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THE CONSTRUCTION RISKS ISSUE

Protections for builders changing in complex market

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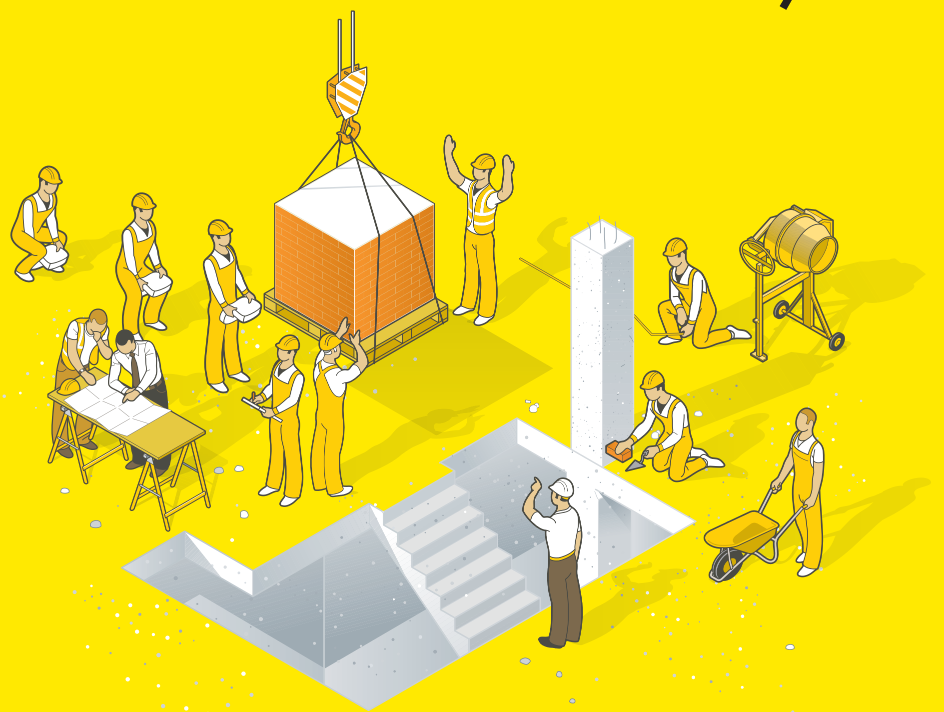

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OVERVIEW

Builders struggle in tough times

Larger contractors buffered, residential firms battered

By LOUISE KERTESZ

The recession and weak economy hammered the construction industry across all segments, with the sharpest blows hitting builders that specialize in private residential construction, and subcontractors and small contractors in all sectors.

Large, diversified contractors entering the recession with strong backlogs protected their bottom lines as revenues sank. In the face of fierce competition, they have pursued profitable work in their competencies rather than chasing unfamiliar work to increase revenues.

The vast majority of contractors in the U.S. are small businesses. Those that have survived have shed employees and costs, but their long-term health is in question, sources said.

"We expect to see more subcontractor failures in the coming months," said Tom Miller, senior vp at Lockton Cos. L.L.C. in Kansas City, Mo.

The total value of all construction put in place fell from $1.167 trillion in 2006 to $803.62 billion in 2010. Private residential construction plunged from $613.73 billion to $238.80 billion in the same period, according to the U.S. Census Bureau. Private nonresidential construction—schools, hotels and office buildings—fell from $408.57 billion in 2008 to $261.80 billion in 2010.

$803.62B

The total value of all construction put in place fell from $1.167 trillion in 2006 to $803.62 billion in 2010. Private residential construction plunged from $613.73 billion to $238.80 billion in the same period.

The industry lost 2.2 million jobs from 2006 to 2010—a 28.8% decline and the largest since the end of World War II, according to the Bureau of Labor Statistics.

Unemployment in the construction industry dropped to 13.3% in September, down from 17.2% a year earlier. But much of the decline was due to workers leaving the industry, according to the Assn. of General Contractors of America.

As construction spending fell, there was "a near equivalent reduction" in construction insurance spending, said Tim Kania, senior vp of construction at Liberty International Underwriters, a division of Liberty Mutual Group Inc., in New York.

"For nonresidential construction, I would posit that insurance spend is off 25% to 30%, or even more than that, because rate degradation was going on at the same time," said Mr. Miller.

"There has been a significant impact on the insurance community because they had less (construction) exposure to insure," said Paul Becker, Nashville, Tenn.-based chairman of the construction practice at Willis North America, a unit of Willis Group Holdings P.L.C.

New carriers have entered the market, capacity is ample, and rates have been competitive for most construction-related coverages, sources said. But with the downturn, combined with catastrophic losses in 2011, "we're starting to see signs of rate hardening," said Michael Anderson, U.S. construction practice leader at Marsh Inc. in Philadelphia.

"Insurance companies have come through the downturn and their balance sheets are in pretty good shape," he added.

"How (construction) companies and owners protect themselves is partnering with the right people—not the least expensive, but those who understand your exposure, who have sufficient capacity, longevity and financial stability," said Mr. Kania.

Rates are not as competitive for professional liability, as more contractors take on the added liability for the design as well as the construction of a building, Mr. Becker said. Workers compensation rates also may see a hardening in 2012, sources said.

The surety market is "healthy and profitable," said Rick Ciullo, chief operating officer at Chubb Surety, a unit of Chubb Corp. in Warren, N.J. "Contractors with good business plans and strong financials should have no problems finding surety."

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Backlogs float larger companies

Despite the weak economy, which has hit the construction industry particularly hard, large builders say they are still finding opportunities.

"Our clients for the most part have weathered the storm well," said Geoffrey Hall, New York-based senior vp of the construction industry practice at ACE USA, a division of ACE Ltd.

"Backlogs have all begun to increase" at the biggest builders, said Tom Miller, senior vp at Lockton Cos. L.L.C. in Kansas City, Mo.

"We're doing well," said Kosta Bitsis, project executive and vp of special projects at Dimeo Construction Co. in Providence, R.I. "Obviously there are less project opportunities and a lot of competition, but we had such a fantastic backlog of work that it allowed us to almost ride out the downturn," he said.

Dimeo has been working in the academic and institutional markets and multifamily residential construction.

"We shrank a little, but for the most part we maintained our workforce, and we've actually started hiring again," Mr. Bitsis said.

Dimeo's challenges include higher materials costs, just as financing has become more difficult and institutional clients have reduced or deferred capital investment as fundraising declined.

"Since 2004, Dimeo has been involved with over $1 billion in sustainable projects," Mr. Bitsis said.

"We're seeing a clear movement of our clients and others to LEED-certified buildings," said Mark Gryc, vp and chief engineer at Factory Mutual Insurance Co., which does business as FM Global, in Johnston, R.I. Dimeo built FM Global's new LEED-certified headquarters.

Green construction is "good for the local economies" because local suppliers are used, "so you're not transporting materials across the continent," Mr. Gryc said.

"I wouldn't say the downturn in the economy has had a big effect on us," said an executive at one of the five largest U.S. construction companies, who wished to remain unidentified. "We're a diverse contractor with a big backlog built before the economic troubles came along. We continued to maintain our revenues and backlog and profitability. I believe this is the case with all the big companies," he said.

"We've done well, although it's a lot more competitive now," said Warren Perkins, vp of risk management at Boh Bros. Construction Co. in New Orleans. Boh Bros. has been in "a unique situation" because of its involvement with recovery efforts in New Orleans after Katrina, funded with federal money.

"The bubble's going to burst" as federal funding ends, Mr. Perkins said, and Boh will again bid on infrastructure projects in other states, he said.

Joseph Jarboe, senior vp at Clark Construction Group L.L.C., said the Bethesda, Md.-based builder has done primarily publicly funded construction work in the past two years, including projects in Washington, on military bases and a Veterans Administration hospital in New Orleans.

"We're maintaining. We're certainly not growing," Mr. Jarboe said.

But "there's a very big question mark about funding at the federal level" going forward, and private owners have put off building due to the uncertain economy, Mr. Jarboe said.

"A key element in turning the construction industry around is confidence," said ACE USA's Mr. Hall.

Despite "competition getting increasingly fierce," Clark "has a set of guidelines and standards we want to work within," Mr. Jarboe said.

Successful builders have maintained their standards, sources said.

In a down economy, "there's a temptation to cut corners, which can be very dangerous," said Jim Conroy, vp and chief underwriting officer of construction commercial markets at Liberty Mutual Group Inc. in Boston. "The successful, forward-thinking contractors have to understand that even though the profit margins are tight," safety, quality materials and a high-quality workforce are important.

"In boom times there's no need for contractors to look for ways to reduce costs," said Seth Hausman, Minneapolis-based head of operations and profit management for Zurich North America's construction business.

"Our customers who have been most successful (in the downturn) have been much more aggressive in risk management," with "pretask planning" to avoid expensive rework; focusing on "supply chain risk" to ensure products will perform as intended; and integrated project delivery, which involves collaborating among engineers and contractors to find ways "to drive costs out of a project," he said.

—By Louise Kertesz

THE CONSTRUCTION RISKS ISSUE

The construction industry remains a key driver of the U.S. economy. With the commercial sector hit hard by the recession, government-funded projects are being used to try to create jobs and stimulate economic growth.

Regardless of whether those efforts are successful, the economic challenges affecting the sector are prompting changes in insurance products and financing.

While insurance capacity for construction companies is plentiful as insurers search for new business opportunities in the struggling economy, in some areas of construction, insurers are seeking to curb their exposures or offer separate coverages for developing risks.

And for many of the accounts they are underwriting they are imposing more stringent collateral requirements that are creating a range of problems for policyholders seeking to make best use of their available resources.

In this special report on the construction sector, we take an in-depth look at the risk management and insurance concerns for all firms operating in the construction field and assess what options are open to them to better address those exposures.

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CONSTRUCTION DEFECT RISKS

Defects may implode Las Vegas hotel project

Builder, owner dispute need to destroy building

By MICHAEL BRADFORD

LAS VEGAS—A dispute over construction defects at a newly built Las Vegas hotel may end with the building being demolished before it welcomes a single guest.

That's the way CityCenter Las Vegas, a community of hotels and shops, would like to see the standoff end over its Harmon Hotel. Construction on the nearly completed 28-story hotel was halted in 2008 when steel reinforcements were found to be faulty. CityCenter is pushing to have the building imploded, saying it is unsafe and beyond repair.

While CityCenter and its parent, MGM Resorts International, argue that it is in the interest of public safety to destroy the structure, Perini Building Co. Inc., the hotel's Las Vegas-based builder, alleges the owner simply came to the realization that the tower would be a bad bet in the current economy.

Perini argues that the Harmon Hotel was defectively designed but is structurally sound, and any construction defects can be repaired.

The dispute has spawned not only litigation in state courts, but also debate over the unusual measures that the hotel owner is taking to prevent the building from opening.

"This is the first time I've heard of an owner wanting to knock down a building of this size because of construction defects," said Jonathan Cass, a partner in the law firm Cohen Seglias Pallas Greenhall & Furman P.C. in Philadelphia.

Ed Seglias, a partner in the firm, said, "We usually don't see an owner responding this way. This is highly unusual."

"This definitely is an unusual event," agreed Michael Herlihy, Boston-based executive vp at broker Ames & Gough Inc. "It's not the type of thing we're used to seeing out there."

Perini officials declined comment on the controversy, but said in a July statement that the hotel's owner wants it destroyed because it is "worth more dead than alive to MGM. Otherwise, MGM would allow Perini to repair it. MGM never intended to complete the Harmon after the economic downturn," the statement said.

"If market conditions were better and MGM found that demand existed for the Harmon hotel rooms, MGM would not be claiming that the Harmon is unstable," Perini said.

MGM argues that the hotel is so riddled with defects that it is unsafe and the extent and cost of repairs are nearly beyond estimation.

An MGM spokesman said an engineer it hired backs up its position.

He provided a July 11, 2011, letter from Chukwuma G. Ekwueme, an associate principal with Weidlinger Associates Inc., the engineering firm hired by MGM, to William Ham, vp of facility operations at CityCenter. In it, Mr. Ekwueme said reinforcing steel was missing or misplaced throughout the structure below the 21st floor.

"In addition," Mr. Ekwueme wrote, "there is insufficient concrete cover to reinforcing steel in numerous structural members, resulting in inadequate fire resistance in the tower."

> 'This is the first time I've heard of an owner wanting to knock down a building of this size because of construction defects.'
>
> Jonathan Cass,
> Cohen Seglias Pallas Greenhall & Furman P.C.

In the letter, Mr. Ekwueme said it is likely that the hotel would suffer a "partial or complete collapse" if there were an earthquake that would not be expected to damage structures built to local earthquake code standards.

These types of structural defects would be unusual because engineers usually make certain there are no such defects, as structural design and construction are such critical aspects of a building, Mr. Herlihy said.

But when such defects occur, "they are difficult to fix," Mr. Herlihy said.

Construction on the nearly completed 28-story Harmon Hotel was halted in 2008 when steel reinforcements were found to be faulty.

AP PHOTO

The MGM spokesman said the engineer's report proved that repairing the hotel would be "problematic at best. We're still unsure what it would take to repair it. Our team came to the conclusion that it would be best to remove it by implosion."

A plan to implode the building was filed with local authorities in August, the spokesman said, but no decision had been made as of mid-October on when that might happen.

Perini has disputed the Weidlinger report, referring to a previous study commissioned by the Clark County, Nev., Building Department and carried out by Walter P. Moore & Associates Inc. That report agrees with Perini's assessment that the Harman is structurally sound, the builder said in an August statement.

The Moore & Associates report "placed blame on MGM for improper design and required MGM to address those design deficiencies," Perini said in the statement, which led MGM to "buy another opinion, which Weidlinger has provided."

CityCenter has lost hundreds of millions of dollars on the project, according to MGM's financial reports.

In its 2010 annual report, MGM said CityCenter recorded an "impairment charge of $279 million in the third quarter of 2010" after the company decided it was unlikely that the Harmon Hotel would be completed.

Perini filed suit in Nevada state court in Clark County in March 2010 against MGM unit MGM Mirage Design Group and other defendants, alleging that the builder was owed about $490 million for its work. It also charged that the defendants failed to provide complete design documents, among other allegations.

Aside from the $490 million, Perini also alleges that it and CityCenter subcontractors are owed more than $200 million, much of it unrelated to the Harmon Hotel project but delayed while MGM uses allegations of hotel construction defects "as a ruse" not to pay. The litigation is stalled over procedural issues.

Regardless of how the dispute over the Harmon Hotel is resolved, it is unlikely that anyone, whether it's the owner, builder or design firm, has the amount of insurance it would take to cover the damages being alleged, Mr. Seglias said.

