. Besides, there were bigger problems: hospital costs, indemnity expense and litigation rates.

Those days are over, and two new studies indicate they are not likely to return any time soon.

Last year, prescription drug costs in workers comp were up 12%. This was better than 2003, when inflation was approximately 18% over 2002, according to Health Strategy Associates' "Second Annual Survey of Prescription Drug Management in Workers Compensation," released in March. Yet several years of increasing inflation rates have pushed drugs' portion of total medical expense to 12.1%.

What's the answer? First, let's diagnose the ailment. Numerous factors drive prescription drug costs, including several new drugs on the market that address musculoskeletal conditions. Other factors are direct-to-consumer advertising, aggressive "detailing" by drugmakers and possibly the lack of health coverage, leading employees to seek drugs through their workers comp program. Whatever the cause, the results are higher prices, more pills prescribed and more types of drugs prescribed.

## Price vs. utilization

Twenty-eight states have pharmacy fee schedules. In addition, many workers comp payers use pharmacy benefit managers such as industry giants PMSI/Tmesys, ExpressComp, MSC, Progressive and CypressCare. These PBMs negotiate discounts below the fee schedule or the usual and customary rate and pass some of the discount to their customers.

Unfortunately, price has a small impact on total costs. According to a 2004 study by the National Council on Compensation Insurance, price increases were a relatively small contributor to the overall increase in workers compensation drug costs. Utilization—the volume of drugs prescribed—had twice the impact of price.

Controlling price is child's play: Use a fee schedule or a PBM-negotiated rate, pay that and save. Unfortunately, the widespread use of PBMs and fee schedules proves that these price controls do not work. If they did, we would not have double-digit rate trends. We are left with the much harder challenge of addressing utilization.

The key to utilization is the person who writes the scripts: the treating physician. Health Strategy Associates' survey noted that many respondents believe the physician has more control over the drugs prescribed, and thus over drug costs, than any other single party. As one respondent said, "The root of the problem is the physicians; they are treating more (claimants) with more drugs than they used to."

## What can employers do?

Find a good PBM with:

- A demonstrated history of managing pharmacy in workers comp.
- Very strong clinical pharmacy management programs.
- Flexible and sophisticated reporting capabilities.
- A demonstrated ability to interface information technology systems to enable data/eligibility sharing in as close to real time as possible.
- The ability to integrate paper bills, retail transactions and mail order in one database/process.

Noticeably absent in the "good PBM" definition are the usual "selection" criteria: large networks and deep discounts. While this may seem heretical, price is not nearly as important as utilization. A large retail network is great, but it is not useful if the pharmacies don't recognize the PBM's name, it has poor IT connections or the PBM has little understanding of—or the ability to manage—the clinical aspects.

Moreover, pharmacies that provide deep discounts will likely get higher reimbursement if they send scripts to a third-party biller, which then bills the PBM and the payer at fee schedule. While the pharmacy may offer a low price, its lack of margin does not motivate it to comply with drug utilization review or other programs.

It is critical that your PBM understand that the primary driver of workers compensation pharmacy expense is the treating physician and that the PBM has a long-term plan for changing prescribing behavior. Ask about the PBM's analysis capabilities. Can it identify physicians who are outlier prescribers? Can it report that data? What are the PBM's strategies for using the information?

Data should also drive the PBM's focus on short-term cost management. Can it alert claims handlers to potentially problematic claims? Can its IT system send alerts to specific adjusters for specific claims? Do alerts include actionable indicators of the adjuster options?

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# Don't get shortchanged on Katrina cover

By Kirk Pasich

In the aftermath of Hurricane Katrina, many businesses are grappling with obtaining coverage under their property insurance policies for both physical property losses and time-element losses. Because of the length and complexity of provisions in property policies, policyholders may overlook coverage that is worth potentially millions of dollars or lose coverage because of various time traps.

One common question that policyholders now face is that of what caused their loss—the winds and rain of Katrina, tides or "flood," or something else. Many policies have differing deductibles and limits for hurricane-caused damage and flood-caused damage, and many policies exclude flood damage.

Policyholders generally are aware of the rule of "efficient proximate causation," which applies in many jurisdictions. Under this rule, coverage typically depends on what is the "efficient proximate cause"—that is, the primary cause, or the cause that set the others in motion. If that cause is covered by a policy, then coverage is afforded. If that cause is excluded, then even if other causes contribute to the loss, coverage typically is not afforded. However, policyholders often overlook that the efficient proximate cause doctrine may not apply when two covered causes contribute to a loss. In its Aug. 26 decision in *Hit Factory Inc. vs. Royal Insurance Co. of America*, the U.S District Court for the Southern District of New York held that the doctrine of efficient proximate cause does not apply when two coverages potentially apply to a given loss. As the court explained, there is no reason to apply the doctrine to a loss caused by two covered perils when the insurer "knew of the possibility that two coverages might apply to one damage, and yet did not outline any limitations, aside from limiting damages to the actual loss or damages sustained by the insured." Thus, when two perils contribute to a single loss, the policyholder should seek the full limits available for each of the coverages, not a single limit based on the efficient proximate cause doctrine.

Regardless of the number of causes, policyholders should look at the full scope of time-element coverages available. Policyholders should consider all potential extensions of coverage and the specific wording of each extension. For example, many property insurance policies provide coverage for "service interruption." Most of those policies address "service interruption" in the form of an interruption of services such as energy or water.

But some service interruption provisions are not restricted to energy or water. Instead, they may apply to other sources of interruption. For example, some policies may provide coverage for interruption arising from damage or loss to any "direct service provider's property" that is situated outside of the insured's premises. This provision can be construed to include services provided by employees and thus may afford coverage if employees cannot work because their homes have been destroyed or damaged by the hurricane.

When a policyholder is attempting to measure the amount of its business interruption loss, it should not short-change itself. Policyholders frequently measure their loss by comparing the income they would have generated without the hurricane to the income they actually generated. This may result, though, in a lower insurance recovery than the law permits. A policyholder should consider measuring its loss

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# Drugs: Control of utilization

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Finally, how does the PBM evaluate itself? If the PBM is judged solely on the basis of discounts below fee schedule, you may see actual savings per script, which is meaningless when the real criterion is pharmacy cost per claim. Cost per claim is the only metric that accounts for the real impact of price, utilization, generic substitution, formulary management and network penetration.

Do these criteria add up to meaningful total savings? The answer is a resounding "yes." Two of the payers in HSA's survey had annual total pharmacy cost increases in the lower single digits. These payers worked diligently and tirelessly to understand the issues, develop sophisticated programs and monitor results carefully. So can you.

*Joseph Paduda is a nationally recognized expert on insurance and managed care issues in workers compensation, disability and group health. To request a copy of "The Second Annual Survey—Prescription Drug Management in Workers Compensation," conducted by Health Strategy Associates and sponsored by Tmesys, e-mail Mr. Paduda at jpaduda@healthstrategyassoc.com.*

Perspectives

# Managing sustainability risks is critical

By Dan R. Anderson

A new dimension of risks is emerging, which I term sustainability risks. Increasingly, businesses are being pressured to address environmental and social responsibility performance in addition to the traditional financial performance. The driving force of this trend is the increasing environmental and social risk costs that adversely impact the financial bottom line.

If the firm's sustainability risks are not properly managed, its reputation, directors and officers, and financial viability are threatened. In an effort to assist risk managers to develop sustainability risk management strategies, I have just completed a book entitled "Corporate Survival: The Critical Importance of Sustainability Risk Management." Its main points are briefly discussed below.

Risk managers have been confronted with environmental risks since the 1970s, and, more recently, corporate social responsibility risks portend problems. A series of developments indicate that the level of sustainability risks is reaching new dimensions and will significantly expand in the future. For instance, in the liability area, standards for determining negligence are rising, the scope of injuries and damage is expanding, the Sarbanes-Oxley Act is increasing disclosure of environmental liabilities and new theories of liability are developing.

For example, concern over global warming has focused on increasing property risks, but the island states of Tuvalu, Kiribati and Maldives, the Inuits and numerous environmental groups are exploring litigation against the United States and fossil fuel companies for damages caused by global warming.

The combination of the increasing number of nongovernmental organizations and their ability to instantaneously send information around the world to large numbers of individuals at virtually no extra cost through the Internet has greatly increased the effectiveness of boycotts. Large numbers of the Fortune 500 have incurred boycott pressures. Among the companies affected are Nike, Shell Oil Co., Starbucks Corp., Citigroup, ExxonMobil Corp., Coca-Cola Co., Nestlé, Dow Chemical Co. and Ford Motor Co. Boycott risks resemble business interruption risks by reducing revenues. Boycotts also

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## Cover: Don't be shortchanged

Continued from page 36

not based on what it would have made if there had been no hurricane but based on what it would have made had its facilities and operations not been affected by the hurricane while others were negatively impacted by the hurricane. As the U.S. District Court for the Eastern District of Louisiana explained in its 1997 decision in *Levitz Furniture Corp. vs. Houston Casualty Co.*, the policy "does not exclude profit opportunities due to increased consumer demand created by" an insured peril. As it further explained, "Business interruption loss earnings may include sales (the insured) would have made in the aftermath of the flood had it been open for business during that period."

Finally, property policies typically have time requirements for things like providing notice, filing a proof of loss and filing suit. While many states show some leniency if an insured fails to comply with a deadline—typically when the insurer has not been prejudiced by any delay—other states do not. Many policies provide a short period within which the insured must give notice or file a proof of loss—some as short as 30 or 60 days—rather than simply requiring the insured to file a proof of loss upon the insurer's request or as soon as practicable. Therefore, a policyholder should carefully review all such provisions of the policy to avoid any potential forfeiture of coverage.

Property policies may provide a wide range of coverage for losses following Katrina. A policyholder must carefully navigate the policy provisions and claim process, though, to ensure that it is obtaining all of the coverage for which it has paid and that it is complying with deadlines and procedural requirements.

*Kirk A. Pasich is a founding partner of the Los Angeles office of the law firm of Dickstein Shapiro Morin & Oshinsky L.L.P.*

# Sustainability: Addressing environmental, social responsibility performance

Continued from page 38

produce huge reputation damage. Developing strategies for responding to boycott risks is an important component of sustainability risk management.

U.S.-based multinational companies face uncertainty and difficult decisions due to new sustainability regulations in the European Union, Japan and other countries. The European Union, Japan, Russia and Canada have all ratified the Kyoto Protocol, which mandates a reduction in greenhouse gas emissions. The European Union has recently enacted directives that require manufacturers to take back, recycle and reuse waste electrical and electronic equipment; call for the restriction of hazardous substances such as lead, mercury, cadmium, hexavalent chromium and certain flame retardants; and mandate the registration, evaluation and authorization of chemicals.

U.S.-based corporations operating in the European Union, Japan and other countries must decide whether to use two sets of products/chemicals and greenhouse gas emission strategies or adopt the higher E.U. standards for all their operations and products. These companies must also deal with the uncertainty that such legislation may later pass in the United States.

Oil shortages and rising prices have caught the world's attention, but many ecosystems are under pressure. A study in Science magazine found that in the past 50 years, industrial-scale commercial fishing has depleted the oceans' populations of large predatory fish such as tuna, swordfish, halibut, grouper, cod and marlin by 90%. If current deforestation rates continue, the Amazon rainforest could be wiped out in 80 years. A United Nations report estimates that half the world's population could face serious water shortages by 2025. Current extinction rates of animals and plants will result in the sixth great wave of extinction. The last one, involving the dinosaurs, occurred 65 million years ago. Such unsustainable development presents risks for industries dependent on ecosystems and firms that may be held accountable for damaging these systems.

Social justice risks derive from the unfair treatment of workers and peoples in foreign countries. Sweatshop conditions supporting repressive governments and gender discrimination litigation such as the class action suit involving 1.6 million Wal-Mart workers represent a few of the increasing social sustainability risks.

Sustainability risk management employs such techniques as waste reduction, improved recycling and product design and more-efficient energy and transportation systems. Several companies have formed partnerships with NGOs. Qualifying for ISO 14001, meeting Dow Jones Sustainability Index requirements, issuing corporate sustainability reports and joining with other businesses in voluntary associations such as the Ceres coalition or the World Business Council for Sustainable Development can bolster a firm's sustainability risk management efforts. Retooling sustainability risk financing strategies offers greater protection, particularly for directors and officers.

Several leading corporations, including General Electric Corp., Toyota Motor Corp., FedEx Corp. and Costco Wholesale Corp., have expanded their sustainability efforts. By developing sustainability risk management systems, risk managers can assist in their firms' overall management strategy and can help their firms reduce risk costs, create competitive advantage, augment reputation and increase the bottom line.

*Dan R. Anderson is Leslie P. Schultz professor of risk management and insurance at the University of Wisconsin School of Business in Madison.*



# Homebuilder captive meets insurance need while making a profit

## *Contractors covered for construction defects*

By ROBERTO CENICEROS

**KAPALUA, Hawaii**—By running its captive like a commercial insurance company, Shea Homes strives to generate underwriting profits for the captive and provide needed insurance coverage to its business partners, one of its top executives said.

The Honolulu-based facility offers several liability coverages to contractors and subcontractors of the unit of Walnut, Calif.-based J.F. Shea Co. Inc., including completed-operations coverage that has been a difficult line in California, said Bruce Varker, chief financial officer of Shea Homes.

And by operating with a conservative pricing and loss reserving policy, the captive has developed a solid asset base and earns "a reasonable underwriting profit," Mr. Varker said.

Shea established its captive, Partners Insurance Co. Inc., to provide general liability, workers compensation and completed-operations coverage for the contractors and subcontractors that build properties for the general contractor, which builds residential communities.

Construction contractors buy completed-operations insurance to protect them against construction-defect claims, and it was this coverage that was the "predominant issue we were looking to solve" when Shea formed the captive, he said.

Because of a difficult market for completed-operations insurance, California-based contractors in recent years increasingly have sought to license captives to provide the coverage, with several forming in Hawaii for that purpose, said Jason Palmer, managing director for Willis Management (Hawaii) Ltd. in Honolulu.

A 10-year statute of repose, or limitations, for bringing construction

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# Shea: Homebuilder captive offers construction defects cover while making a profit

Continued from page 40

defect lawsuits in California has exacerbated market conditions for contractors seeking the insurance, explained Mr. Palmer, whose office provides management services for Partners Insurance Co.

Mr. Palmer said he expects the trend of West Coast homebuilders forming Hawaii captives to insure against construction defect claims will continue. Several contractors have sought Mr. Varker's advice on how to go about doing so.

Messrs. Palmer and Varker spoke at the Hawaii Captive Insurance Council's Forum 2005, held Nov. 1-4 in Kapalua, Hawaii.

To earn a profit from its captive, Shea has drawn on past experience and claims data gleaned from operating a rolling wrap-up program from 1997 to 2001, Mr. Varker said.

Shea provided coverage for its construction partners through the wrap-up program and essentially purchased first-dollar coverage for the risk, Mr. Varker said. The wrap-up offered several advantages. For example, it reduced the number of claims and counterclaims filed between Shea and its contractors when plaintiffs filed construction-defect claims against them.

The coverage purchased during the 1997-2001 period was "fairly expensive," but not as expensive as it became when the market hardened around 2001, he said.

Shea then launched Partners Insurance Co. in 2001, after rates shot up. Not only were prices on the rise,

While the captive strives to earn an operating profit, Shea is comfortable it is not at risk of running afoul of state insurance regulators.

but insurers providing completed-operations coverage failed to credit years of work that Shea put into improving its construction quality in order to reduce losses, Mr. Varker said.

Today, Shea's captive has about $300 million in assets and operates "pretty conservatively" by setting loss reserves and prices annually after an actuarial review of losses for each past year, Mr. Varker said.

Mr. Varker did not elaborate on how much of a profit the captive earns, but he noted that it varies from year to year. Uncertainty about the captive's profits and losses arises because of long-tail liability stemming from California's 10-year statute of repose.

Shea's "trade partners" that pay premiums to the captive range from sole proprietors to large corporations, Mr. Varker said. Instead of the trade partners writing checks to the captive, Shea offsets construction contract payments with "insurance trade partner credits."

While the captive strives to earn an operating profit, Shea has conducted analyses, including consultations with attorneys, and is comfortable it is not at risk of running afoul of state insurance regulators concerned that it is selling insurance, Mr. Varker said.

More recently, Shea has begun using the captive to help fund builders warranty policies sold to consumers, Mr. Varker said. The captive does not insure the coverage, though, but instead reimburses Shea for related payouts, he said.

# Captive owners could face higher governance standards

By ROBERTO CENICEROS

**KAPALUA, Hawaii**—Although a National Assn. of Insurance Commissioners model rule regarding corporate governance is not slated to apply to pure captives, captive owners would be wise to assume otherwise, speakers told the Hawaii Captive Insurance Council.

The NAIC's Model Audit Rule—which is expected to contain sections mirroring the Sarbanes Oxley Act of 2002—remains in development but is currently intended only for insurance companies, acknowledged Ross R. Murakami, managing partner at accounting and consulting firm KMH L.L.P. in Honolulu.