Even if MGM or CityCenter has insurance that would apply, it is unlikely to be written to limits that would cover losses of more than $200 million due to construction defects, he said. "There's no way anybody is paying off like that," Mr. Seglias said.

Mr. Cass pointed out that commercial general liability policies usually preclude coverage of faulty workmanship.

In its annual report, MGM noted that it carries a $1 million per-occurrence deductible on its general liability claims.

Regardless of who is found at fault, defense costs are piling up for the parties involved in litigation.

"There are times when the insurer will step up and provide a defense even though they are not technically required to do so," said Mr. Seglias. "But they may reserve their right to pay."

CONSTRUCTION DEFECT RISKS

Confusion over construction defect liability spawns legal battles

By MIKE TSIKOUDAKIS

Four states recently have passed statutes defining construction defect claims as occurrences, but commercial general liability policyholders continue to be frustrated by coverage gaps for faulty work construction.

Although incongruous court decisions over whether construction defect claims are covered under CGL policies continue to drive uncertainty in coverage and increase litigation costs, a unique trend among states may take the battle out of the courts, experts say.

Contractors, subcontractors, land owners or developers can be named in a construction defect suit, and the issue of coverage arises when one of those entities turns to their CGL policy for coverage against those claims, said Julian Ehrlich, senior vp of claims for Aon Risk Solutions' constructions services group in New York.

"One of the interesting and compelling aspects of the issue of coverage for defective construction is that jurisdictions differ, so policyholders don't know what they're going to get," Mr. Ehrlich said.

At the root of the issue is whether construction defects, defined as damages resulting from shoddy or faulty work, constitute an occurrence triggering the policy, experts say.

"In context of construction defect, the term 'occurrence' is ambiguous," Mr. Ehrlich said. "The definition of terms frames the debate, and here we have undefined terms."

The policy language within the CGL form has been interpreted differently by courts deciding construction defect claims, causing disparities in coverage for policyholders, experts say.

The CGL form was designed to apply to various risks across many different industries, said Frank Armstrong, Tampa, Fla.-based senior vp and national director of construction claims for Willis North America.

"Certain pieces of it don't fit well, at least according to some courts in the country, with coverage for construction defect risks," he said.

Typically, once a loss occurs, the CGL insuring agreement must be satisfied, which generally means there must be property damage arising from an occurrence as defined by the policy, Mr. Armstrong said. Once the insuring agreement is satisfied, different policy provisions will be applied to determine the scope of coverage.

"The insuring agreement and other policy provisions have been interpreted by courts around the country in different ways," he said.

The word "occurrence" is "where the problem starts," he said, noting that two courts in different states interpret the exact

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PROFESSIONAL LIABILITY

Contractors professional liability demand rises

Still-evolving needs driven by increased design involvement

By JUDY GREENWALD

New approaches to building projects, as well as new techniques, are leading to increased demand for professional liability insurance for contractors, say many observers.

While such coverage for architects and engineers has been around for many years, it is only in recent years that professional liability coverage for contractors has been developed, and observers describe it as a still-evolving field.

Ten or 15 years ago, people would shake their heads at the idea of professional liability coverage for contractors, asking, "How could they be held liable for professional risk when they don't provide professional services?" said Jeffrey M. Slivka, executive vp at Bordentown, N.J.-based New Day Underwriting Managers L.L.C.

But that is no longer the case. Observers say there has been a blurring of the once-sharp lines between contractors and architects and designers. Increasingly, contractors are being drawn into the design process, which exposes them to possible liability.

Observers generally describe the market, which is estimated to be about $350 million in annual premiums, as competitive, with claims falling within the low-frequency, high-severity arena.

Traditionally, said Mr. Slivka, under the "design-bid-build" method, a project would be designed, bids put out, and the project built. "The demarcation lines of exposure were pretty well segregated," said Jeffrey Coe, Atlanta-based national practice leader for Marsh USA Inc.'s design industry group.

But to decrease the amount of time involved, under the "design-build" concept, the construction may begin while only 20% of the building has been designed, which cuts back significantly on the amount of time it takes, said Mr. Slivka.

There may be only one contract, with one entity responsible for designing and building the project. Contractors may now take the design responsibilities in-house, and even subcontract them out to design firms, said Mr. Coe. "At a minimum, they have vicarious liability exposure."

Two new approaches that have emerged from this approach are integrated project delivery, in which teams work together; and building information modeling, which involves computer-developed 3-D models of projects (see related story).

Contractors professional liability insurance "fills a tremendous void that is becoming increasingly more apparent to contractors and construction management firms in their insurance programs," said Richard Hartman, vp, architects and engineers professional liability for Arch Insurance Group Inc. in New York.

Contractors' biggest exposure is for claims filed against them for project delays and cost overruns. But traditional general liability insurance offers coverage only for bodily injury and property damage, and does not cover financial or economic losses, he said.

"The contractors themselves are starting to realize the changes in these project delivery methods is exposing them more and more" to professional liability risks, said Mr. Slivka.

Furthermore, owners are beginning "more and more to require the coverage," said Michael Davis, Philadelphia-based product management director for construction professional and pollution lines for Zurich North America.

"It's a snowball effect," said Mr. Davis. The exposure generates policies over time, "and then as more contractors are buying it, it's become less of a rare thing but more commonplace. Then owners start saying, 'Why doesn't my contractor carry that?'" It then becomes a competitive advantage for the insurers that offer it, he said.

Cady Sinks, Chevy Chase, Md.-based assistant vp at Victor O. Schinnerer & Co., said the application count at her firm was up 13% for the January-to-September period this year compared with the same period a year ago, while new business premiums were up about 40%, "so we're seeing a really good increase over our 2010 numbers."

How much the overall market will continue to grow, however, depends on the overall economy, said Keith Jurss, Chicago-based senior vp of professional liability for the national construction practice of Willis North America.

Meanwhile, any contractor whose work is more than 25% residential is going to find obtaining coverage "pretty challenging," said Matt Gough, senior vp and partner with Washington-based broker Ames & Gough. "It is not an area that a lot of insurers have healthy appetites for," because of losses and the large number of dormant residential projects.

Contracts generally are individually negotiated, say observers. George Pigault, vp with Liberty International Underwriters, a unit of Liberty Mutual Group Inc., in New York, said, "There's less uniformity in the construction professional liability market" than perhaps in architects and engineers professional liability, "so

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Collaborative methods increase exposure

New approaches that have emerged in construction that have led to an increased demand for contractors' professional liability insurance include integrated project delivery and building information modeling, although both may present underwriting challenges for insurers.

Observers say the idea behind IPD is that all the team members involved in a construction project—including contractors, architects, engineers and subcontractors—work together collaboratively. The parties indemnify one another, agreeing to hold one another harmless for errors made.

With integrated project delivery, the parties "agree to put the project first," said Jeffrey M. Slivka, executive vp at Bordentown, N.J.-based New Day Underwriting Managers L.L.C. It is a delivery method, but it is also a change in the mindset of the team involved in the design and construction process, he said.

The approach has had some success in recent years, with projects being completed on time—or even ahead of schedule—and on budget, with reduced errors and reduced risk, said George Pigault, vp with Liberty International Underwriters, a unit of Liberty Mutual Group Inc., in New York. There is a greater degree of risk management on the front end, "thereby allowing projects to go smoother."

But on the other hand, the blurring of responsibilities "creates new risks and new exposures for contractors."

"In terms of what can go wrong, you can still have issues of delay, you can still have issues of design defect and construction defect that can take place," said Mr. Pigault.

Jeffrey Coe, Atlanta-based national practice leader for Marsh USA Inc.'s design industry group, said that because it is a shared risk, "there's no real basis to establish negligence, which is the trigger for all of these professional liability policies. It's really been a challenge" to underwrite this business, he said.

Keith Jurss, Chicago-based senior vp of professional liability for the national construction practice of Willis North America, said the industry is going to have to "figure out how we make the insurance products work with IPD, because the owners and contractors and everybody are driving toward that."

Building information modeling involves computer-developed 3-D models of construction projects. These can identify problems that may arise from the design before the project is built. Contractors may be brought in for their input into these models, which increases their possible liability.

For Richard Hartman, vp, architects and engineers professional liability for Arch Insurance Group Inc. in New York, the question is if a contractor has input into the model, "are they acting as a designer or are they acting as contractor?" Those questions "really haven't yet been answered," he said.

—By Judy Greenwald

GENERAL LIABILITY

Construction underwriting tightens as insurers eye project losses

By SHEENA HARRISON

Many construction project insurers are restricting who is covered and what coverage is provided through additional insured endorsements, while some states have limited the indemnity that builders can provide each other through their commercial general liability insurance, experts say.

"What has been going on in the market for the last few years is…the use of more restrictive versions of additional insured endorsements, and understanding for our clients how important those are," said Jamie Knoop, senior vp of the construction services team at Lockton Cos. L.L.C. in Irvine, Calif.

Changes include higher limits of liability that increase the threshold before additional insured coverage kicks in, and requirements that additional insureds be identified specifically in endorsements for the coverage to apply to them, insurers and brokers say.

Mr. Knoop said he's noticed a reduction in policies that cover contractor losses on completed projects.

"There's a plethora of all these additional insured endorsements that can seriously diminish coverage without careful contract review," Mr. Knoop said.

In addition, states such as Texas and California passed legislation this year limiting the ability of developers or general contractors to be held harmless by subcontractors, or to be covered by subcontractors' insurance policies, for project errors or damages on their behalf.

Tightened policies in those states and others during the past several years have shifted the ways in which additional insured endorsements are being written and used.

Many such changes are being driven by carriers who say endorsements have been providing broader-than-intended coverage for general contractors and subcontractors, said Craig Stanovich, principal and consultant with Holden, Mass.-based Austin & Stanovich Risk Managers L.L.C.

"Quite a few insurers are basically saying, 'Hey, we're just providing too much coverage, and we're not getting any premium for it,'" Mr. Stanovich said.

Case law also is shaping the endorsement landscape, he said. For instance, an Illinois appellate court ruled in March that Itasca, Ill.-based contractor FCL Builders Inc. could not be covered under a policy issued by Westfield Insurance Co. because FCL did not have a signed contract identifying it as an additional insured under a general contractor on the pro-

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Opinions

EDITORIAL

Liability burden should be eased

Construction projects can be complex undertakings. Multiple companies often are involved in designing and building commercial and residential buildings, and the projects frequently take several years to complete.

Accordingly, insurance coverage for construction risks also can be complex as all the parties involved need protection for their specific needs. Yet insurers provide ample capacity for the construction sector, and in several areas are expanding the products they offer to address evolving needs and to clarify coverage.

One area that needs additional clarity, however, is how commercial general liability policies address construction defect risks. As we report on page 4, policyholders are frustrated by conflicting court decisions in various states over whether construction defect claims constitute an occurrence under CGL policies.

With differing judicial interpretations of the CGL wordings, policyholders don't know whether their CGL policies will cover their construction defect claims. And, on the other side of the equation, insurers don't know whether they will have to pay claims that have been filed.

Such inconsistencies add to the costs for both sides and create an uncertain atmosphere for businesses struggling to generate revenues in a particularly hard-hit area of the economy. Policyholders don't know what uninsured costs they may face if a construction project goes wrong and insurers face a much tougher time underwriting the risks.

The good news is that some state governments have recognized the problem and are addressing it through legislation. Arkansas, Colorado, Hawaii and South Carolina have passed laws legislating that construction defect claims constitute an occurrence under CGL policies.

Those states may benefit economically as the laws make them more attractive places for construction firms to do business, but more importantly the laws reduce the risk of protracted legal disputes.

As with all state legislation, there will be the risk that different states' laws will differ so much that they will add to the confusion, but leaving the decisions to state courts likely will produce even more inconsistencies.

Given the overall importance of the construction industry to the struggling U.S. economy, states can and should act quickly to ease this liability burden.

LETTERS

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COMMENTARY

Heroes deserve second look

Occasionally, I see a workers compensation claim denial that captures intense media attention and embarrasses an employer or insurer before they reverse their original decision not to pay.

But by the time they change course, the trouncing of the brand's reputation has been accomplished. It's usually done by several newspapers, blogs and TV news outlets chasing the story.

These cases usually make me wonder: If the insurer or employer is going to reverse their claim denial eventually anyway, why didn't they spare themselves the brand damage by accepting the claim when they first received it?

ROBERTO **CENICEROS**
SENIOR EDITOR

Perhaps this is too theoretical of a question without any real means for insurers, employers or their third-party administrators to evaluate claim denials up front to determine whether the media will take interest.

I haven't heard of predictive modeling for workers comp claims set up to help make such determinations, or of adjusters receiving training in media relations. And really, denial or acceptance of a claim shouldn't hinge on whether the case would make a good news story that might make a claims payer look bad.

Those decisions should be about sticking to the law on what is compensable and what isn't.

But I was reminded that the issue is worth thinking about when another one of these stories recently generated headlines for a week or longer.

You may have heard about Mark Lindquist, the group-home worker hailed as a hero for putting his life on the line in a vain attempt to save three men with Down syndrome from the May 22 tornado that heavily damaged Joplin, Mo.

He suffered extensive injuries and wound up in a coma for about two months, eventually facing at least $2.5 million in medical bills.

But his employer's workers comp insurer, Lansing, Mich.-based Accident Fund Insurance Co. of America, at first declined to pay.

The insurer cited state law limiting recovery for injuries received during a tornado to situations where the employee was subjected to a greater harm than that of the general public.

But after national media reports about the denial, Accident Fund said in October it received additional information about the claim and would pay after all.

Sure, claim denials should be based on laws applying to the specific facts of the case. And new, additional information can surface.

But if insurers or employers are eventually going to reverse their denial, might it make sense to consider a different decision before the brand damage occurs?

And here are a couple of hints for doing that:

One, media consumers love stories about heroes wronged by insurers and employers.

Two, when someone worthy of community hero status files a claim, collect that additional information before deciding whether to deny.

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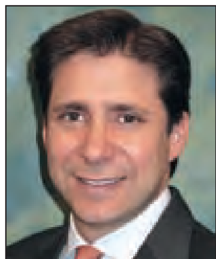
Perspectives

ACCESS TO CAPITAL in the challenging economy is difficult for firms in the construction industry, and they need to manage their funds to make every dollar count. Policyholder collateral obligations, however, are unavoidable. Here, Brian McGrath, the national construction claims practice leader for Marsh Inc., and Dan Aronson, co-chair of the collateral solutions group at Marsh Inc., offer steps construction firms can take to reduce the amount of collateral dedicated to their insurance programs and thus free up working capital or gain additional borrowing capacity.

Manage collateral during slow construction market

Mr. McGrath



Mr. Aronson

Taking a disciplined approach to collateral management can help mitigate a company's overall collateral needs.