Still, it could eventually emerge as "the gold standard" for management practices that even captive owners would be held to, Mr. Murakami told the HCIC's Forum 2005, held Nov. 1-4 in Kapalua, Hawaii.

Stakeholders are increasingly holding business entities and their captives to audit and management standards that they are not legally required to meet, noted Michael Evans, senior vp and chief risk and compliance officer for Sutter Health, a Sacramento, Calif.-based group of hospital and physician organizations with nearly 43,000 employees.

Sarbanes-Oxley, for example, is supposed to apply only to publicly traded companies, Mr. Evans explained. Yet many stakeholders now hold nonprofit organizations accountable for meeting many of the standards required by the legislation, he said. Those stakeholders include auditors seeking assurances before signing off on their audits, legal counsel engaging in bond sale transactions and outside board members expecting similar practices as those adopted in the for-profit corporate world.

Insurers that write directors and officers liability coverage for Sutter Health's directors and for the board of its Hawaii-domiciled captive also look for compliance with the governance principles laid out in Sarbanes-Oxley, Mr. Evans said. Even consumers feeling aggrieved by cor-

"We don't have shareholder suits...but what we have is the public acting as if they are shareholders and bringing actions, often through class action suits."

**Michael Evans**
**Sutter Health**

porate governance failures are pressuring nonprofit entities to adopt stronger management standards, he added.

"We don't have shareholder suits...but what we have is the public acting as if they are shareholders and bringing actions, often through class action suits," said Mr. Evans, who is also president and chief executive officer of Honolulu based Sutter Insurance Services Corp. "So it's a type of scrutiny we are going through."

Sarbanes-Oxley requires public companies to adhere to governance standards designed to improve financial and accounting practices. Among other measures, it calls for companies to maintain independent, competent audit committees and certified financial statements.

Similarly, an NAIC working group is developing the Model Audit Rule with an eye to addressing the issues of auditor independence, enhanced financial disclosure and corporate responsibility for internal controls, Mr. Murakami said. With the working group advocating for adoption of the rule, "it appears that the question is not if the provisions of SOX will be implemented but which provisions will be adopted and when," he added.

Even though the rule is expected to apply to insurers but not to captives, preparing to meet its standards could help captive owners develop best practices for management and auditing, Mr. Murakami said. It might also be wise to prepare in case captives are ultimately required to adhere to the rule.

Because the model rule is being written for insurers, captive owners would have to customize its proposed provisions, Mr. Murakami noted. Among other measures, captive owners could begin by assessing the effectiveness of their internal control systems and processes for preparing financial reports, he said.



# Hawaii captive forum features traditional feast

The Hawaii Captive Insurance Council served up generous portions of island tradition alongside conference sessions during its biennial forum, held Nov. 1-4 in Kapalua, Hawaii.

Forum 2005 attracted 300 registrants to the Ritz-Carlton Kapalua, where sessions addressed reinsurance trends, captive regulation, taxes and captive formations, among other topics.

Traditional Hawaiian dancers entertained conference attendees during a dinner featuring kalua pig. The roasted pork is traditionally cooked in an earthen pit called an imu and is served at luaus.

Arrangements for the next HCIC forum are still being finalized. For more information, contact Krysten Coulter, HCIC project coordinator, at 808-247-0417.


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# Communication efforts help reduce depression, cut costs

By GLORIA GONZALEZ

**NEW YORK**—Depression in the workplace has a big impact on workers and their employers, but companies can take steps to help their employees and lower their own costs related to the disease.

One large employer, Reston, Va.-based Sprint Nextel Corp., is trying to address the problems by raising awareness of the disease within its work force and encouraging employees to participate in its employee assistance and disease management programs. Sprint, which merged with Reston, Va.-based Nextel in August, now has 78,000 active employees and 18,000 retirees.

Sprint was reluctant initially to attempt to explore its employees' behavior and potential links to depression and other mental health conditions, said Collier Case, director of health and productivity benefits. Company executives changed their minds, though, after receiving feedback from managers about the problems being caused by depression in the workplace, he said.

"It became very clear to us...that depression was creating a significant impact on the work environment," Mr. Case said during the New York Business Group on Health's "Mental Health Benefits: Maximizing Quality and Outcomes" conference, held Nov. 4 in New York.

He said, "The business unit managers were clamoring and knocking on our doors, saying, 'What do we do to improve the situation?'"

Sprint's claims data showed that costs related to depression had reached $7.2 million a year. In addition, the total number of workdays missed due to depression was estimated at between 113,757 and 189,595 days a year, he said. "It really was a business decision," Mr. Case said.

The company decided it needed to raise awareness of depression and create a safe and supportive environment for detection and treatment of the disease, he said. Sprint wanted to emphasize the various support resources available through its employee assistance and disease management programs, Mr. Case said.

"What we can do is be supportive of them and give them the resources to get appropriate care," he said.

The company's efforts to raise employee awareness began with a comprehensive communications effort, in which the company published articles on depression in its monthly newsletter and communicated with managers on a bimonthly basis. Sprint also held an online health forum in which a university expert spoke to employees about depression and stress resilience and answered their questions during a live Webcast.

"We wanted to de-stigmatize depression by openly talking about it to our employees," Mr. Case said.

Early results of Sprint's campaign to address depression in the workplace have been promising, according to Mr. Case. In the first quarter of 2005, 1,115 people enrolled in its depression disease management program. An additional 685 people enrolled after the company launched its communications campaign, he said.

Sprint's claims data shows a 10% increase in the number of patient visits for depression in 2005 compared with 2004. In addition, 58% of EAP contacts in 2005 have been related to stress, emotional and psychological issues compared with 50% in 2004.

"We think that's directly related to the initiatives we've put forth and that we've told employees, 'It's OK. We really want you to get the care that you need,'" Mr. Case said.

The company has estimated that getting good treatment for the disease for its employees will reduce absenteeism by about 25% and could reduce direct medical costs by about $750,000 per year, which Mr. Case called a conservative estimate.



## Pensions: Canadian employers welcome ruling

Continued from page 3

board "had a duty to inform members in advance of potential changes to the plan in order that members have the ability to make informed financial decisions."

The ruling disturbed Canadian employers, who usually are responsible for the administration of pension plans in the private sector, and pension experts because it created an obligation to disclose all possible changes, a level of duty that seemed "quite onerous," said Greg Hurst, a Vancouver-based pensions consultant with Heath Benefits Consulting Inc.

Employers also were concerned that disclosing plan changes not yet finalized would create confusion among plan members, said Ross Gascho, a partner with law firm Fasken Martineau DuMoulin L.L.P. based in Toronto.

The trial court's decision also was problematic because it provided no clear guidance on the time frame for disclosure, pension experts say. "This case was very troubling for plan sponsors because they never knew when the obligation to disclose arises," Mr. Pibworth said.

In overturning the decision, though, the Court of Appeal ruled that there is no legal authority to impose a disclosure obligation of pension plan changes that are under consideration.

"The court has taken a very common-sense approach to pension plan administration."

Stephen Pibworth
Hewitt Associates Canada

"I think the court has taken a very common-sense approach to pension plan administration in that there is no duty to disclose changes to the pension plan until the changes have been finalized," Mr. Pibworth said.

If the trial court's decision had been upheld, the risk of new litigation would have increased for plan sponsors because there would have been a possible claim for failure to disclose within the proper time frame, said David Stamp, a Toronto-based partner in the litigation department of law firm Osler, Hoskin & Harcourt L.L.P. "It would've open the door for employees or pension plan members to bring claims against employers saying, 'You didn't disclose at the appropriate time,' " said Mr. Stamp, who represented the board in the dispute.

The main issues arising from the trial court's ruling were the obligation to disclose possible changes and the lack of an established time frame in which to do so, pension experts say. But another key factor was the trial judge's finding that the board's recommendation of a Jan. 1, 1999, effective date constituted a breach of its fiduciary duty to treat all plan members fairly and equitably.

The Court of Appeal overturned this, recognizing that an effective date would necessarily create a dividing line with some members benefiting from the plan changes while others did not and upholding an administrator's right to make this decision, as long as it is done reasonably, lawyers say.

"That's an important principle in the fiduciary world," said Nancy Chaplick, a Toronto-based partner in Osler's pensions and benefits department.

The plan members have until Dec. 30 to file an application to the Supreme Court of Canada, asking for leave to appeal the decision. Osler does not yet know if they will file an appeal, Mr. Stamp said.

Most legal experts, though, said it is unlikely that the Supreme Court would accept the case, given that it agrees to hear only a small percentage of appeals and usually does not hear pension cases. "This will probably stand and become the operative law on this point," said Paul Timmins, a lawyer and senior consultant with Watson Wyatt's Canadian retirement practice in Toronto.

# Automatic enrollment boosts participation in 401(k) plans

By GLORIA GONZALEZ

**NEW YORK**—Automatic enrollment and investment features for 401(k) pension plans are a good way to overcome the inertia that keeps employees from being adequately prepared for retirement, experts say.

"Participant inertia is creating a problem for participants and companies," said Jeff Maggioncalda, president and chief executive officer for Financial Engines Inc., an investment advisor for defined contribution plans based in Palo Alto, Calif.

"In particular, not enough people are enrolling in 401(k) plans, not enough people are saving an adequate amount of money—not enough to take full advantage of the company match—and not enough people are making good investment decisions," Mr. Maggioncalda said at The Conference Board's 2005 Pensions and Retirement Conference, held Nov. 1-2 in New York.

> "Sponsors are a little more urgently saying, 'It's not optional we help these folks—we need to do it for them; we need to do it for the company.' "
>
> **Jeff Maggioncalda**
> **Financial Engines Inc.**

"They've got too much money piling up in money market funds; they've got too much money piling up in company stock. And automatic features are a really effective way to address these concerns," he said.

By the end of the year, the Department of Labor is expected to issue draft guidelines that will provide a safe harbor for plan sponsors that implement automatic features, Mr. Maggioncalda said.

"The government is basically deciding that, with the pressure on pension funds and Social Security ... the 401(k) is really going to be the backbone of our retirement system here," he said.

After closing its defined benefit pension plans in 2004, BHP Billiton decided to automatically enroll its new hires in its 401(k) plan at 6% of salary to take full advantage of the company match, said Daniel Helman, team leader, retirement services, in Houston for the North American unit of BHP Billiton, a diversified resource company based in Melbourne, Australia.

During benefits enrollment, new hires are told exactly how to opt out of the 401(k) program, but only one employee has chosen not to participate, he said.

The company chose as its default option a managed account program—in which a professional investment manager oversees the employees' portfolios—because it addressed several key concerns, he said. About 93% of employees have remained in the managed account program the company automatically places them into, he said.

BHP did not want to select investments itself, and it did not want employees to lose money and then say the risk had not been explained to them, he said. In the managed account program, responsibility and liability is delegated to the investment manager, and the risk is personalized for each employee, disclosed in writing and explained by an advisor, he explained.

Having a managed account program helps companies address the needs of what Mr. Maggioncalda calls the "do it for me" group of people. Pension plans have been designed to be full of choices, but the vast majority of people do not want many choices; they want someone to help them, he said.

"These folks are looking for a solution that is more simple, less time consuming, than what's been available so far," he said.

One of the big challenges for plan sponsors is that many plan participants fail to make investment decisions because they are overwhelmed with choices, so a large percentage of the assets end up in money market funds or company stock, he said. "It's not just the participants' problem any more," he said. "Sponsors are a little more urgently saying, 'It's not optional we help these folks—we need to do it for them; we need to do it for the company.' "

Because the biggest reason 401(k) accounts lose money is an overinvestment in company stock, the potential for litigation becomes a key issue for plan sponsors, Mr. Maggioncalda said, citing the numerous lawsuits associated with company stock in 401(k) plans.

Managed accounts are designed to help address these risks, he noted. Financial Engines, for example, will sell down the percentage of company stock in an employee's portfolio to 20%. Employees can go online and retain more than 20% of company stock if they choose to do so, but a Financial Engine advisor will explain why that is not a good idea and will stress the importance of diversifying their assets.

# COMINGS & GOINGS - INDUSTRY

## Agents/Brokers

Dallas-based insurance wholesaler Colemont Corp. has named **David Stevoff** chief operating officer of Colemont Brokerage Group, the company's U.S. subsidiary. Mr. Stevoff, who will be based in Chicago, will be responsible for the operations and productivity of Colemont's U.S. offices. He previously was Chicago office president.

London-based Willis Group Holdings Ltd. has appointed **Keith A. Dobrolinsky** national partner of the broker's captive, actuarial and pooling solutions practice. Mr. Dobrolinsky, who is based in Chicago, succeeds **Guy Ragosta**, who is leaving Willis to become a chief executive officer outside the insurance industry. Mr. Dobrolinsky previously was president of Arthur J. Gallagher & Co.'s Midwest region public and nonprofit division.

In addition, Willis has appointed **Jennifer Rutecky** health care practice principal and senior vp in its Atlanta office. She joins Willis from Palmer & Cay Inc.

Chicago-based Aon Corp. has appointed **John J. Kelly** executive vp for its newly formed global large corporate business group. Mr. Kelly joins Aon from Willis.

Chicago-based Acordia Inc. has named **Joan Goldberg** senior vp and East regional practice leader in Boston. Previously, she was a senior vp in the brokerage's risk finance group. **William Holden** has been named senior vp and West regional manager in Acordia's Sherman Oaks, Calif., office. He joins Acordia from USI of Southern California Insurance Services, where he was an executive vp.

## Reinsurance

Stoney Creek, N.C.-based reinsurance broker Axiom Group has named **David C. Smith** senior vp of Axiom Intermediaries L.L.C. Mr. Smith, who will be based in Axiom's Wilton, Conn., office, most recently was an executive vp at Alea North America.

Heath Lambert Group in London has named two directors in its reinsurance division, **Roland Vella** and **Chris Underwood.** Both join Heath Lambert from Thompson Heath & Bond.

## Insurers

**Douglas Kline** will retire at year end as senior vp and chief operating officer of Pembroke, Bermuda-based Oil Insurance Ltd. He served 12 years at OIL after a long career at Sun Co. Inc. Mr. Kline will be succeeded as COO by **George Hutchings**, who has assumed responsibility sEnergy Insurance Ltd., a unit of the OIL Group of Cos. Mr. Hutchings previously was senior vp and COO of Oil Casualty Insurance Ltd. Succeeding him in that post at OCIL will be **Jerry Rivers**, former executive vp and director of sales and marketing at The Park Group, a Bermuda-based brokerage.

New York-based American International Group Inc. has elected **John W. Keogh** senior vp, domestic general insurance. Mr. Keogh will continue as president and CEO of AIG unit National Union Fire Insurance Co. of Pittsburgh, Pa., a post he has held since 2000.

Also within the AIG companies, Boston-based Lexington Insurance Co. made several senior-level promotions:

- Fred Fontein has been named product line officer for professional liability programs. Mr. Fontein, previously senior vp, will be responsible for professional liability and social services programs.
- John Willett has been appointed senior vp of AI Risk Specialists Insurance, with overall management responsibility for AI Risk. Mr. Willett, who also is practice leader of AIG Real Estate Solutions, previously was Lexington's vp and director of marketing.


Mr. Douglas


Mr. Page

Sydney, Australia-based Associated Marine Insurers Agents Pty. Ltd. has named **Andrew Black** manager-hull underwriting. Previously he operated his own consulting company.

GE Insurance Solutions in London has named **Torben Thomsen** to lead its newly established Continental Europe life and health division. Most recently he headed the insurer's life and health division in South, West, and Northern Europe.

## Managed care

USNow, a Dallas-based provider of limited-benefit managed health care plans, has named **Stephen Douglas** chief operating officer. His responsibilities will include sales, customer service, account management and development. Mr. Douglas previously was vp of sales and operations.

## Other suppliers

**R. Nick Page** has been appointed vp of clinical services and business development at PMSI-Timesys, a Tampa, Fla.-based provider of cost-containment services for pharmacy and specialty medical services, including workers compensation and catastrophic care. Mr. Page previously was director of pharmacy operations for PBM Plus Inc. in Milford, Ohio.

New York-based Buck Consultants has appointed several senior consultants:

- **Lori Hornquist** has joined Buck's Dallas office as a director in the health and welfare practice. Previously, she was a senior consultant and practice leader at Benefit Partners Inc.
- **Laura Bryniarski** has joined the Chicago office as a director in the personalized and electronic communication group. She joins Buck from Watson Wyatt, where she was a senior communication consultant.
- **Wayde Friez** has joined Buck in its Atlanta office as a principal in its retirement practice. Previously, he was a senior manager at Deloitte & Touche.

# Between the Lines

Compiled by Joanne Wojcik

## Immunity from liability? Try wishfulthinking.com

You've heard of the "no-call" list? Well, now there's a "no-sue" list.

A New York-based company is offering to shield anyone from liability by posting a special "hold-harmless" agreement on its Web site, *www.heldharmless.com.* Individuals pay just $19.95, while businesses are charged $49.95, for a year's worth of protection.