By Brian McGrath and Dan Aronson

The construction industry's economic recovery continues to lag behind that of the United States overall, with an unemployment rate of more than 13%, according to the latest data from the Bureau of Labor Statistics. Although there are some pockets of growth—including in the health care and private education sectors—public and private capital to fund construction projects remains in large part on the sidelines, with no sign of significant improvement in the near term.

For construction firms operating in this challenging environment, access to capital and effectively managing it can mean the difference between staying viable and going out of business. One unavoidable capital outlay that has proved challenging for risk managers in all industries over the past few years involves the collateral obligations associated with fronted and loss-sensitive casualty insurance programs.

Insurers typically require organizations with such programs to post collateral to guarantee payment of claims falling within large deductibles. Most primary casualty programs are written as loss-sensitive; letters of credit are the collateral instrument most readily accepted by insurers.

During the economic downturn and credit crisis, banks have materially changed the parameters of credit facilities for many insureds. This has resulted in reduced LOC capacity, increased LOC fees and, in some cases, a requirement for cash collateral to secure an LOC. At the same time, insurers have become more conservative about their credit risk, often limiting the aggregate exposure to LOCs from individual banks.

Construction firms with deductible insurance programs cannot avoid collateral requirements, but there are steps they can take to reduce the amount of collateral dedicated to their insurance programs and thus free up working capital or gain additional borrowing capacity. Effectively managing collateral in today's difficult construction market is a function of having in place effective processes, products and programs.

Process

The amount of collateral a construction company is required to pay depends, in general, on the value of claims the insurer expects to pay within the construction firm's deductible layer until the claims are closed. Quite simply, the fewer claims there are outstanding, the less collateral that is owed.

Effective claims management and loss control processes can go a long way toward this effort, and should include the following criteria:

- Active engagement with your selected claims administrator. Ongoing scrutiny of and discussions surrounding the extent of your reserve and your plan for claims disposition are essential to an effective claims program.
- An outcomes-driven analysis of the prospective claims administrator. When selecting or reviewing your claims administrator, focus on historical claims outcomes rather than claims handling fees, as such fees represent only a small percentage of the overall cost of claims. Failure to use an outcomes-based analysis can lead to longer claim duration, which often leads to more significant collateral requirements.
- A dedicated focus to resolve older and legacy claims. These claims typically result in a greater administrative and collateral strain on an organization. Through the resolution of these losses, an organization can expect to see a potential reconsideration of its collateral requirements.
- A robust safety and loss-control program. Preventing claims from occurring is the best way to reduce liabilities and associated collateral obligations. A culture of "safety first" with support from top leadership on down is likely to improve the effectiveness of a well-designed safety plan.

In order to ensure an accurate portrait of future liabilities, construction firms should conduct a thorough liability analysis of existing and new claims, looking at case reserves, reserving philosophies and loss-development factors. Once an accurate estimate of outstanding liabilities is established, a construction firm should meet with its insurer's senior credit officers—similar to its banking partners—to discuss the firm's financial strength, liquidity position and overall outlook. By establishing that relationship, insurers are apt to feel more comfortable with a client's risk profile and are more likely to accept a lower collateral amount than the liabilities they are fronting.

Product

Product is an important consideration in reducing collateral obligations. Approved types of collateral depend upon the insurer's appetite and the insured's financial credit. For most situations, acceptable collateral forms will consist of a combination of one or more of the following:

- Letter of credit.
- Trust, which is cash and/or certain marketable securities held in trust.
- Cash collateral, which is cash paid to an insurer within the policy year to pay claims.
- Pledge and securities, which are marketable securities pledged to the insurer.
- Surety bond, which is rarely accepted and covers only up to 30% of the total collateral requirement.
- Credit fee, which is a fee to reduce the collateral requirement.

Several large construction firms have historically preferred to post LOCs and preserve cash for reinvestment into the company, as the internal rate of return was higher than the cost of an LOC. Given current economic conditions, some of these firms now have on their balance sheets excess cash that is neither being put to use nor earning a meaningful return.

Construction firms in this situation should weigh whether using excess cash makes more financial sense to the company than posting an LOC. Cash can be used in various structures and products, and in many cases produces a similar or better return than balance-sheet cash.

For example:

- One alternative cash option is a cash-backed LOC, which can generate a fixed or variable return on the posted cash (net of fees), thereby eliminating LOC fees and generating investment returns on the cash.
- For larger companies with significant collateral requirements, a capital market solution that provides an unsecured LOC may be an option.

Construction firms should work with their brokers to actively reduce collateral requirements and secure appropriate forms of collateral with historical insurers, not just the current one.

Program

Program design changes are another option that construction firms can consider when seeking to reduce the cost of collateral. For example, a loss-sensitive liability program could be structured as a self-insured retention, thereby eliminating the collateral obligation altogether. When considering this option, however, a construction firm needs to ensure that contract and insurance certificate holders will allow it to maintain an SIR, as insurers only provide coverage in excess of the retention.

A loss portfolio transfer is another option to consider if there is available cash and historical liabilities on the balance sheet. An LPT is a fixed or adjustable payment of premium that satisfies reimbursable loss obligations for specific policy years. An LPT eliminates the applicable collateral requirement and associated fees.

There is no magic solution to relieve a construction firm of collateral obligations. However, taking a disciplined approach to collateral management that focuses on having in place effective processes, products and programs can help mitigate a company's overall collateral needs, thus freeing scarce financial resources to be used for other business strategies.

Brian McGrath is the national construction claims practice leader for Marsh Inc. in Grand Rapids, Mich. He can be reached at brian.j.mcgrath-@marsh.com or 616-233-4267. Dan Aronson is co-chair of the collateral solutions group at Marsh Inc. in New York He can be reached at daniel.e.aronson@marsh.com or 212-345-5934.

SAFETY

OSHA tightens fall protection rules

Residential builders must comply with commercial rules

By JOANNE WOJCIK

In response to the high number of deaths related to falls in residential construction, the federal Occupational Safety and Health Administration says it is requiring employers operating in the residential construction industry to use the same methods of fall protection that historically have been used in the commercial construction industry.

While these safety methods—including guardrail systems, safety net systems or personal fall arrest systems—are likely to add costs to residential construction, experts say the investment will pay off for contractors through lower workers compensation insurance premiums and prevention of a job shutdown or delay should a fatality occur.

Residential falls account for roughly 29% of all fall fatalities in the overall construction industry, according to OSHA, and falls from roofs accounted for nearly 35% of those. In fact, falls in residential construction accounted for more deaths than any other of the four hazards OSHA has identified as the leading causes of fatalities in the construction industry, including "struck-by" hazards, electrocutions and "caught in-between" hazards.

"No worker should have to pay with their life trying to make a living. Our hope is that we can work together to prevent falls and save lives," said David Michaels, assistant secretary of labor for OSHA, in a narrative accompanying a presentation the agency has made available on its website.

The new directive, which took effect June 16, states that all residential construction industry employers must protect their workers who are engaged in work at six feet or more above lower levels by conventional fall protection systems or by other fall protection measures allowed under the OSHA directive, which has been in place for commercial construction since 1926 (see box).

"Gone are the special alternative procedures allowed under the old directive for certain residential construction activities," Mr. Michaels said.

However, employers in residential construction still can use other fall protection measures, such as positioning safety monitors on roofs, if they can demonstrate that it would not be feasible to comply with the new directive or if it would create a greater hazard, he said. But any alternative fall protection plan must be written and site-specific and prepared by a qualified safety professional, he said. Moreover, the OSHA directive requires that the fall protection plan be posted at the job site and that all workers exposed to fall hazards be trained to recognize potential fall hazards and in the procedures they must follow to minimize those hazards.

The new OSHA directive applies in all states except those that have their own occupational safety programs, such as California. However, any state fall protection standard must be at least as effective as the federal standard, according to OSHA.

Walter Lee, vp and manager of loss control services for the Southern California region at Lockton Cos. L.L.C. in Los Angeles, attributed the surge in residential fall deaths that triggered OSHA's decision to implement the new directive to corners being cut in safety during the housing boom.

"When the housing boom was going on, a lot of residential con-

See INJURIES page 12

NEW SAFETY STANDARDS

The new directive for fall protection safety in the residential construction industry requires residential contractors to implement conventional fall protection systems like those that have been in use by the commercial construction industry since 1926. Some examples are:

- Guardrail systems
- Safety net systems
- Personal fall arrest systems that include anchors, a full-body harness and a lanyard connection to prevent a falling worker from reaching the ground
- Personal fall restraint system that ties off workers to prevent them from reaching past the unprotected side or edge
- Scaffolds, ladders or aerial lifts including forklifts with basket attachments

Source: Occupational Safety and Health Administration

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Injuries: OSHA tightens regulations

CONTINUED FROM PAGE 10

struction workers were paid piece rates—by the square footage or by how fast they worked....They're not incentivized by wearing hard hats. They actually removed the guards on Skilsaws so they can work faster. Safety and preplanning takes time and money," he said.

As a result, "injuries skyrocketed. That's the primary reason OSHA pushed through these regulations," Mr. Lee said.

Though many of Lockton's clients already put the new fall protection measures in place prior to the OSHA directive being issued, Mr. Lee said the added cost has made it more difficult for them to compete with contractors that have not put those measures in place.

"But at the same time, a company with a safe work record is paying less for work comp insurance. They gain a competitive advantage on insurance costs, so it does pay in the long run," he said.

Ariel Jenkins, senior risk control manager at Safety National based in St. Louis, said he anticipates there will be some resistance to adhering to the new directive among residential construction industry employers because of the added cost during the economic downturn.

While the cost of a simple roof anchor only amounts to about $200 per worker, other systems like under-eave guardrails are more expensive, costing "in the thousands," he said.

However, Mr. Jenkins said he expects the directive ultimately will result in savings for contractors over the long haul, both through reduced workers compensation insurance premiums and in less downtime should an accident occur that would cause a temporary shutdown at a building site for an OSHA investigation.

"Initially, there's going to be resistance to it purely because they've done it a certain way for so many years and have taken calculated risks that no one would fall. The sentiment out there is OSHA and the federal government are overstepping their bounds," he said. "I have seen these accidents over the years. They're preventable."

The cost of an OSHA fine when an accident occurs as a result of failing to adhere to the new standard can be particularly detrimental to small and midsize residential contractors, according to Kevin Barry, vp at Marsh Risk Consulting in Philadelphia.

"There are several levels of violations. You could have a $40,000 fine" in situations where a contractor was aware of the hazard but "blatantly disregarded the issue and put someone's life at risk," he said.

Ted Christensen, construction industry specialist at Liberty Mutual Group Inc. in Hopkinton, Mass., estimated it will cost residential contractors between $300 and $400 to outfit each worker with the appropriate fall protection equipment.

"If you look at that vs. what a fall injury costs, it's a no-brainer," he said.

Bob Kohnke, owner of First Link Safety Inc. in Boise, Idaho, and author of the OSHA Partnership Program for Construction, said the residential construction industry slowdown may make it somewhat easier for contractors to comply with the new OSHA standard because it will allow more time for implementation and training.

"Training is important. We find if people are tied off at a height where they're not protected, that if they fall, their lanyard is not going to prevent them from hitting the ground," he said.

> 'A company with a safe work record is paying less for work comp insurance. They gain a competitive advantage on insurance costs, so it does pay in the long run.'
>
> Walter Lee, Lockton Cos. L.L.C.

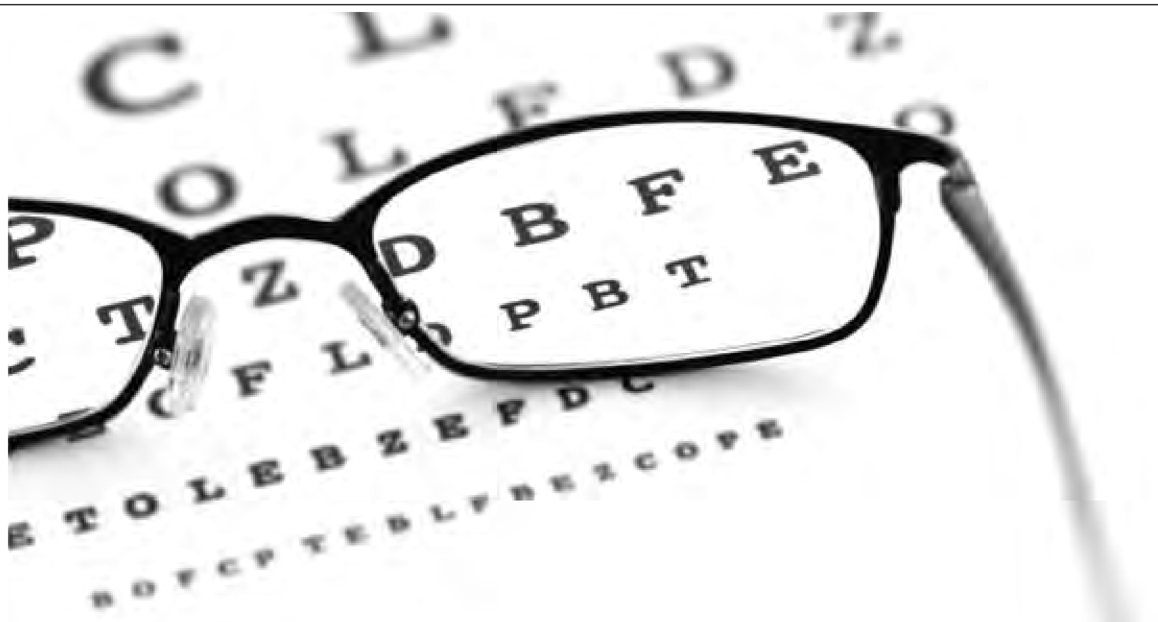
Moreover, "equipment suppliers are now providing much better fall protection equipment than ever before. So this takes away the excuse the industry had for not providing fall protection," Mr. Kohnke said.

Part of the reason OSHA had given more leniency to residential construction was because, until recently, "there wasn't a lot of fall protection technology available," said Scott Staffon, a senior vp and safety consultant in Willis North America's construction practice in Minneapolis. "The fall protection companies focused resources on the commercial side of the house and didn't focus much on residential."

Today, however, "the technology exists. There are hundreds of options available to comply with this standard," he said.

Moreover, pricing is down as fall protection equipment vendors compete for business at a time when fewer housing projects are in the works, Mr. Staffon said.

"I think it's a very good thing for the residential construction industry to start gravitating toward fall protection," he said. "On the commercial side of the house, we were having less falls. But on the residential side, falls seemed to be inching upward. All this is going to make it a much safer industry."