Membership to Held Harmless includes a downloadable ID card that says the holder is immune from lawsuits.

But don't give out your credit card number just yet. The contact number provided on a company document is a non-working number at American International Group Inc. A spokesman for the New York-based insurer said the company has no connection to the Web site.

"It is probably everybody's wish…say a magic word and immunize themselves from lawsuits, particularly the frivolous ones," said Bud London, a partner at London Fischer L.L.P. in New York. "In this modern era, it's not surprising to learn of someone using the Internet to sell a product that only can be characterized as mystical. Protecting oneself from lawsuits is what insurance does. If that protection can now be purchased for any and all risks at a total cost of $20, the very least that I can say is that the insurance company stocks will soon take a beating."

## Teaching an old doc new tricks

In the wake of studies that show a doctor who has a good bedside manner is less likely to be sued, medical malpractice insurer ProMutual Group has developed a course in communication skills.

"We've analyzed a lot of the claims and found that you clearly see it comes back to communication," said Maureen Mondor, vp of risk management for the Boston-based insurer.

"The old ones, especially, were never taught the basics. They don't even introduce themselves to patients" on the first consultation. "We're hoping that it will reduce" losses and claims, she said, adding the insurer is considering offering premium discounts to the doctors who take the course.

The course also teaches physicians how to be better listeners, another complaint patients often assert. "They also need to learn to pay attention to the tone of voice and body language," Ms. Mondor said.

The course, developed with Tufts Health Care Institute, costs $6,000, and the insurer pays 50%. So far, a handful of doctors have taken the course.

In three daylong sessions over a four-month period, physicians are videotaped interviewing actors who portray patients. Afterward, instructors make suggestions on the doctors' communications skills. The coursework also includes questionnaires on communication, health care outcomes, risks and liabilities. An online component lets doctors work on handling issues such as patients who do not speak English and collaborating more efficiently with their staff and peers.

## Lloyd's very much in the picture

Once criticized as an eyesore because of its inside-out design, the Lloyd's of London building is becoming a Hollywood icon.

The Lloyd's Underwriting Room, where brokers and underwriters meet to negotiate insuring some of the world's toughest risks, was transformed this month into the headquarters of a bond trading firm for "A Good Year," a new film by Sir Ridley Scott starring Russell Crowe. About 50 Lloyd's employees serve as extras.

**Movie director Sir Ridley Scott was in the Lloyd's Building earlier this month shooting scenes for his forthcoming film "A Good Year."**

One scene depicts the alarm felt by the bond company's staff after learning Mr. Crowe's character has used his influence to score a huge profit.

Designed by Richard Rogers and opened in 1986, the building has been used often in Hollywood productions, including "Entrapment," starring Sean Connery and Catherine Zeta-Jones; "Spy Game" with Brad Pitt; and "Proof of Life," which also starred Mr. Crowe. Even the women's loo got its 15 minutes of fame in the first "Bridget Jones Diary."

*Tips and feedback from readers are welcome. Please send information to jwojcik@businessinsurance.com.*

# Katrina: Flood of lawsuits hits insurers, others

**Continued from page 4**

ed to a letter from the Center for Toxicology and Environmental Health L.L.C., a Little Rock, Ark.-based consulting company, that said the homes it has tested show that with "limited exceptions" the level of hydrocarbons are not unhealthy in homes not yet cleaned.

The spill, according to the letter, "should not be expected to present any long-term health and safety issues."

The spokeswoman said the company is offering to settle claims with homeowners and "has offered to clean their homes whether they settle with us or not."

Mr. Becnel's firm also is suing the Army Corps of Engineers and around 20 contractors, charging the Corps knew the levees in New Orleans would not hold up to a major hurricane and did nothing to rectify that possibility. He said the contractors also share some blame in faulty levee construction.

A spokesman for the Army Corps of Engineers would not comment on the litigation.

And Mr. Becnel said he has filed suit against Jefferson Parish President Aaron Broussard, alleging that Mr. Broussard was responsible for flooding because he ordered pumping station operators out of the city before the storm hit.

Mr. Broussard has said the pump operators were moved out of harm's way so that they could return to operate the equipment when Katrina passed. As it turned out, many of the pump operators were unable to get back into the city because debris and water blocked roads.

Around a dozen oil companies are being sued by attorneys who charge the companies are responsible for property damage in the New Orleans area because their dredging activities destroyed coastal marshes that had protected the region from winds and tidal surges.

Exploration and drilling activities created a "superhighway for salt water to intrude into the marshes" and destroy the plant life that "was a natural barrier for storm surges and wind," said plaintiffs attorney Val P. Exnicios, of the New Orleans law firm Liska, Exnicios & Nungesser.

Mr. Exnicios' firm also is suing several oil companies on behalf of the United Commercial Fisherman's Assn.

That suit charges that more than 9 million gallons of crude oil escaped the oil companies' facilities and destroyed oyster beds and seafood breeding grounds, thereby devastating the commercial fishing business in that region of the Gulf of Mexico.

The exact amount of that loss has yet to be determined, said Mr. Exnicios. The Louisiana Department of Wildlife and Fisheries has estimated losses to the state's fisheries could reach $1.29 billion. While many oyster beds remain closed, some have reopened for harvesting.

Insurers, meanwhile, are being hit with lawsuits from policyholders.

Mississippi Attorney General Jim Hood has sued insurers on behalf of policyholders in the state seeking to invalidate their policies' flood-loss exclusions (*BI*, Oct. 24).

Richard Scruggs, an attorney with the Scruggs Law Firm in Oxford, Miss., filed suit in state court in Pascagoula, Miss., seeking to compel homeowners insurers to pay for Katrina-related damages that the insurers contend they never intended to cover. The firm said more than 1,000 families have joined the litigation. Mr. Scruggs became famous as the attorney who led the multistate litigation against tobacco companies.

In Louisiana, 56 insurers have been sued after they refused to pay what policyholders say is required to move downed trees. The property owners, some of whom have received estimates as high as $150,000 to remove the trees, claim the insurers are offering only $500 in some cases to pay for the damage.

C. Douglas Howard, an attorney with the Covington, La., firm Howard, Reed & Taylor, which is representing the plaintiffs, said he expects thousands of policyholders to join the suit.

Insurers have taken the position that the trees are debris as covered by their policies, Mr. Howard noted, while the suit claims they are "an asset of the property" that had aesthetic value to homeowners and, in some cases, economic value as timber.

# U.K. pension 'triggers' get cautious welcome

By BARBARA COCKBURN

**LONDON**—Seeking to ensure the security of workers' retirement benefits, the U.K. pension regulator has proposed "triggers" under which it would step in to investigate an employer's defined benefit plan funding.

The London-based Pensions Regulator is seeking public comment by Jan. 20, 2006, on proposals contained in a consultation document it published last month. A formal statement of the regulator's use of powers is scheduled for release in early 2006.

Concerned that funding shortfalls put pension plan members' benefits at risk, the regulator will base its triggers on technical provisions—or the pension plan trustees' target funding level—as well as the trustees' recovery plan to correct any deficits. Specifically, the following financial information would be considered when determining whether the pension regulator should intervene.

- The value of an employer's pension plan assets and liabilities, a expressed under Financial Reporting Standard 17.

The accounting standard requires public U.K. companies to list the assets and liabilities of their defined benefit pension plans on their balance sheets.

- An employer's risk-based assessment by the Pension Protection Fund.

The PPF, modeled loosely on the U.S. Pension Benefit Guaranty Corp., was set up to meet the unfunded obligations of insolvent employers with defined benefit pension plans. It is currently funded by a flat fee on employers, but beginning in April 2006, the PPF will charge a risk-based levy that will take into account an employer's level of plan underfunding, its risk of insolvency and the amount of benefits the fund would have to pay.

Following research the pension regulator commissioned from the London-based accountancy firm PricewaterhouseCoopers, the regulator expects to require employers to correct a pension fund deficit within 10 years. PwC found that 65% of U.K. companies could pay

See PENSIONS / page 51


Firefighters in Bondy, France, inspect a riot-damaged carpet store.

## French riot damage expected to have limited impact on insurers

By SARAH VEYSEY

**PARIS**—Insured property losses from two weeks of rioting across France are not expected to be significant.

Several businesses and have sustained damage and thousands of cars have been set afire in the violence, which began Oct. 27 in the Paris suburb of Clichy-sous-Bois. The unrest, which had diminished late last week, was sparked by the deaths of two teenagers of North African descent, who are believed to have been electrocuted while hiding from police in an electrical substation.

In the days following the initial rioting, violence spread to other areas of France, and the government declared a state of emergency in Amiens, Dijon, Le Harvre, Lille, Paris, Marseille, Nice, Rouen, Strasbourg and Toulouse.