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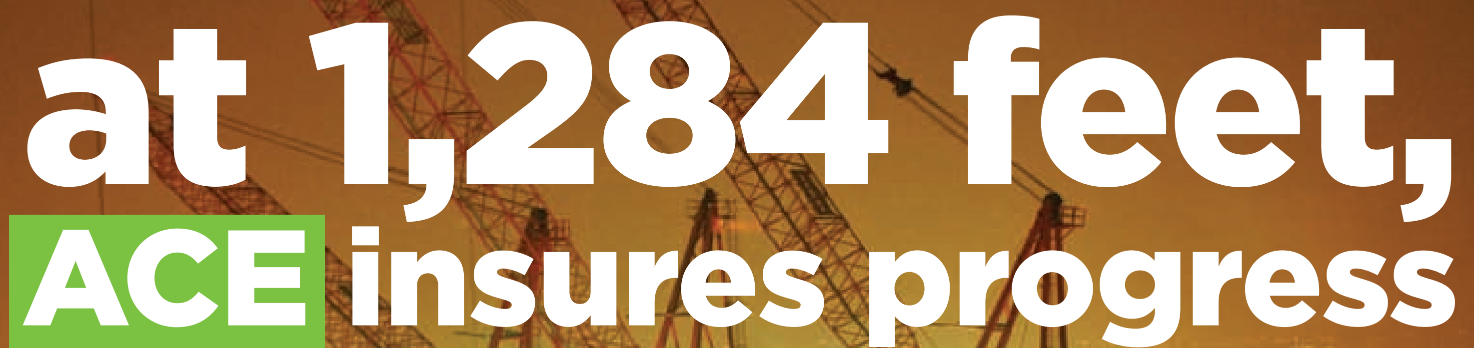

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RISK MANAGEMENT

Lessons learned from tragedy

Structures at World Trade Center site built with risk management, safety in mind

By MATT DUNNING

NEW YORK—At the World Trade Center site in New York, the architects responsible for the planned skyscrapers, memorial plaza and museum sought to commemorate the events of Sept. 11, 2001, aesthetically by restoring the site's dominance of the Manhattan skyline while paying tribute to what was lost 10 years ago.

The builders of those projects—the Port Authority of New York and New Jersey and Silverstein Properties Inc.—have sought to honor the events of that day in a different way: by using the lessons learned from the original World Trade Center's collapse to manage construction and occupancy risks associated with the new projects at the site.

One of the most significant ways in which the events of 9/11 have informed risk management at the Trade Center site, say risk managers and safety experts involved with the rebuilding, has been in the engineering and construction of the new high-rise towers. Silverstein Properties' reconstructed 52-story 7 World Trade Center, which was built across the street from the actual Trade Center site in 2005, served as the model for how the four Trade Center site towers would be designed from the standpoint of safety and security.

"We recognized two important challenges: that (building) codes would be changing; and our design needed to anticipate this and, in fact, exceed the potential code changes," said Shari Natovitz, vp of risk management for Silverstein Properties. The design also would need to "exhibit the life-safety features required to assure tenants that this would be among the safest buildings in the world. We and our design consultants met that challenge by designing above code."

All four of the World Trade Center site's new towers will be constructed around reinforced, monolithic concrete cores that span each building from top to bottom, which risk managers for the Port Authority and Silverstein said provide increased capability to withstand a violent impact similar to the 9/11 attacks. Additionally, each tower's base, particularly that of the flagship 1 World Trade Center, will be made of high-density steel and concrete to protect against ground-based catastrophes or attacks. In 2005, the New York Police Department insisted the Port Authority make additional safety and security adjustments to the base of 1 WTC, resulting in the removal of nearly all the windows and the use of even heavier, 14,000psi concrete—seven times the density of sidewalk pavement.

JOE WOOLHEAD

Buildings being constructed on the World Trade Center site incorporate life-safety features aimed at assuring tenants that they will be occupying some of the safest buildings in the world.

"It's a much different type of construction" than the original World Trade Center, said James Keane, general manager of operations, safety and risk management for the Port Authority. Mr. Keane said the original twin towers were built around segmented concrete cores and relied more heavily on perimeter steel columns to support their weight.

In addition to the solid, reinforced core columns and higher-density perimeter steel construction, Mr. Keane said designers incorporated several other safety and security elements that took their cues from the difficulties workers and emergency responders had in evacuating the twin towers on Sept. 11. The new towers all will feature widened, pressurized stairwells—with a dedicated stairway for emergency responders—concrete-protected sprinklers, emergency risers and communication systems, and protected tenant collection points on each floor.

"A lot of lessons from Sept. 11 were put into the design of the new buildings to best protect occupants and emergency responders," Mr. Keane said, "and the result is a set of very robust towers."

The events of Sept. 11 also informed to a large extent both developers' experiences in the insurance marketplace when the time came to seek coverage for their respective projects.

Silverstein Properties had just endured a complex and bitter dispute over insurance payouts from the first World Trade Center's collapse at the time it brought its projects to the marketplace in 2007. Though she was not with the company when it purchased coverage for the original towers, Ms. Natovitz said she was well acquainted with the "areas that required improvement either in strategy or execution."

Paramount among them was contract certainty, she said, especially in consideration of the company's insurance dispute.

"Silverstein and Willis North America worked together to assure that a complete coverage form was part of the submission for each line of coverage," Ms. Natovitz said. "Willis then managed the process of assuring concurrency, and Silverstein rechecked the finalized contracts."

While much of what happened at the World Trade Center on Sept. 11 has lent insight into reducing the risks of rebuilding the site, some lingering effects of the attacks have proven less helpful. In 2005 and 2006, when the Port Authority first brought its projects to the insurance market, there was little interest generated among U.S.-based insurers in the program, Mr. Keane said.

"The domestic market wasn't really ready for the World Trade Center construction," Mr. Keane said. "Part of it was an overall market fear of terrorism, but the complexity of the project itself would involve hundreds of contractors working in close quarters together, and that all had to be protected as well."

"We also had to rebuild a lot of relationships with the marketplace post-9/11," he added.

Given the physical, emotional and political complexity of the work, Ms. Natovitz and Mr. Keane said working in concert to provide near-constant communication and detailed information to their brokers and underwriters was crucial to overcoming market nervousness about rebuilding on the site.

"Once you worked your way through the communication challenges, eliminating redundancies and eliminating any potential gaps, what we had was a profile that we could present to the insurance marketplace that demonstrated an across-the-board commitment to building out these projects as safely as possible," Ms. Natovitz said.

SURETY

Surety losses likely to rise as economic problems continue

But sector healthy despite downturn in construction

By MARK A. HOFMANN

The surety industry remains healthy despite a downturn in government-backed construction projects, according to industry observers.

But experts say they expect losses may begin to rise as the economy remains in the doldrums. And smaller and midsize contractors—and their subcontractors—are feeling the pinch harder than their national or global competitors.

Nevertheless, capacity is no problem, as the industry is better capitalized than it was when it hit a rough patch a decade ago.

The bulk of the surety business involves government contracts, according to market observers. Underwriter loss ratios have been favorable so far, with the Washington-based Surety and Fidelity Assn. of America reporting that as of June 30 of this year, the loss ratio stood at 11.8%. But financially strapped state and local governments have been cutting back on projects, cutting into contactor balance sheets.

"The way we look at it, the surety industry is a cyclical business," said Drew Brach, Marsh USA Inc.'s U.S. surety practice leader in Grand Rapids, Mich. He said the cycle historically goes through four stages: crisis, recovery, boom and worsening.

"Right now, we are in the worsening stage, which typically leads to an increase in construction defaults," he said. "While we haven't seen significant increases in defaults yet, we're seeing some early warning signs. There's a tremendous amount of stress on financial statements, less work, and many contractors haven't reduced their overhead enough to compensate for the changes."

"When that happens, they have losses and they have cash flow issues," said Mr. Brach. He said the surety industry is bracing for losses in 2012 and 2013. "Contractor balance sheets are going to reflect reduced revenues and, in some cases, we're seeing reductions of up to 60%" over a two-year period, he said.

"Contract surety underwriting is conservative given the economy," said Mark Baechle, senior vp and surety leader-Chicago for Willis Group Holdings P.L.C. "There's been a precipitous drop in construction spending over the past three to three and a half years. That has led to fewer opportunities for contractors," he said, adding that, even so, the first half of this year has been highly profitable for surety underwriters.

The construction market is in a difficult time, said Roland Richter, Philadelphia-based marketing vp for Liberty Mutual Insurance Group Inc.'s Liberty Mutual Surety unit.

"Government spending is down fairly significantly this year," he said. "If they're not building, the contractors aren't working and fewer bonds are being written," said Mr. Richter.

He noted that in any economic cycle, there is a lag before its impact is felt. After the economy turns into recession, tax revenues flowing into state and local governments have a six-to-12-month period before they feel the impact on their revenue streams, Mr. Richter said.

The surety industry is in "challenging times," said Mike Bond, head of surety for Zurich North America in Owings Mills, Md.

"Construction spending is down 20% from its peak in 2008, which puts construction spending

See **SURETY** page 16

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Construction wrap-up cover evolves

More contractors negotiating coverage for cost savings

By ROBERTO CENICEROS

Although today's wrap-up insurance programs for large construction projects retain many traditional elements, a substantial shift in the arrangements is under way, several brokers said.

The ongoing changes include more contractors negotiating for the coverage rather than construction project owners buying the insurance.

Wrap-ups—which can be either owner-controlled insurance programs or contractor-controlled insurance programs, depending on who sponsors them—refer to the combining of insurance coverage for a construction project's owner, the general contractor and all subcontractors working on the site.

The arrangements traditionally have coordinated workers compensation and general liability coverage under one program, although additional insurance products such as builders risk and environmental coverage may be included.

Historically, potential insurance cost savings have been the main driver for insurance purchasers seeking wrap-up coverage, although there have been additional advantages.

Public entities wanting to attract minority contractors to building projects, for example, can ease their entrance by providing necessary insurance rather than requiring that minority-owned businesses purchase their own policies at a higher cost.

Wrap-ups can reduce an owner's insurance expense, or even help produce a profit, by allowing them to accept only construction bids that exclude the contractor's and subcontractor's insurance costs for lines covered by the wrap-up.

Negotiating for one large policy covering everyone working on a project reduces the overall insurance pricing that thousands of small subcontractors lacking purchasing clout normally encounter when they buy their own individual coverages.

> **'Safety and the insurance go hand in hand because most of these modern-day wrap-ups have large self-insured retentions.'**
>
> Don Waddell, WRISC Inc.

The savings the arrangements produce then can pay for developing, staffing and enforcing stringent safety programs coordinated for everyone on the project, said Don Waddell, president of Veneta, Ore.-based WRISC Inc., a risk management consultant specializing in construction and public-entity projects.

"Safety and the insurance go hand in hand because most of these modern-day wrap-ups have large self-insured retentions," Mr. Waddell said. "So much of the total final (insurance) cost to the sponsor is driven by the amount of claims. It's not unusual to see deductibles ranging from $100,000 per accident up to $500,000. Most wrap-up deductibles fall into that category."

There also are other efficiencies. Relying on one centralized claims management system, for instance, can reduce litigation when contractors and subcontractors are all covered by the same insurer, Mr. Waddell added.

While project owners traditionally negotiated for wrap-ups, in today's market it is increasingly common for large contractors, rather than project owners, to purchase the insurance arrangements under CCIPs.

"We are seeing a big rise in contractor-controlled insurance programs," said Michael Hastings, project risk practice leader in Atlanta for Marsh USA Inc.'s U.S. construction practice.

There are now an equal number of contractors seeking CCIP coverage as there are owners seeking OCIP arrangements, added Angela Skow, head of controlled insurance programs in Addison, Texas, for Zurich Financial Services Ltd.

One reason for the shift is that insurer appetite for wrap-ups has changed, sources said. Years ago, when insurers earned healthy interest from the large premiums that wrap-ups generate, more underwriters willingly provided the coverage. But today, fewer insurers underwrite wrap-up coverage, although two or three have entered the market recently, sources said.

With the current investment environment, the insurers capable of providing wrap-ups want greater assurances about a wrap-up client's ability to manage the complicated risks generated by a large construction project.

The underwriters also have less appetite for clients that will build only one project, brokers said.

Large, sophisticated contractors, in contrast, can provide insurers with the ability to earn recurring income from multiple construction projects that the contractors will undertake over time. This helps insurers spread their risk, because if they take a loss on one deal negotiated by a building contractor, they will have other opportunities to make up for that loss and profit from the contractor's other projects, Mr. Hastings said.

"If I am an underwriter and I am looking at an owner client who is going to build one project, and it will be the only project they have built in the last 20 years and the only one they will build, I am not going to be anxious to sell a program to them," Mr. Hastings said. "Because if I get (the underwriting) wrong on that one project, I have no chance of getting it back."

There also are more CCIPs now because over the past two years or so, more project owners have required in their bid specifications that general contractors bring the insurance programs to the table, said Tim Walsh, executive vp and managing national director of Aon Risk Services' construction services group's national wrap-up group.

"They are putting it in their specifications, where historically that was never the case," Mr. Walsh said.

But "coverage certainty," not just financial gain, is a main driver behind contractor demand for CCIPs, several brokers said.

"That is a real important issue for contractors," said David DeLaRue, senior vp and managing director of Willis North America's project insurance practice in Dallas.

"It is not so much (of an issue) for owners who are hiring big general contractors who have established records and very high-quality insurance programs," he said.

But contractors who hire subcontractors, who in turn hire other subcontractors, can use a wrap-up to eliminate uncertainties about whether the subs will not bring the coverage limits and insurance product quality to a construction project that general contractors need to meet their contractual obligations, Mr. DeLaRue said.

"It's a cost/profit opportunity, but it's more of a coverage certainty issue for them," Mr. DeLaRue added.

Coverage certainty also means that contractors do not have to worry about subcontractors failing to obtain consistent terms and conditions during annual insurance renewals that take place while working on projects that take years to complete.

Contractors also don't have to worry about not being able to locate a subcontractor to tap the subcontractor's insurance for claims filed years after a project is completed.

Another significant change in wrap-up trends is that contractors are purchasing general liability coverage only, excluding the workers comp coverage that was a traditional staple of the arrangements.

That has happened because state workers comp reforms and insurer competition over the past few years drove down the line's price and made it easier for subcontractors to obtain the insurance on their own, sources said.

Lower-cost workers comp insurance also has meant contractors are less able to derive savings when including the line in CCIPs. Meanwhile, coverage certainty remains a major consideration for CCIP purchasers.

Overall, there are fewer wrap-up projects than in years past because of the economy's impact on construction, said Peter Probolus, wrap-up marketing director for commercial markets for Liberty Mutual Group Inc. in Boston. Many projects under way, however, often have government financing, such as for public infrastructure construction.

Surety: Losses to increase

CONTINUED FROM PAGE 14

at about the same level as it was in 2000," he said. "In spite of that, the surety industry continues to show extremely robust results. The losses at midyear reported by the Surety and Fidelity Assn. of America were actually down from the same time the prior year" at this year's midyear, he said.

But the expectation is that will change next year and in 2013 unless the construction industry picks up, said Mr. Bond.

Sufficient capacity is "absolutely" available, said Zurich's Mr. Bond. "As long as the results in the overall surety market remain as strong as they are, there will be sufficient capacity in the market."

"There is capacity available for contractors who happen to have work these days," said Rick Ciullo, chief operating officer for Chubb Corp.'s surety operations in Warren, N.J.

"Right now, the industry is flush with capital," said Geoff Heekin, managing director of Aon Risk Solutions' construction services group in Chicago. "We're entering into (2012) with more capital around contract surety than we've seen in a decade."

"We are going to have more defaults but plenty of capital to support the business, unlike in the early 2000s," he said.

Demand is down, but supply of surety is at least available, said Chubb's Mr. Ciullo. From an underwriting perspective, surety underwriters are concerned with the health of their customer base. When contractors have built up organizations to do a certain amount of work, and if there is less work, contractors either have to cut their overhead to match the available work or they have to be prepared to take work at substantially lower margins, Mr. Ciullo said.

As public construction has dropped, there's been a slight uptick in demand for surety by private owners, said Willis' Mr. Baechle.

"We are seeing more private owners requiring bonds, often driven by lender requirements," he said. Developers of shopping centers, distribution centers and other projects are requiring surety bonds, and also asking them of subcontractors more often, he said.

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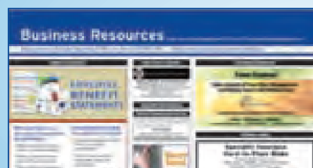

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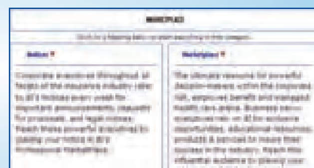

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Perspectives

RECOGNIZING THE DIVERSE INTERESTS that exist on a project is vital to managing a project's risk, especially since risk can be "owned" for years beyond the project's completion. But relying on historical means and methods is difficult when contract terms can change overnight in the wake of a judge's ruling or a legislature's vote. Tim McGinnis and David DeLaRue, senior vps in Willis Group Holding P.L.C.'s national construction practice in Dallas, address these concerns as they urge contractors to consider the various options available to them in the form of contractor-controlled insurance programs.

Finding coverage certainty in ever-changing market

Mr. McGinnis

Mr. DeLaRue

OF NOTE

Key considerations for potential CCIP sponsors

- Clear picture of historic and future project pipeline, including projected geographies, estimated annual volume, average project size, average project term, average project value and method of securing business, i.e., hard bid or negotiated.
- Pre-qualification of subcontractors. Underwriters will want to know the quality and reputations of the subcontractors you work with.
- Demonstration of a quality safety program.
- Commitment to invest and dedicate resources. A successful CCIP requires support from the entire organization, including risk management, project management, and sales.
- Awareness and negotiation of the broadest terms and conditions available.

By Tim McGinnis and David DeLaRue

Most contractors working in today's complex legal environment appreciate the fact that while project risk may begin at mobilization, it does not end with completion. Contractors can "own" risk for 10 or more years beyond completion.

Whether the project is a small strip center or a large airport terminal, contractors are being forced to devote more attention to construction risk. The declining economy and potential for more claims arising from defective work have created an environment that demands a long-term risk management solution.

Relying on contractor certificates of insurance alone is dangerous. As each year passes, insurance terms and conditions can erode, requiring the risk manager to go beyond the certificate of insurance to actually review policies. Exposures covered by yesterday's policy form can be excluded by tomorrow's renewal. These realities challenge even the most experienced risk manager.

Additional challenges face the construction risk manager who has relied on historical means and methods. Courthouses and state legislatures have proven to be shaky foundations for risk management. A decision from the bench or vote from the House can weaken the contractor's contractual protections and put the company at greater risk.

Traditional insurance requirements, including additional insured status, have been the standard for a number of years as general contractors (and indeed owners) seek to align insurance in the event of a loss. Given the uncertainties of time, ever-changing policy forms and legal decisions, this approach can create concerns about the availability of insurance policies and limits, especially because once a project is completed, most risk managers do not track certificates post-completion for the full statute of repose.

Recognizing the diverse interests that exist on a project is vital to managing a project's risks. Under the conventional insurance approach, multiple contractors result in multiple insurers, each of which has different policy terms and conditions with the intention of protecting both their insured's and their own financial interest. Plaintiff attorneys thrive in the traditional environment of construction risk management, while contractor-defendants are often caught in the middle—resulting in project delays and additional costs.

The lack of certainty about the claim process has focused the construction industry's attention on longer-term solutions. One solution employed for a number of years is the controlled insurance program, which provides every contractor working on a job site uniform insurance coverage with one carrier. The most common coverages under CIPs are workers compensation and general liability (primary and excess/umbrella). The benefits are a reduced cost of risk via lower insurance expenses and lower claim costs. While CIPs have existed for more than 30 years, historically owners of the construction project sponsored the consolidated insurance program, called owner-controlled insurance programs. Yet many contractors and some insurance carriers have not always viewed OCIPs in a positive light and have expressed dissatisfaction with owners/sponsors who purchase inferior coverage or owners who focus on pricing only. Another significant issue with OCIPs has been the lack of investment and oversight of the claim and safety protocols.

Contractors, driven in part by dissatisfaction with owner-controlled programs and increasingly concerned about the quality and consistency of coverage that their subcontractors had in place, recognized the risk management value of this approach about a decade ago, kicking off an evolution of innovation in the industry that has led to the common contractor-controlled insurance programs we see today. Insurance carriers' appetites also have evolved, and contractors today have more options regarding CCIPs, i.e. large project-specific CCIPs, rolling CCIPs and general liability-only CCIPs. Consequently, contractors are building expertise within their risk management practices for managing CCIPs.

CCIPs gain traction

As contractors' comfort level with this approach increases, both single-project programs and "rolling" or multiple-project programs are gaining popularity. Rolling programs are designed to cover most, if not all, of the work done by the contractor. While not designed to replace the contractor's practice program, they do allow significant control of all the liabilities arising on projects, both from the general contractor and its subcontractors. This is critical, as it creates greater coverage certainty for all parties on the job vs. the traditional downward flow of liability approach with multiple insurance carriers and multiple policies involved over a number of years.

One of the biggest advantages of this approach is that a single insurance provider provides a uniform claim defense, which reduces the involvement of multiple carriers and related defense counsels. This efficiency focuses the insurance program on claim resolution rather than on the allocation of fault to the various defendants—creating delay and related costs.

The general contractor also gains efficiency by reducing the need to review contractor certificates of insurance and policies over many years. Certificate management, a major issue for contractors, is both costly and uncertain, given the fact that certificates do not amend coverage but only confirm it at the instant they are issued. They do not prove coverage or assure it will be in place at a future time when a loss may occur.

Austin Commercial Construction L.L.C. was an early pioneer of the rolling CCIP, and their boldness surprised the underwriting community. They did not go unchallenged: Carriers wrestled with the idea of making a long-term commitment to the contractor lacking specific information on the work planned. However, by working with the contractors and the insurance carrier, initial challenges were met with program design innovations that are now standard with most rolling CCIPs. For example, CCIP premium historically was based on payroll, but with the advent of rolling CCIP programs, premium is now based on construction values. After more than 10 years of managing a rolling CCIP, Austin and others have realized the financial and coverage benefits of the rolling CCIP.

Today, there is nothing uncommon about a CCIP. In fact, owners sometimes require contractors to consider the approach as part of their construction proposal, as they understand the benefits of fewer disputes and a more streamlined insurance claim process. A recent Willis survey revealed that many of the top 50 contractors in the U.S. (ranked by revenue size) have used this approach on a project-specific or rolling basis.

Interest in the CCIP is growing and, as exposures change, today's construction risk manager should certainly consider the benefits of managing risk with a CIP. Even with new project delivery approaches, such as integrated project delivery, CCIPs perform well to enhance the integrated approach by providing common and cohesive coverage for all the construction partners.

We believe the future is bright for CCIPs. Increased participation/sponsorship by contractors will continue to respond to the ever-changing conditions of the construction market. For sponsors of CCIPs, securing a program with the current favorable market conditions will lead to increased opportunities for revenue growth ahead of eventual rate firming.

Tim McGinnis and David DeLaRue are senior vps in Willis Group Holdings P.L.C.'s national construction practice in Dallas. Mr. McGinnis can be contacted at Tim.McGinnis@willis.com or 972-715-6263. Mr. DeLaRue can be contacted at delarue_dm@willis.com or 972-715-6216.

Perspectives

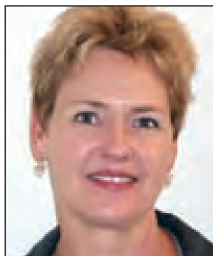
INSURANCE CONTRACTS FOR CONSTRUCTION COVERAGE is tricky, as it is tied to obligations from the owner to the general contractor and from the general contractor to the subcontractors. Various levels of coverage and indemnification apply at all levels. Here, Mary Ann Krautheim, client strategy officer for Aon Risk Solutions' construction services group, describes how to navigate this continually changing issue.

Building the right coverage

By Mary Ann Krautheim

The best risk managers work with their brokers and insurers to obtain the broadest possible coverage for their risks. For risk managers in the construction sector, this may not be enough to assure that coverage is intact or aligned with contractual requirements of all parties, both upstream and downstream.

Construction claims can be tricky to sort out, as they are tied to contractual obligations from the owner to the general contractor, and from the general contractor to the subcontractor. Proper alignment among all parties and a clear understanding of the obligations of each party to contract is a must. Each party must also rely upon the support of the insurance policies purchased to support these obligations to the same degree as liabilities are transferred in the contract. Changes in case law have added to claims challenges for construction risk managers, resulting in the need to scrutinize contracts with owners.


Ms. Krautheim

One of the most difficult areas for a construction risk manager to navigate is the alignment of contractual obligations and the expectation of how the general liability insurance policies of each party will—or will not—apply to contractual undertakings.

Ideally, insurance provisions and contractual obligations work in concert. Contractual requirements are fairly straightforward in setting forth required insurance specifications. The contract outlines the distribution of risks between parties, in which the terms shift liabilities. More often, however, not all obligations entered into contractual agreements are commensurate with coverage. Two particular areas for review in the contract are the indemnity provisions and the request for additional insured status. Of course, statements vary and should be reviewed in relationship to the policy.

The indemnity provision in a contract transfers liability from one party to another. This pass-through may be complete or partial. In construction contracts, these agreements are routinely utilized to shift liability for potential loss occurring on the construction site or for damage that might occur after the project has been put to use. The general contractor will require subcontractors to indemnify the contractor in case of bodily injury or property damage for which the general contractor is legally responsible. General contractors consider such provisions to be essential, particularly in light of statutes enacted in many states that hold general contractors liable to injured workers, even when the general contractor is free from negligence or fault.

In some cases, a subcontractor may agree to indemnify the general contractor for bodily injury or property damage that results from or arises out of the general contractor's own negligence. Most jurisdictions have enacted legislation that invalidates broad form indemnity contracts, which would require a subcontractor to indemnify the general contractor for its sole negligence, as contrary to public policy, insofar as such provisions would induce the general contractor to engage in hazardous activity as it would be indemnified for the consequences.

The additional insured provision requires one party to obtain insurance to cover the liability of another. The policy will determine the depth and breadth of this coverage, if there is coverage at all. The additional insured language that is crafted in the contract may not be paralleled in the insurance policy. Many insurers have crafted their additional insured language that relies upon the exact transfer of liability as it is written in the contract itself.

The additional insured language of the insurance policy and contractual indemnity provisions operate independently of one another. Contract language will dictate the terms of additional insured status required. Additional insured status is determined by the policy language and is not limited by individual anti-indemnity statutes, as is the case with contractual liability.

Clear contract language

It is usually the intent of the general contractor that the insurance provided by the subcontractor be the primary coverage. That said, the contract should clearly delineate the specific intent of all parties to have the subcontractor's coverage act as primary and not contribute with the insurance provided by the general contractor. Absent specific endorsement, the other insurance provisions in the commercial general liability policies may determine that the subcontractor's coverage is excess to the general contractor's, or that the policies provide concurrent coverage, instead of providing for the treatment of limits. Regardless of the intent of the parties as expressed in the contract, the other insurance clauses of each party's policy will be applied to share coverage in some fashion.

The general contractor must be named additional insured under the subcontractor's policy by endorsement, and the endorsement must clearly state that coverage under the subcontractor's policy is primary and noncontributory. The failure of a subcontractor to maintain policy language as required by contract may be the basis of a claim for contract breach. It is imperative that the general contractor review the pertinent insurance clauses, endorsements and limits to assure contractual compliance. This may not be achieved by merely accepting a certificate of insurance, as policy language is often altered from what is generally provided in standard Insurance Services Office Inc. policies.

Many insurers have created manuscript endorsement language that is tied directly to written contract provisions. The basis of these changes is meant to avoid covering damages that were not contemplated in the terms and conditions of risk transfer afforded the contractor.

It is also important to understand that an additional insured does not always enjoy the same privileges under the policy as does a named insured. Additionally, the named insured has certain obligations under the policy relative to reporting requirements, premium payment and deductible payments. Also, only the named insured has cancellation rights under the policy.

Other considerations include:

- The additional insured endorsement may be limited to the specific language as written in the contract. The endorsement may limit the availability of coverage intended by the policy if the language is not in sync.
- The additional insured may have coverage under the policy but will lose in the ability to control defense of the claim. The insurance carrier will most likely retain this right.
- The additional insured language must be clearly stated as primary and noncontributory. This language should also be stated in the excess coverage to avoid priority of coverage disputes.

Tenders of defense must be timely to avoid late notice and other potential issues that work to the detriment of the additional insured. Many additional insured endorsements restate conditions that typically apply to the named insured to the additional insured relative to timely tender.

Limits or aggregate erosion can leave the additional insured with inadequate limits in the event of a claim.

While these technical issues have been discussed at length, it is critical for construction risk managers to frequently review best practices and all contract requirements against the appropriate policy language. For a general contractor, it is wise to carefully craft contract language to achieve the appropriate protection. This includes understanding the various iterations of additional insured endorsements.

Other considerations

Following is an example of language typically employed by general contractors:

"Subcontractor is required to add contractor as additional insured per (CG 20 10 11 85) endorsement or equivalent. If CG 20 10 11 85 is not available, CG 20 10 10 01 must be accompanied by CG 20 37 01 (or 07 04 versions). All coverage shall be primary and noncontributory with any other insurance available to contractor or owner."