But commercial property damage

See RIOTS / page 51

# Buyers want clear, certain coverage

By SARAH VEYSEY

Most U.K. risk managers say they want ambiguity and subjectivity removed from insurance documentation when the London insurance market adopts contract certainty, but not at the expense of customized policy wordings, according to a survey.

In addition, a majority of insurance buyers said they would be prepared to start the renewal process sooner in order to ensure that contract certainty is achieved.

The Assn. of Insurance & Risk Managers and London-based accounting firm Ernst & Young L.L.P. conducted a survey of 111 AIRMIC members—corporate insurance buyers—about their attitudes on contract certainty.

The United Kingdom's insurance regulator, the Financial Services Authority, has set a deadline of January 2007 for the London insurance market to achieve contract certainty for insurance buyers at policy inception.

Almost all—89%—of respondents to the survey said they wanted to see ambiguity and subjectivity removed from insurance documentation.

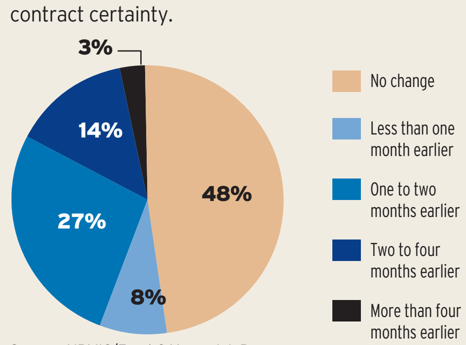
However, more than half of the respondents—55%—said they did not think that there should be a rigid template for the wording of policies or slips.

Just less than one-quarter—24%—of respondents said they would prefer a standard industry slip or policy wording, while 14% said they would prefer to see a standardized broker slip or policy wording, and 6% said they would like to see a standardized in-

See AIRMIC / next page

### Early starters

The survey asked risk managers to what extent they intended to start collecting underwriting and other data for renewals earlier as a result of the drive for contract certainty.




Source: AIRMIC/Ernst & Young L.L.P.

# Talanx grows commercial book with Gerling buy

By RICK MILLER

**HANNOVER, Germany**—Talanx A.G. of Germany's plan to acquire its smaller domestic competitor Gerling Group is expected to create the largest commercial property/casualty insurer in the country.

But while analysts say the combined company may be a stronger player in the German marketplace, the merger is not necessarily good news for insurance buyers, according to one insurance broker.

In a deal analysts value at about 1.50 billion euros ($1.77 billion), Hannover-based Talanx, Germany's third-largest insurer, announced last week that it will take over the operating insurance companies of Cologne-based Gerling, pending regulatory approval.

Talanx is known for its majority stake in Hannover Reinsurance Co., as well as for selling private and industrial insurance through its HDI brand.

Gerling is known for serving pharmaceutical firms and smaller to midsize companies in the German marketplace, analysts say. Gerling is also a prominent life insurer and has capitalized on contacts it has made through its property/casualty business to build its corporate pensions business, experts note.

The transaction combines two century-old insurers that up until now have been fairly evenly matched in the commercial lines market, ranking behind only dominant Allianz A.G. Holding in Munich, analysts say.

Talanx reported 14.20 billion euros ($16.76 billion) in gross premiums in 2004, of which 1.50 billion euros ($1.77 billion) was from commercial property/casualty lines, according to a Talanx spokesman. Gerling reported premium volume of 4.2 billion euros ($4.96 billion) last year, with property/casualty business accounting for 2.3 billion euros ($2.71 billion) of that, 65% of which is from its industrial business, a company spokesman said.

While Allianz does not break out premium details on its commercial business, it reported gross premiums of 43.8 billion euros ($51.68 billion) in 2004.

"By combining these two busi-

See GERLING / next page

# Updates

## KWELM creditors to get last big payout

Creditors of the KWELM group of companies will receive $770 million in December in the last major payout by administrators of the collapsed London market companies. The payment will increase the average payout to creditors to 88.7% of liabilities, up from an average of 64% of liabilities in May of this year, the administrators said in a statement. The companies–Kingscroft Insurance Co. Ltd., Walbrook Insurance Co. Ltd., El Paso Insurance Co. Ltd., Lime Street Insurance Co. Ltd. and Mutual Reinsurance Co. Ltd.–wrote mainly U.S. casualty, professional indemnity and other liability business and entered a so-called scheme of arrangement in 1993.

## Former HIH CFO charged by ASIC

The former chief financial officer of HIH Insurance Ltd. faces criminal charges brought in connection with his authorization of documents relating to an HIH financial transaction. The Australian Securities and Investments Commission charges that Dominic Fodera "authorized the issue of a prospectus by HIH Holdings (NZ) Ltd. for converting notes, from which there was a material omission" in October 1998, ASIC said in a statement. The omission concerned a transaction between HIH and Societe Générale "relating to SG's taking up a priority allocation of the notes in the approximate sum of $35 million Australian ($21.6 million) in exchange for HIH Insurance Ltd. depositing about $35 million Australian with SG."

## Omega sets up Bermuda division

Omega Underwriting Holdings P.L.C. will set up a Bermuda-based insurance and reinsurance arm. The group will raise capital of £90 million ($156.7 million) to support its Lloyd's of London syndicate 958, which mainly writes short-tail property insurance and reinsurance, and to support the proposed Bermuda-based unit. Omega said the Bermuda company, Omega Specialty Insurance Co. Ltd., will underwrite "predominantly short-tail lines" and begin operations in the first quarter of 2006.

## Briefly noted

The London-based **RI3K** reinsurance exchange will extend its system to allow commercial primary insurance to be traded via its electronic hub. By the end of this month, RI3K will allow users to place coverage for international property, North American property and terrorism classes of business.

# Gerling: Talanx plans to grow commercial book

**Continued from previous page**

nesses, they actually become the market leader in industrial insurance in Germany and, therefore, will be more able to fight attacks from Allianz concerning price initiatives," said Carsten Zielke, head of insurance research at WestLB in Dusseldorf, Germany.

"On a commercial level, (the merger) will significantly strengthen the consolidated entity, both on the property and casualty side and on the life side," said Vasilis Katsipis, London-based assistant general manager for A.M Best Co. of Oldwick, N.J.

Some, though, question whether the merger will be good for German insurance buyers.

"I don't think it will help (my) clients," said Norbert Noehrbass, chief executive officer of Ecclesia Group in Detmold, Germany, and a member of the board of EOS RISQ N.V., a European insurance broker network.

"Risk managers will move parts of the placements to other carriers, because, No. 1, they will not get the combined capacity," he said. "I have clients that have 20% of a policy with (Talanx's) HDI and 20% with Gerling, so I don't see that the same risk will be written as usual," Mr. Noehrbass said.

"No. 2, I don't think that clients want to have so much capacity with both of them," Mr. Noehrbass said.

Indeed, Best put its A ratings of HDI and Hannover under review with negative implications, in part because of concerns that a merged Talanx-Gerling will likely lose some of its industrial risk portfolio. "Companies actually want to spread their risks," noted Mr. Katsipis.

Standard & Poor's Corp. put its AA- ratings of Talanx's insurance subsidiaries under review with negative implications. S&P affirmed its AA- rating of Hannover Re .

Hiltrud Besgen, an S&P analyst in Frankfurt, said in a statement that the move reflects "the likely negative impact on the currently very strong capitalization of Talanx A.G.'s consolidated primary insurance operations, due to the acquisition of the financially weaker Gerling."

# AIRMIC: Buyers want clarity

**Continued from previous page**

surer slip or policy wording.

Just over half of the respondents to the survey—51%—said they expected contract certainty initiatives to have "a little" effect on their ability to have customized policy wordings, while 26% said they believed contract certainty initiatives would not reduce their ability to have customized wordings at all.

A further 14% of respondents said they were not sure yet whether contract certainty projects would reduce their ability to have customized wordings, while 10% believed that contract certainty initiatives would reduce their ability to have customized wordings "very much."

In addition, around 57% of the respondents said they would be willing to begin contract negotiations earlier as part of a push for contract certainty.

Speaking last week at a conference hosted by the Guernsey Insurance Company Management Assn. in London, David Gamble, executive director of AIRMIC, said that achieving contract certainty would require a "behavior change" from buyers, brokers as well as insurers.

He said it was encouraging that many insurance buyers said they would begin contract negotiations earlier, and he urged them to be vocal in the renewal process and let their brokers and insurers understand their needs early in that process.