This language is designed to provide the general contractor with coverage for both ongoing and completed operations. General contractors also should consider whether the limits contemplated in the contract are sufficient given the scope of work. Many general contractors have begun to require higher occurrence limits of their subcontractors as well as specified excess liability limits. The excess liability policy should ideally also name the general contractor as an additional insured on a primary and noncontributory basis. The following are additional points to consider:

- Whether the additional insured's own insurance will be excess of and not contribute with additional insured coverage regardless of any other insurance clause.
- Whether the general contractor has procured broad indemnification from the downstream party.
- Whether certificates of insurance are sufficient evidence of coverage or if the general contractor should also request copies of the additional insured endorsement. The terms of these endorsements change with individual carriers and their appetite for risk.

It is important for risk managers to take these points into consideration when drafting and reviewing contracts. It is equally important to check the general liability policy, including all relevant endorsements on an annual basis. Policies continually change, which makes it difficult for contractors to maintain a degree of confidence that all parties of the contract are in compliance or covered by their insurance policies. While the challenge is not new to the industry, it is ongoing and continually poses an obstacle for risk managers.

Mary Ann Krautheim is client strategy officer for Aon Risk Solutions' construction services group in New York. She can be contacted at mary.ann.krautheim@aon.com or 212-441-2013.

The information in the piece is not legal advice and should not be construed as such and, of course, that nothing in the article constitutes a contract of coverage and coverage is subject to underwriters' assessments of risks and the specific terms and conditions of the policy issued.

Defects: Confusion spawns legal battles

CONTINUED FROM PAGE 4

same word and definition differently with respect to construction defect.

Further exacerbating the matter is the cost of litigation for policyholders, experts say.

F. Warren Jacoby, Philadelphia-based vice chairman at Cozen O'Connor and head of the law firm's construction law and litigation practice, said "the biggest challenge right now is the cost of litigation."

"People are just tiring of the judicial process," he said. "In the court systems, you get bogged down with e-discovery and all sorts of issues, so the litigation process has become very expensive for most people."

Construction defect litigation is expensive and lengthy, as the construction industry often is forced to litigate insurance coverage issues while at the same time defending against the construction defect claim in the underlying case, said Jeffrey J. Vita, a partner at law firm Saxe Doernberger & Vita P.C. in Hamden, Conn.

Insurance solutions for construction defect claims are expensive and somewhat limited, experts say.

"There's a least one major carrier out there that is offering an endorsement that, for example, will provide coverage for construction defect under the law of the most favorable state that the policyholder does business in," Mr. Ehrlich said.

Construction defect endorsements are common, with only a few major construction markets not offering the coverage, said Paul Primavera, senior vp and practice leader of Lockton Cos. L.L.C.'s national claim advisory group in Washington.

The endorsement provides the certainty and consistency of coverage for construction defects so it doesn't change depending upon the jurisdiction, Mr. Primavera said.

"The one aspect of it that is somewhat inconsistent is the pricing, or lack thereof," he said. "The cost associated with that will depend on the appetite of the individual insurer with that particular policyholder, and also depends on the size of the policyholder if they take a retention."

While courts are trending to side with policyholders that a construction defect claim constitutes an occurrence under their CGL policies, four states have passed legislative statutes to address the issue, experts say.

Arkansas, Colorado, Hawaii and South Carolina have laws that legislate that construction defect claims constitute occurrences.

The disparity in court decisions has led the construction industry to seek relief through legislative efforts, said Willis' Mr. Armstrong, who noted that the legislation initiated and ultimately passed was "unique," in that it essentially creates statutory law on how certain CGL terms are to be applied for construction defect losses.

"State legislatures…have recognized this battleground, and they have taken it out of the courts' hands, and they've passed legislation that in various forms says faulty work does constitute an accident under a CGL policy," said Mr. Vita.

"They have done it specifically for these construction claims," he said.

Colorado was the first state to pass a law, H.B. 10-1394, in May 2010. The Legislature addressed the conflicting expectations of insureds because of the complex and lengthy endorsements and exclusions facing construction professionals, according to the bill.

"In interpreting a liability insurance policy issued to a construction professional, a court shall presume that the work of a construction professional that results in property damage, including damage to the work itself or other work, is an accident unless the property damage is intended and expected by the insured," the statute reads.

"The legislatures have stepped in to try to get some relief for the construction industry, which is so vital to so many of the states' economies," Mr. Vita said.

"You have to read the specific language of each of those four statutes because they vary significantly in what they say. But the general intent is to take this issue out of the courts' hands," he said.

Mr. Ehrlich of Aon said the effects of the legislation may create more uncertainty as states and courts continue to define CGL policy language with respect to construction defect claims.

"It remains to be seen whether that trend will spread, whether more legislatures will address that issue and attempt to resolve it by statute," he said.

"These four states have stepped up. I expect that you're going to see more states pass similar legislation in the coming year or two," Mr. Vita said.

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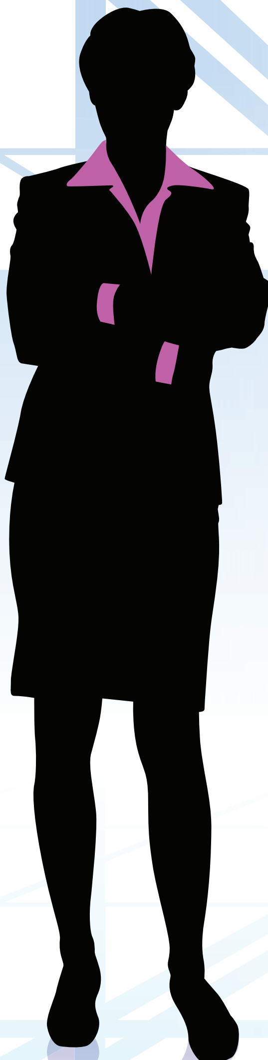

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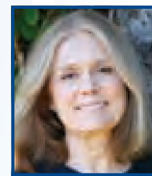

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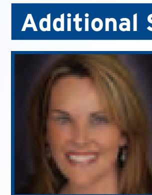

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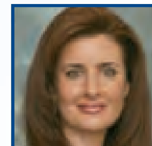

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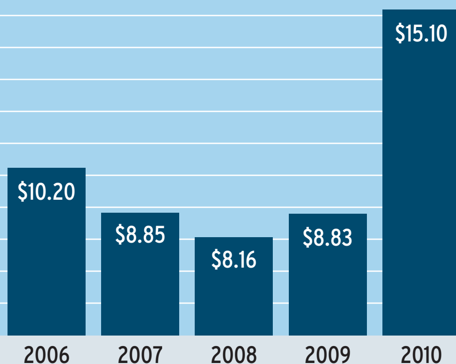
Advisen Ltd., a global insurance data and analytics provider, has been tracking commercial insurance pricing changes since 2000 in its proprietary Premium Index. Below are changes in pricing for builders risk, general liability, umbrella/excess coverage and workers compensation, according to Advisen.

BUILDERS RISK

Premiums paid per $1 million in coverage

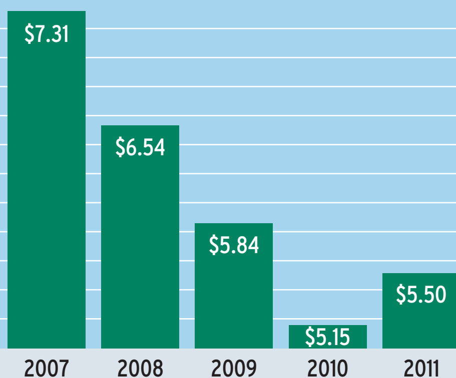


GENERAL LIABILITY

Premiums paid per $1 million in coverage

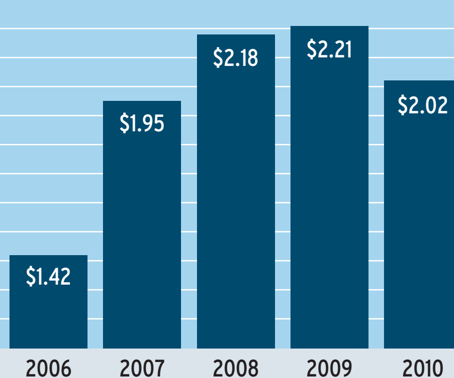
UMBRELLA/EXCESS

Premiums paid per $1 million in coverage



WORKERS COMPENSATION

Premiums paid per employee



Overview: Tough times

CONTINUED FROM PAGE 3

"We have not seen a wholesale closure of businesses or a big uptick in loss ratio," he said. In 2008, Mr. Ciullo said, "we thought it would be a bloodbath in 2011 and it would show up in surety. That hasn't happened."

He added, "We expect failures to increase when the economy picks up" as weakened contractors can't qualify for surety and lose business that becomes available.

Michael Bosse, chair of law firm Bernstein Shur Sawyer & Nelson P.A.'s construction practice group in Portland, Maine, said that with money tighter, contractors are operating with fewer and often less-skilled employees.

"In my practice in the past couple of years, I've seen many more performance bond claims than I ever had before," he said. As a result, contractors have not been able to get bonding, "which cuts them out of a large sector of government work," he said.

Sources including Ken Simonson, chief economist at Associated General Contractors in Washington, predict this year's overall construction spending will be flat to down slightly. Spending on public works will decline with the end of federal stimulus funding and the completion of hurricane-related work and projects including military base realignment, Mr. Simonson says.

State and local governments, which depend on property taxes, will have less money to spend on needed infrastructure repair, including roads and bridges. "Our sense is there will be an increased move toward public/private partnerships" involving builders financing part of that work, said Mr. Anderson.

Versions of that model, known as P3, in which architects, engineers and builders partner in a risk-bearing consortium, are popular in Europe and Canada and "is starting to take hold in the U.S.," added Henry Lombardi, executive vp for Aon Risk Solutions' construction services group in New York. But the model creates challenges for insurers, who are trying to develop coverages for those projects. Each state has different legislation for these partnerships and "there is no uniformity in contracting," he said.

Sources said there are signs the industry will recover in certain segments beginning in 2012. Apartment construction was up 13% in August from a year ago, with 12-month multifamily housing starts up 55%, Mr. Simonson said.

Improvement also is expected in the energy and power sector—oil and gas structures, pipelines, renewable energy including wind and solar, and shale deposits of natural gas; deep port construction, tied to the widening of the Panama Canal; manufacturing, which includes construction of large data centers; health care; warehouses; and endowed facilities including colleges.

Professional Marketplace

REQUEST FOR PROPOSAL

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Santa Clara Valley Transportation Authority (VTA) seeks proposals from qualified firms to provide Workers' Compensation Claims Third Party Administration Services and Managed Care Services. Parties interested in obtaining a copy of this Request for Proposals may do so by accessing the VTA website at www.VTA.org. All parties are asked to register on the website so that they may be automatically notified of any changes to the RFP document. Requests for a printed copy of the RFP may be emailed to patty.ferguson@vta.org or faxed to (408) 955-9729. Please include the following information:

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A Pre-Proposal Conference is scheduled for 10:00 a.m. PST on Thursday, December 1, 2011 in Building A, Conference Room 109, 3331 N. First Street, San Jose, CA 95134. Proposals are due by close of business on Thursday, December 15, 2011.

For 2012 *BI* Rates or Editorial Calendar call Monique at 212.210.0129

LEGAL NOTICE

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE PETITION OF DAN YORAM SCHWARZMANN, AS ADMINISTRATOR OF FOLKSAM INTERNATIONAL INSURANCE COMPANY (UK) LIMITED, DEBTOR IN A FOREIGN PROCEEDING
CASE NO. 02-14070 (SCC)

NOTICE IS HEREBY GIVEN THAT ON OCTOBER 26, 2011, THE BANKRUPTCY COURT ENTERED AN ORDER (THE "ORDER") CONTINUING THE PRELIMINARY INJUNCTION ORDER PURSUANT TO 11 U.S.C. §304 ORIGINALLY ENTERED IN THIS CASE ON SEPTEMBER 9, 2002. THE ORDER SHALL REMAIN IN EFFECT PENDING A HEARING SCHEDULED FOR APRIL 25, 2012 AT 10:00 A.M. (THE "RETURN DATE") BEFORE THE HONORABLE SHELLEY C. CHAPMAN, UNITED STATES BANKRUPTCY JUDGE, IN THE UNITED STATES BANKRUPTCY COURT LOCATED AT ONE BOWLING GREEN, NEW YORK, NEW YORK. ALL PAPERS SUBMITTED FOR THE PURPOSE OF OPPOSING THE CONTINUATION OF THE ORDER AFTER THE RETURN DATE SHALL BE FILED WITH THE COURT, WITH A COPY TO THE CHAMBERS OF THE HONORABLE SHELLEY C. CHAPMAN AND SERVED ON COUNSEL FOR THE ADMINISTRATOR LISTED BELOW, SO AS TO BE RECEIVED AT LEAST FOURTEEN (14) DAYS PRIOR TO THE RETURN DATE. ANY PERSON WISHING TO OBTAIN A COPY OF THE ORDER SHOULD CONTACT COUNSEL TO THE ADMINISTRATOR.

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE PETITION OF ROLF ÅBJÖRNSSON, AS OFFICIAL RECEIVER OF ATERFORSAKRING AB LUAP, DEBTOR IN A FOREIGN PROCEEDING
CASE NO. 03-10945 (SCC)

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MF Global coverage led by HCC Holdings

HCC Holdings Inc. is the primary directors and officers insurer for MF Global Holdings Ltd., the securities firm that had been headed by former New Jersey Gov. Jon Corzine that is now in bankruptcy. MF Global has $250 million in coverage, and the insurer has posted $25 million in connection with the account, according to a market source. A unit of Willis Group Holdings P.L.C. is the broker, the source said. Block & Leviton L.L.P. has filed a purported class action suit in connection with the bankruptcy, charging violations of securities laws on behalf of MF Global's common stockholders from May 20, 2011, through Oct. 28, 2011.

Insurance rates still soft in most sectors

Insurance rates continue to be soft across most sectors, according to Jardine Lloyd Thompson Group P.L.C., which said it had seen strong organic growth from its risk and insurance business from Latin America and Asia, but that conditions in more developed markets, such as Europe, have been more challenging. Meanwhile, MarketScout reported that property/casualty insurance rates remained flat in October.

401(k)s would be hit hard by changes

Many 401(k) participants likely would see lower account balances if federal lawmakers implement a pair of proposals aimed at changing the tax treatment of 401(k) retirement plans, according to a study by the Employee Benefit Research Institute. The study said the measures could significantly erode retirement accounts for workers and force low-income households to decrease or eliminate future retirement contributions.

Cat bond issuance down 23.5%

Catastrophe bond issuance was down 23.5% to $2.28 billion during the first nine months of this year compared with the same period last year, according to a report by Willis Group Holdings P.L.C.'s Willis Capital Markets & Advisory operation. It said the decrease "can be largely attributable" to catastrophe losses during the first half of the year and changes in catastrophe models. During the third quarter of the year, though, four cat bond issuances in five tranches brought $676 million in new capital into the market.

Insurers ordered to refund $114.5M

Eleven health insurers have been ordered to refund $114.5 million to policyholders in New York under minimum medical spending requirements similar to those being enacted nationwide under health care reform beginning this year. The refunds will be paid to holders of group and individual health insurance policies that cover 573,748 people in New York.

SCIF expects to see 1% rate decrease

The California State Compensation Insurance Fund expects to see a 1% average decrease in collectible premiums under a new rating plan filed with the state Department of Insurance. SCIF said it plans to maintain its overall rate level, but will adopt "rate relativity" adjustments from the California Workers' Compensation Insurance Rating Bureau for new and renewed policies effective Dec. 1.

Errors & Omissions

- An In Brief item in the Nov. 7 issue misspelled the name of Florida Insurance Commissioner Kevin M. McCarty.
- In the Nov. 7 issue, a company featured in the Best Places to Work in Insurance feature was misidentified. The correct name of the company is United Heartland.

Liability: Contractors seeking coverage

CONTINUED FROM PAGE 6

certain carriers will respond differently to exposures within their policies."

David Grigg, New York-based vp of construction professional liability for XL Insurance, a unit of XL Group P.L.C., said, "We have base forms," but there is generally "quite a lot of tailoring in those base forms to meet the particular requirements of our individual contractor accounts."

Observers generally characterize contractors' professional liability as low-frequency, high-severity.

"The coverage is generally viewed more as a cat cover," said Mr. Grigg.

"When something goes awry, it's generally pretty bad," said Mr. Coe.

The market is segmented, with some insurers focusing on large contractors and others on the small or midsize markets. Zurich, for instance, will offer up to $50 million in coverage, said Mr. Davis. Liberty Mutual offers coverage for mid-market firms typically in the $5 million to $10 million range, Mr. Pigault said.

While insurers generally will not provide more than $50 million of capacity individually, much higher towers can be built through excess layers, observers say.

Mr. Slivka said there are about six to eight insurers "who have been doing it for some time and know what they're doing." Then, "you have a handful that get into it and think they know what they're doing," but there is a "lack of commitment, and they either get out or pull back."

Mr. Hartman noted the contractors professional liability market is in marked contrast to the longer-established architects and engineers market, in which some 50 insurers participate.

Mr. Grigg said in terms of rates, "The professional lines generally throughout the last few years have held up better than many property and casualty product lines." While there has certainly been price softening, "it's a product line which has held up pretty well."

"I would like to see some rate increases, but I think the competition's preventing that from happening," said Mr. Jurss. Unless there has been a significant loss-adverse scenario, most business "tends to be pretty flat and, in most instances, declining," he said.

Mr. Coe said he anticipates the market will remain competitive "as much in terms of coverage and terms" as in pricing.

Observers say the market is still developing. "It's a relatively new area of professional liability," said Mr. Slivka. Claims are being paid, but "you still don't have the number of claims to bring some certainty to the insurance and the price of the insurance."

For general liability or workers compensation lines, for instance, "you've got so much data, those lines of insurance can bring some certainty to pricing." But in this area, "there's not a lot of data when it comes to claims information."

Underwriting: Insurers eye project losses

CONTINUED FROM PAGE 6

ject.

"Some courts are now paying more attention to who agreed to do what with whom," Mr. Stanovich said of how endorsements are being interpreted.

Limitations on additional insured coverage have carriers taking a closer look at whether subcontractors hired by insured contractors can cover project losses, said Michael Hastings, Atlanta-based national project insurance practice leader for Marsh Inc.'s national construction practice.

"Because insurers are not necessarily confident that those subcontractors will have adequate coverage or will not have gaps in coverage, they are sometimes requiring a list of subcontractors, and they want to have the right to audit the insurance maintained by subcontractors that are on a project," Mr. Hastings said.

Industry experts say the restrictions have begun to push the use of owner- or contractor-controlled wrapup programs for large projects, which provide consistent general liability coverage for all parties involved.

"Really you're looking for the efficiency of risk engineering, as well as consistent contract language and limits…as opposed to individual policies being presented by hundreds of different subcontractors and hundreds of different insurers," said Geoffrey Hall, New York-based senior vp of ACE USA's construction industry practice group.

In addition, experts say changing project delivery models also are affecting ways in which insurers underwrite projects.

Integrated project delivery, a model in which owners, architects and contractors work under one contract to collaboratively design and build developments, is being used to help improve development efficiency.

Such agreements, while seen as beneficial in project construction, can make it difficult to determine which party is liable if a project goes wrong, Mr. Hastings said.

"Under IPD, claims of poor project delivery or poor performance that would traditionally be brought by the project owner against the design or construction team are blurred by a collaborative design process, and typically precluded by the multiparty agreement," he said.

Public-private partnerships, in which projects are developed collaboratively between privately owned companies and governmental groups, also have become more popular in recent years and pose unique coverage issues, said Karen Schwartzkopf, Minneapolis-based senior vp of construction for Zurich North America.

Several such developments have gotten under way in the past year, Ms. Schwartzkopf said, including the $1.1 billion Port of Miami Tunnel project under construction in Florida and the $1.6 billion Eagle P3 commuter rail project being developed in Denver.

The development model is becoming more popular as cash-strapped public entities seek to finance needed infrastructure upgrades. But private companies may have liability that extends beyond the project construction, since they often agree to operate or maintain projects for a period of time after their completion, Ms. Schwartzkopf said.

"Unique to every contract, you have to look at what the allocation of risk provision is and what are the risks assumed under that contract," she said.

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End Page

Company faces clash with Titan

Mostly known for carving through defensive lines, Tennessee Titans running back Chris Johnson reportedly is taking on an offensive effort of a different sort.

According to a report by the celebrity news website TMZ.com, Mr. Johnson is exploring legal action against the makers of a plastic replica of the star player's signature dreadlocks. The product, called "Dreads on a Stick," consists of synthetic black dreadlocks attached to, well, a stick. The packaging, according to TMZ.com, featured unauthorized uses of Mr. Johnson's name and likeness.

According to the website's report, Mr. Johnson was furious about the product and worried that his fans would be tricked into believing he had formally endorsed it.

"My lawyers are on it," Mr. Johnson reportedly told TMZ.com. "The site is already shut down, and I'm investigating to see if these guys made any money off of this deceptive scheme."

One of the makers of the product also reportedly spoke to TMZ, claiming that he and his company had "been involved with Chris Johnson and his business team for the last six months."

AP PHOTO

Mr. Johnson

AP PHOTOS

Lindsay Lohan (left) claims rapper Pitbull (above) exploits her name in the song "Give Me Everything." The rapper reportedly filed a countersuit against Ms. Lohan.

Lindsay Lohan asks court to muzzle rapper Pitbull

Lindsay Lohan is sick and tired of people saying what they want about her, so this time she is on the other side of the courtroom—as a plaintiff.

The actress is suing rapper Armando Christian Perez, known as Pitbull, for allegedly defamatory lyrics that caused irreparable harm, according to news reports.

The lyrics in question tie Ms. Lohan to her legal troubles, where most recently she is serving 120 hours of community service at a Los Angeles morgue as part of a shoplifting sentence, according to reports.

In the suit, which was filed in a county court in New York in August, Ms. Lohan claims the rapper exploits her name in the song "Give Me Everything," where he rhymes, "Hustlers move aside, so I'm tiptoeing to keep flowin'/I got it locked up like Lindsay Lohan," according to news reports.

But the performer reportedly filed a countersuit against Ms. Lohan, claiming that the actress has damaged her own reputation with her numerous run-ins with the law.

The countersuit also questions whether Ms. Lohan is a resident of the state of New York and has falsely attested to her residence, according to news reports.

With experience as a plaintiff and defendant, and all her legal woes, perhaps Ms. Lohan might decide to pursue a career in criminal law.

Firm says ex-worker a risk taker

Irony was defined when a risk management professional allegedly pilfered confidential data when she left her company.

Computershare Ltd. this week confirmed that the confidential data taken by its former employee was not shareholder data, as originally suspected, but nevertheless damaging, according to news reports.

Canton, Mass.-based investor services firm Computershare claims former employee Kathyann Pace took sensitive company information when she did not return the company's laptop computer after she resigned, according to a suit filed in federal court in Boston in February.

Ms. Pace was a risk analyst in Computershare's enterprise risk management and internal audit department from 2007 to 2010, according to court documents.

The suit reportedly was filed to force Ms. Pace to return the company's electronic equipment.

But Ms. Pace, who signed a confidentiality agreement, said she lost the portable storage thumb drive that she had copied the files onto, according to court documents.

Computershare is suing Ms. Pace for injunctive and monetary relief for violations against the Computer Fraud and Abuse Act, conversion and breach of contract.

The company must be hoping that the former employee did not take its moniker literally.

ALDRIN'S LAWSUIT DISAPPEARS INTO THIN AIR

Astronauts successfully protect millions of dollars in equipment when they launch into space, but guarding their own images may be another matter.

Astronaut Buzz Aldrin has lost a lawsuit in which he charged New York-based The Topps Co. Inc. with improperly using his image in a series of historic trading cards, according to reports.

U.S. District Judge Dean D. Pregerson in Los Angeles ruled Sept. 27 that Topps' use of photographs from the Apollo 11 moon mission was protected as "free speech of an issue of public interest," according to the Los Angeles Times. Mr. Aldrin had argued Topps' use of his image was "unprotected commercial speech."

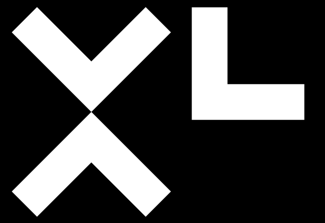
Mr. Aldrin is appealing the decision to the 9th U.S. Circuit Court of Appeals in San Francisco.

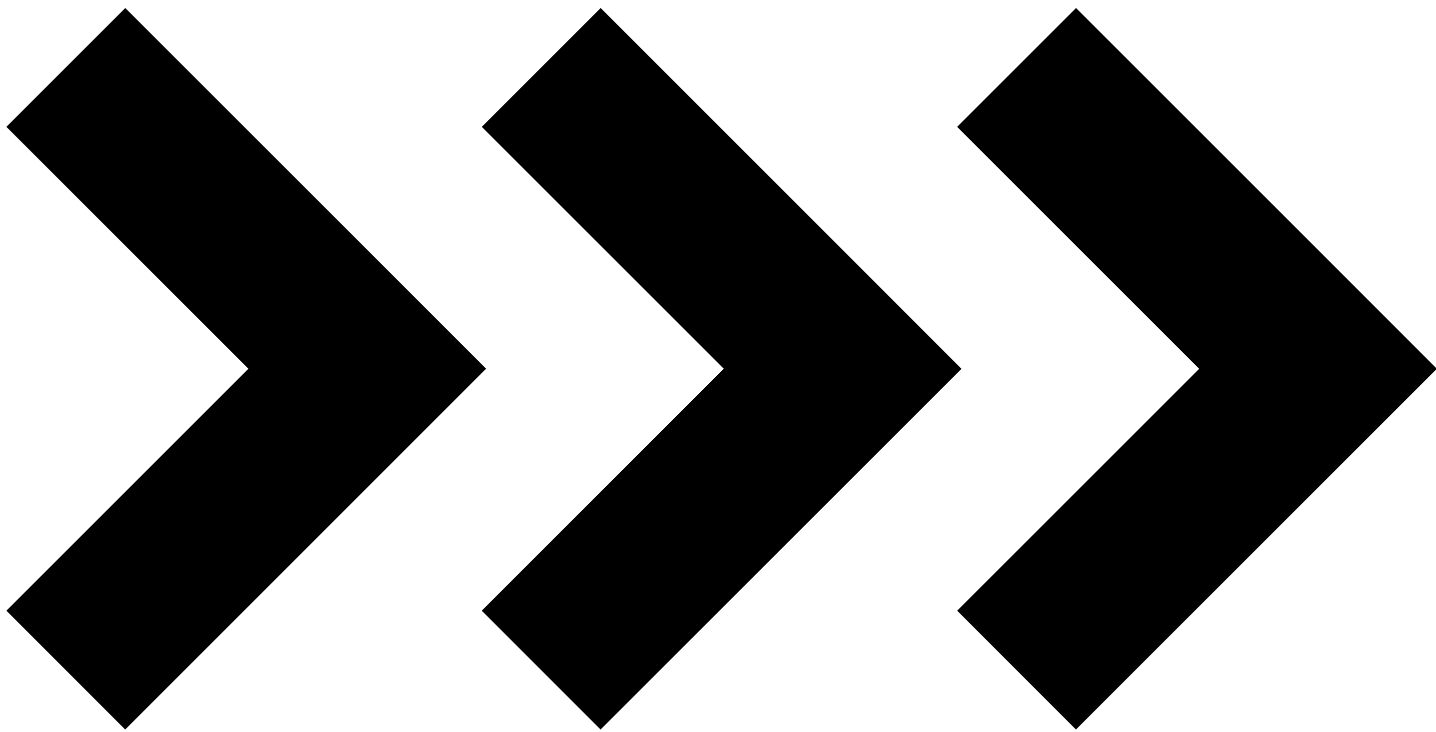
The "Topps American Heritage" 2009 series of trading card includes hundreds of images of well-known American politicians, actors, athletes and events, including a photograph of Mr. Aldrin taken during his historic mission.

This is not the first such case. In 2010, astronaut Bruce McCandless II filed suit against New York-based Sony Music Entertainment and New York-based Getty Images (US) Inc., among others, charging they had misappropriated his image for commercial gain and had refused to compensate him for its use.

The defendants had used a picture of him taken while he traveled 320 feet from the space shuttle on the first untethered flight for the cover of female vocalist Dido's 2008 album, "Safe Trip Home." The suit was subsequently amicably settled, according to reports.