## LEGAL NOTICE

**UNITED STATES BANKRUPTCY COURT**
**SOUTHERN DISTRICT OF NEW YORK**

| | |
|---|---|
| In re<br>RELIANCE NATIONAL INSURANCE COMPANY (EUROPE) LIMITED,<br>Debtors in Foreign Proceeding. | In a Case Under Section 304 of the Bankruptcy Code<br><br>Case No. 05-46232-ALG |

**SUMMONS AND NOTICE OF PETITION AND REQUEST FOR PERMANENT INJUNCTION PURSUANT TO SECTION 304(b) OF THE BANKRUTPCY CODE**

**PLEASE TAKE NOTICE** that this case was commenced by the filing of a Petition on October 13, 2006 pursuant to section 304 of title 11 of the United States Code (the **Bankruptcy Code**) and pursuant to an order of the United States Bankruptcy Court for the Southern District of New York (the **Bankruptcy Court**), a hearing will be held on February 27, 2006, at 2:00 p.m., or as soon thereafter as counsel may be heard, before the Honorable Allan L. Gropper in Courtroom 617 of the Bankruptcy Court which is located at The Alexander Hamilton Custom House, One Bowling Green, New York, New York 10004, to consider the petition (the **Petition**) of Richard Paul Whatton as the foreign representative (the **Foreign Representative**) of RELIANCE NATIONAL INSURANCE COMPANY (EUROPE) LIMITED (the **Company**) requesting entry of an order pursuant to sections 105(a) and 304(b) of the Bankruptcy Code granting permanent injunctive relief (the **Permanent Injunction Order**) giving full force and effect in the United States to the Scheme of Arrangement (the **Scheme**) between the Company and its Scheme Creditors (as defined in the Scheme).

The Scheme has been proposed pursuant to section 425 of the Companies Act 1985 of Great Britain. If the requisite statutory majorities of creditors (i.e. a majority in number representing 75% in value of those in each class present and voting in person or in proxy) approve the Scheme at a meeting scheduled for February 2, 2006, a hearing to sanction the Scheme will be held on February 23, 2006 before the High Court of Justice of England and Wales. If that Court sanctions the Scheme, the Foreign Representative will proceed with his request for the Permanent Injunction Order.

A summary of the proposed Permanent Injunction Order is set forth in Appendix A to the Explanatory Statement relating to the Scheme, which has been mailed to all known Scheme Creditors. Copies of the Scheme, Explanatory Statement, Petition, Summons, form of the Permanent Injunction Order and the Memorandum of Points and Authorities in Support of the Petition are available by written request to the Foreign Representative's US counsel:

Allen & Overy LLP
1221 Avenue of the Americas
New York, New York 10020
(212) 610-6399 (Facsimile)
theresa.dagostino@allenovery.com (email)
Attention: Theresa D'Agostino

**YOU ARE HEREBY SUMMONED** and required to submit to the Clerk of the Bankruptcy Court a motion, answer, objection or other response to the Petition electronically in accordance with General Order M-182 by registered users of the Bankruptcy Court's electronic filing system, and by all other parties in interest, on a 3.5 inch disc, preferably in Portable Document Format (**PDF**), WordPerfect or any other Windows-based word processing format, with hard copy to the Chambers of the Honorable Allan L. Gropper, and served upon Allen & Overy LLP, 1221 Avenue of the Americas, New York, New York, 10020 (Attn: Ken Coleman and Stephen Doody), counsel to the Foreign Representative, so as to be received on or before December 30, 2005 at 5:00 p.m., New York time. If you fail to respond, the Permanent Injunction Order may be entered.

Dated: New York, New York
November 1, 2005

ALLEN & OVERY LLP
Attorneys for the Foreign Representative
By: /s/ Ken Coleman
Ken Coleman (KC 9750)
Stephen Doody (SD 6738)
Kelle Gagné (KG 9025)
1221 Avenue of the Americas
New York, New York 10020
(212) 610-6300



## LEGAL NOTICE

Notice of Substantive Closure Distribution

**KINGSCROFT INSURANCE COMPANY LIMITED (formerly Kraft Insurance Company Limited, Dart and Kraft Insurance Company Limited and Dart Insurance Company Limited)**

and

**WALBROOK INSURANCE COMPANY LIMITED**

and

**EL PASO INSURANCE COMPANY LIMITED**

and

**LIME STREET INSURANCE COMPANY LIMITED (formerly Louisville Insurance Company Limited)**

and

**MUTUAL REINSURANCE COMPANY LIMITED**

**('the KWELM companies')**

The Scheme Administrators have set the substantive closure Payment Percentages as set out below and, subject to the cap of 100% on aggregate Scheme and Adjusting Payments applicable under Clause 3.3.2 of the Scheme of Arrangement, the increased payments due will be paid to creditors on the Substantive Closure Distribution Date of 15th December 2005.

Payments of interest under Clause 3.3.3 of the Scheme of Arrangement are expected to be made to Scheme Creditors of Walbrook during 2006.

| | Existing Payment Percentages | Substantive Closure Payment Percentages |
|---|---|---|
| Kingscroft | 65% | 81% |
| Walbrook | 65% | 100% |
| El Paso | 72% | 95% |
| Lime Street | 68% | 83% |
| Mutual | 53% | 72% |

9 November 2005

**C J HUGHES and I D B BOND**
*Scheme Administrators*
KWELM companies

Address for correspondence:
KWELM Management Services Limited
John Stow House, 18 Bevis Marks,
London EC3A 7JB, United Kingdom
Tel: + 44 (0) 20 7645 4991
Fax: + 44 (0) 20 7645 4777
Email: creditor.helpdesk@kwelm.com

## LEGAL NOTICE

IN THE SUPREME COURT OF BERMUDA
CIVIL JURISDICTION
IN THE MATTER OF
**NRC REINSURANCE COMPANY LIMITED**
**and IN THE MATTER OF THE COMPANIES ACT 1981**
**NOTICE OF SCHEME CREDITORS' MEETINGS**

NOTICE IS HEREBY GIVEN that, by an Order dated 3 November 2005, the Court has directed in accordance with Section 99 of the Companies Act 1981 that creditors meetings (the "Scheme Creditors' Meetings") of NRC Reinsurance Company Limited (the "Company") be held for the purpose of considering and, if thought fit, approving (with or without modification) a Scheme of Arrangement proposed to be made between the Company and the Scheme Creditors. The Meeting of IBNR Scheme Creditors and the meeting of General Scheme Creditors will be held at the offices of Appleby Spurling Hunter, Canon's Court, 22 Victoria Street, Hamilton HM EX Bermuda, on 22 March 2006 at 11:00 am and 11:30 am respectively.

Copies of the Scheme of Arrangement and copies of the Explanatory Statement required to be furnished pursuant to section 100 of the Companies Act 1981 of Bermuda are available from the office of PricewaterhouseCoopers LLP and from the office of Appleby Spurling Hunter. These documents are available free of charge to any person entitled to attend the Scheme Creditors' Meetings during usual business hours on any day (other than a Saturday, Sunday or a statutory holiday) prior to the day appointed for the Scheme Creditors' Meetings.

Scheme Creditors may vote in person at the Scheme Creditors' Meetings or they may appoint another person, whether a Scheme Creditor or not, as their proxy to attend and vote in their place. A Form of Proxy and/or a blank Claim Form for use at the Scheme Creditors' Meetings is available from PricewaterhouseCoopers LLP. Forms of Proxy and a completed and signed Claim Form should be lodged with the Company at NRC Reinsurance Company Limited, c/o Rene Lapierre & Associates, 1801 Avenue McGill College Suite 710, Montreal QC Canada, marked for the attention of Rene Lapierre, no later than 5pm Bermuda time on Thursday 16 March 2006. Forms of Proxy may be sent by facsimile transmission to +1 514-284-1914 by the same time and date provided the original forms are handed to the Chairman of the Scheme Meeting at the meeting or posted to NRC Reinsurance Company Limited, c/o Rene Lapierre & Associates, 1801 Avenue McGill College Suite 710, Montreal QC Canada, marked for the attention of Rene Lapierre, so as to be received by the Company by no later than 3 business days after the relevant Scheme Meeting.

At the direction of the Court, Rene Lapierre or, failing him, Timothy C. Faries, shall be chairman of the Scheme Meetings. The Scheme of Arrangement will be subject to the subsequent approval of the Court.

Any inquiries relating to the Scheme and requests for copies of Scheme documentation should be directed to Stephen Andrew Ward of PricewaterhouseCoopers LLP, Two Commerce Square, 2001 Market Street, Philadelphia, PA 19103, tel. 1-267-330-2027, fax 1-813-329-2099 or email stephen.a.ward@us.pwc.com in the first instance.

**RENE LAPIERRE** *President*
NRC Reinsurance Company Limited

BI 11-14-05 A 51 11/11/05 5:25 PM Page 1



# Pensions: Proposed investigation 'triggers' get cautious welcome

Continued from page 49

off their FRS17 deficits within that time frame.

## Challenge for employers

Several industry sources say, though, that the 10-year period would be difficult for many employers to meet.

John Cridland, deputy director general of the London-based Confederation of British Industry, said the regulator had "rightly taken a pragmatic approach," but "liabilities have risen in a way that no company could have predicted even five years ago. For affected companies, time scales are still critical. To manage their cash flow, companies must be able to pay off deficits over 15 years, which the government originally envisaged, rather than in just 10, he said.

"We want to work with the regulator over the coming months to make sure that the new funding regime is affordable and provides security to scheme members without introducing crippling costs to businesses," Mr. Cridland said.

Tim Keogh, worldwide partner at Mercer Human Resource Consulting, noted that "any trigger involves a degree of approximation and, whilst cutting the workload of the regulator, it runs the risk that some employers and trustees are unnecessarily caught."

"Individual employers would doubtless wish to see a less-stringent trigger. However, the regulator has to balance its interests with its responsibilities to plan members and the wider body of employers who must fund the PPF," Mr. Keogh said.

Brian Morgan, business development director at London-based broker Heath Lambert Group, said the proposed triggers are "a seemingly sensible approach," but he questioned at what level they would be set.

"There is debate in the actuarial industry on the value of FRS17 as a measure of solvency, and nearly every scheme is going to be under pressure from the regulator on this basis, as industry research indicates that most have time frames to reach this level of funding between 12 and 15 years, not 10," he said.

"We are not setting a minimum funding requirement. It is plan-specific; therefore, it is up to the trustees, working with the employer, to schedule the level of contribution. Where a pension plan is in deficit, there needs to be a recovery plan in place to reduce that," said a spokeswoman for the Pensions Regulator.

The aim of the regulator is to be a "referee," not to interfere with the responsibilities of the trustees and employers to ensure plans are fully funded, the spokeswoman said.

For example, if the regulator believes an employer with a shortfall could pay off its deficit sooner than the time frame under its recovery plan, the regulator would discuss the funding with plan trustees.

If pension plan trustees and the employer cannot agree on a funding solution, then trustees would have to report to the regulator, which also would recommend professional mediation of the dispute. As a last resort, the pension regulator would freeze pension plans it deems are not well run or lack appropriate funding or recovery plans.

"It is a rare occurrence for trustees not to take their responsibilities seriously, because the smaller the deficit the smaller the PPF levy will be," which is the incentive, the spokeswoman said.

Keith Faulkner, managing director of Pension Adviser Review, a London-based research analyst, said the triggering approach "paints the landscape so that trustees are aware of the parameters," but he argued that it may lead to "friction between trustees and companies because the benchmark lines are drawn in the sand," because trustees will have to put pressure on employers to fund the shortfall.

According to a survey of 80 clients by global human resources firm Hewitt Associates, 81% of companies and their trustees believe that the target funding levels will represent "a significant problem" because the minimum target funding level is around 100% of the liabilities on an FRS17 accounting basis, which would require the companies to change their approach to funding.

## Trend away from pensions

Membership in defined benefits plans has declined from 8 million in 1967 to 4 million today, and an estimated 54% of plans have closed to new members between 2001 and 2004, according to the consultation document.

A spokesman for the London-based National Assn. for Pension Funds said, "Undoubtedly some may decide that this is the last straw, although the trend away from defined benefit pensions began over a decade ago."

Mr. Faulkner predicted that "we will see more defined benefit plans closing to new employees, and that could well reach 100% in five years from now," so the pension regulator's proposals would not change that trend.

Mr. Morgan said the trigger system could prompt employers to close down defined benefit plans. "They're becoming a luxury item," he said.

The document is available at *www.thepensionsregulator.gov.uk*.

# Riots: Modest insured losses despite unrest

Continued from page 49

has been limited—as most of the rioting has taken place in poor, residential areas—and the commercial losses likely will be covered by property policies, observers say.

No estimates of total insured losses from the rioting were available late last week.

The Paris-based Fédération Française des Sociétés d'Assurances said in a statement that businesses damaged as result of the riots likely will be insured under policy provisions covering losses from riots and civil commotion.

The French insurers' association said, however, that losses from looting committed during rioting are rarely insured.

Although many insurers began to exclude terrorism cover from property policies after the Sept. 11, 2001, terrorist attacks in the United States, most property insurance policies still include losses from riots, strikes and civil commotion, noted Charles Keville, director of the crisis management team at Aon Ltd. in London.

Most vehicle owners will be covered for losses caused by fire under standard auto policies, according to the FFSA.

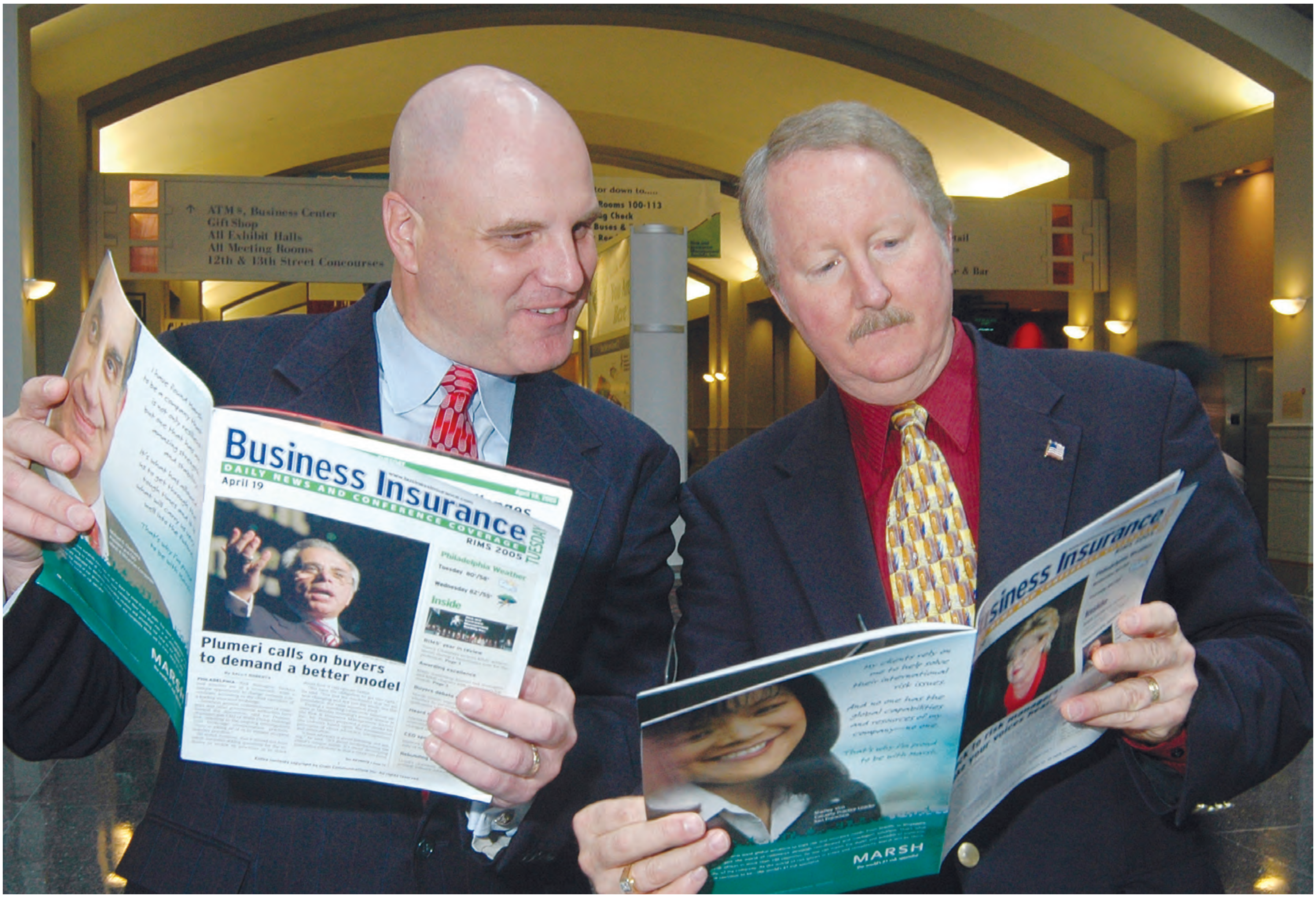



Photo: Michael Marcotte

Lance Ewing (L) and Chris Mandel, RIMS past presidents.