AP PHOTO





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DRIVEN PRODUCERS

THE BUSINESS OF BETTER BROKING

INSIDE THIS ISSUE

Productivity in profile

Mid American Group, Frank Crystal & Co. and BB&T Insurance Services top their respective categories. page **2**

CIAB seeks growth, talent

Q&A with David McGurn, newly elected chairman of the Council of Insurance Agents & Brokers, on attracting the next generation of talent. page **8**

M&A activity heats back up

M&As are picking up as sellers strong enough to wait for improved market conditions and buyers with an eye for quality join forces. page **9**

Recruiting the best and brightest

Brokers must know how to sell the industry and themselves, and should develop programs that will ensure the success of new hires. page **12**

Perspective: Stay focused on value

Agency and brokerage mergers and acquisition are on the upswing, but with this new demand comes a need for an emphasis on value, says OPTIS Partners' Timothy J. Cunningham. page **14**

Business growth in tough times

IMPROVING PRODUCTIVITY in the current economy is a tough task for nearly every business sector, particularly so for businesses such as insurance brokerages that differentiate based on service. As clients find their own resources stretched, they are leaning increasingly on their key insurance advisers to find cost-effective solutions that won't leave them high and dry when losses flow in. To achieve this difficult task, brokers have to make smarter use of their resources and watch their own expenses, while providing top levels of service and expertise at the same time.

In this special supplement to *Business Insurance*, we spotlight the most productive insurance brokers operating in the United States and examine what the top achievers are doing that enables them to grow their business when so many of their competitors are finding it hard to keep pace.

Growth through acquisition clearly is a path that many brokers are taking to grow their businesses as 2011 shapes up to be standout year for acquisitions. But investing in talent by securing the services of proven producers and harnessing the potential of young talent for the insurance broking sector is a key task for all firms striving to succeed in difficult times.

The combination of all these strategies is helping the most productive brokers further gear up their operations and grow their businesses despite all the challenges they face.

—Gavin Souter, Editor

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By the numbers, property to premiums pages **15, 16**

Technology key to success for Mid American

By Russ Banham

WESTMONT, Ill.—Once again, Mid American Group Inc. tops the list as the most productive broker in the United States—for an impressive sixth year in a row. How does the company do it again and again?

Michael Booth, executive vp of the Westmont, Ill.-based insurance brokerage and employee benefits consultancy and administrator, chalks it up, in part, to leveraging best-of-breed technology to operate with the greatest efficiency possible.

"We look at ourselves as technical brokers," said Mr. Booth, who was regional vp of sales for the human resources/payroll division of Ceridian Corp. before joining Mid American. "Most everyone here, including myself, comes from a technical background. We're a highly technical organization, and this guides us to acquire the latest and greatest versions of technology solutions to increase our efficiency in providing our products."

As an example, Mr. Booth noted the firm's continual investments in Web-based human resources information system tools to manage Mid American's payroll, benefits administration, open enrollment and compliance, and in turn leverage this system for its mid-market clients' needs, as well.

For instance, it administers health care flexible spending accounts and COBRA continuation coverage in-house with the Web-based technology for clients.

Mid American also has invested in mobile electronic solutions that allow its field underwriters to interact with the insurer community, whether in the office, on the road or at the client's location.

It also continually beefs up its actuarial services to clients. In the past year, the firm drew hundreds of clients and prospects to actuarial seminars on health care reform and the feasibility of self-insuring. "The feedback was overwhelmingly positive," Mr. Booth said.

Add it up with other cost-saving and productivity-building measures, and Mid American breaks the tape once again. With $5.8 million in revenue last year generated by a staff of 15, this works out to $386,743 in revenue per employee of the firm.

Behind these numbers, however, is the impact on the firm's clients. Mid American's efficiency equates to more dollars that can be directed toward client services.

"We've taken this machine of incredible productivity and efficiency internally and geared it up to provide more and better services for our clients, which then equates to greater client retention," Mr. Booth said. "In other words, by being the most productive and efficient broker, this translates into providing what we consider to be the best value-added services in the brokerage community."

"Our clients are confident in our ability to get the job done, as they know they have an efficient partner working for them," he added. "By being the most productive, it also allows our people to focus their efforts on educating and consulting our clients on their cost-reduction strategies and compliance needs."

Mr. Booth

MID AMERICAN GROUP INC.
Westmont, Ill.

2010 BROKERAGE REVENUE: $5.8 million
EMPLOYEES: 15
REVENUE PER EMPLOYEE: $386,743

Some other productivity enhancements in the recent past that may help the brokerage in the future include its Performance Standards Fiscal guarantee, a service-level agreement promising that the firm will meet all client-oriented deadlines, such as those involving renewals. It even guarantees that employees will return a phone call within 24 hours.

Not surprisingly, Mid American has implemented technology in-house to ensure accountability in this regard. "If we happen to miss a deadline, there are teeth in the agreement—a financial penalty we agree to pay," Mr. Booth said.

And they rarely pay a cent.

'WE LOOK AT OURSELVES as technical brokers. We're a highly technical organization, and this guides us to acquire the latest and greatest versions of technology solutions to increase our efficiency in providing our products.'

MICHAEL BOOTH, MID AMERICAN GROUP INC.

MOST PRODUCTIVE: ALL AGENTS AND BROKERS

Intermediaries* ranked by 2010 brokerage revenues per employee

		REVENUE/EMPLOYEE			BROKERAGE REVENUES			EMPLOYEES		
		2010	2009	% change	2010	2009	% change	2010	2009	% change
1	Mid American Group Inc.	$386,743	$349,870	10.5%	$5,801,150	$4,898,173	18.4%	15	14	7.1%
2	DataRisk L.L.C.[1]	$320,283	$296,667	8.0%	$1,921,700	$1,780,000	8.0%	6	6	NA
3	Frank Crystal & Co. Inc.	$313,167	$304,282	2.9%	$131,530,000	$129,320,000	1.7%	420	425	(1.2%)
4	Capacity Group of Cos.	$304,017	$289,331	5.1%	$60,195,269	$55,262,173	8.9%	198	191	3.7%
5	Mesirow Insurance Services Inc.[2]	$277,764	$282,655	(1.7%)	$87,495,570	$89,036,480	(1.7%)	315	315	0.0%
6	BKCW L.P. dba Bigham Kliewer Chapman & Watts Insurance	$262,852	$255,314	3.0%	$6,834,140	$6,382,847	7.1%	26	25	4.0%
7	Bollinger Inc.	$261,553	$253,279	3.3%	$116,391,174	$106,123,953	9.7%	445	419	6.2%
8	Conner Strong & Buckelew Cos. Inc.	$252,452	$249,066	1.4%	$70,939,000	$68,244,000	3.9%	281	274	2.6%
9	Alliant Insurance Services Inc.	$249,068	$311,507	(20.0%)	$357,661,650	$352,314,100	1.5%	1,436	1,131	27.0%
10	Frenkel & Co. Inc.	$242,279	$231,605	4.6%	$55,481,947	$54,427,247	1.9%	229	235	(2.6%)
11	Western Benefit Solutions L.L.C.	$241,895	$299,500	(19.2%)	$4,596,000	$4,792,000	(4.1%)	19	16	18.8%
12	Graham Co.	$236,087	$226,792	4.1%	$34,940,811	$36,513,491	(4.3%)	148	161	(8.1%)
13	Integro USA Inc.	$235,190	$219,444	7.2%	$80,670,000	$63,200,000	27.6%	343	288	19.1%
14	Beecher Carlson Holdings Inc.	$229,252	$197,411	16.1%	$94,680,900	$95,744,200	(1.1%)	413	485	(14.8%)
15	Associated Financial Group L.L.C.	$228,839	$234,439	(2.4%)	$51,259,900	$52,045,467	(1.5%)	224	222	0.9%
16	USI Holdings Corp.	$226,450	$222,540	1.8%	$632,249,000	$628,009,000	0.7%	2,792	2,822	(1.1%)
17	Woodruff-Sawyer & Co.	$226,417	$227,907	(0.7%)	$65,208,200	$58,800,000	10.9%	288	258	11.6%
18	Assurance Agency Ltd.	$221,871	$203,199	9.2%	$44,818,000	$39,827,000	12.5%	202	196	3.1%
19	Benefit Controls Cos.	$221,765	$297,458	(25.4%)	$18,850,000	$17,550,000	7.4%	85	59	44.1%
20	William Gallagher Associates Insurance Brokers Inc.	$220,973	$227,352	(2.8%)	$43,752,710	$44,333,721	(1.3%)	198	195	1.5%
	Average	$257,946	$258,981	(0.4%)	$98,263,856	$95,430,193	3.0%	404	386	4.5%

*Reflects U.S. agents and brokers in *BI* directory deriving a majority of revenues from commercial retail brokerage or employee benefits. 1 Fiscal year ending Jan. 31. 2 Fiscal year ending March 31. NA= not applicable
Source: *BI* survey
Researched by Kevin Edison

Frank Crystal wins with client service

By Russ Banham

NEW YORK—Any broker will tell you that client service separates the winners from the losers.

At Frank Crystal & Co. Inc., client service is viewed in terms of the quality of the people providing it—and then retaining these talented individuals for their entire careers. As Jim Crystal, chairman and CEO of the privately owned brokerage, puts it, "People are our most important product."

Note that Mr. Crystal, who has more than 40 years of experience in the insurance business, did not say "most important asset." Indeed, he sees the insurance business as less about insurance products and more about developing high-quality producers and support staff to provide exemplary service to clients.

"We have a very strong emphasis here on recruiting and retaining top talent," he said. "Our employees are the 'tail wagging the dog.'"

Apparently, they are wagging it well. Among the top 100 brokers of U.S. business in the 2011 *Business Insurance* ranking, New York-based Frank Crystal & Co. is No. 1 in productivity.

Last year, the firm had $131.5 million in brokerage revenues with a staff of 420 people. This works out to a best-in-class $313,167 in revenue per employee.

Chalk up its success to those hard-working employees Mr. Crystal enthuses over. Many employees expect to spend their careers at the firm, he said, which fosters a sense of security that allows them to focus squarely on the client, not their careers.

"We give out 30-year pins here," Mr. Crystal said.

His father, Frank Crystal, started the business in 1933 in New York's financial district, then exclusively serving the brokerage needs of financial institutions. As these institutions invested capital in new ventures and expanded, the agency scaled its service and product offerings to their needs and those of their directors and officers.

Gradually, Frank Crystal & Co. expanded into other industries and regions. It provides full-service insurance brokerage, risk management and employee benefit solutions to a wide range of industries—from aviation, education and energy to manufacturing, marine and media, among others.

Under Jim Crystal's leadership, Frank Crystal & Co. serves more than 9,500 clients from its corporate New York headquarters, with offices in Washington as well as California, Florida, Oregon, Pennsylvania and Texas. It also continues to spread its wings, recently expanding its Miami and Los Angeles operations, the latter now giving it a footprint in Southern California as it also opens offices in the San Francisco Bay Area.

Aside from its swelling revenue stream, another factor in the firm's productivity is its status as a privately held business, Mr. Crystal said. "In a private company, you can reinvest as you think it is important and where this is important," he said. "We don't have to manage quarterly earnings per share for shareholders' benefit."

Rather, the broker avoids the topsy-turvy stock market and the capital strain this creates. Thus, it can preserve the high level of service provided to clients and the careers of those providing this service, while maintaining control over its expenses. Like all brokers, Frank Crystal continues to seek ways to reduce expenses—without tossing the baby out with the bathwater.

"We're a little bit more tightly controlled, so we therefore have the ability to react to a positive or negative event quicker," Mr. Crystal said.

"The management committee here can drill down to all areas, whether it's underwriting, sales, product line or technology, to scrutinize where we stand at that moment," he adds. "Nothing gets ignored. If it seems expenses are rising in an area, we can take immediate action to learn why. If needed, we can resolve this quickly. It's not easy to make changes fast when you're a monolithic public company."

Jim Crystal

FRANK CRYSTAL & CO. INC.

New York

2010 BROKERAGE REVENUE: $131.5 million

EMPLOYEES: 420

REVENUE PER EMPLOYEE: $313,167

He also said that having a long-term relationship in the brokerage business is crucial. "We aspire to de-transactionalize and de-commoditize the business to where the client feels we are a de facto business aide," Mr. Crystal said. "And we do this by matching them up with the producers who are best suited to handling their accounts."

Producers assist commercial accounts with more than just insurance. Frank Crystal provides consultative services that run the typical gamut and even include the ramifications of various taxes and health care reforms on a client's business. "In this weak economy and soft market, clients are eager for solid advice," Mr. Crystal said.

Down the line, he said the key to staying productive is for Frank Crystal & Co. to maintain its private status, still seeing it as a family business. "I don't want to take a swipe at public companies—it's just a different type of transaction," he said. "I'm on the boards of several public companies; and when you're huge, it is hard to turn the cruise ship around quickly."

In a sales-driven service industry, said Mr. Crystal, "I just happen to believe that being private and lean is a better model."

MOST PRODUCTIVE: LARGEST PRODUCERS OF U.S. BUSINESS

Intermediaries* ranked by 2010 brokerage revenues per employee from U.S.-based clients

		REVENUE/EMPLOYEE			BROKERAGE REVENUES			EMPLOYEES		
	Company	2010	2009	% change	2010	2009	% change	2010	2009	% change
1	Frank Crystal & Co. Inc.	$313,167	$304,282	2.9%	$131,530,000	$129,320,000	1.7%	420	425	(1.2%)
2	Capacity Group of Cos.	$304,017	$289,331	5.1%	$60,195,269	$55,262,173	8.9%	198	191	3.7%
3	Mesirow Insurance Services Inc.[1]	$277,764	$282,655	(1.7%)	$87,495,570	$89,036,480	(1.7%)	315	315	NA
4	Bollinger Inc.	$261,553	$253,279	3.3%	$116,391,174	$106,123,953	9.7%	445	419	6.2%
5	Conner Strong & Buckelew Cos. Inc.	$252,452	$249,066	1.4%	$70,939,000	$68,244,000	3.9%	281	274	2.6%
6	Alliant Insurance Services Inc.	$249,068	$311,507	(20.0%)	$357,661,650	$352,314,100	1.5%	1,436	1,131	27.0%
7	Frenkel & Co. Inc.	$242,279	$231,605	4.6%	$55,481,947	$54,427,247	1.9%	229	235	(2.6%)
8	Graham Co.	$236,087	$226,792	4.1%	$34,940,811	$36,513,491	(4.3%)	148	161	(8.1%)
9	Integro USA Inc.	$235,190	$219,444	7.2%	$80,670,000	$63,200,000	27.6%	343	288	19.1%
10	Beecher Carlson Holdings Inc.	$229,252	$197,411	16.1%	$94,680,900	$95,744,200	(1.1%)	413	485	(14.8%)
	Average	$260,284	$256,738	1.4%	$108,998,833	$105,018,765	3.8%	624	593	5.2%

*Reflects U.S. agents and brokers in *BI* directory deriving a majority of revenue from commercial retail brokerage or employee benefits. 1 Fiscal year ending March 31.
Source: *BI* survey
Researched by Kevin Edison

BB&T reduces costs, enhances service

By Russ Banham

RALEIGH, N.C.—For H. Wade Reece, chairman and CEO of BB&T Insurance Services Inc., earning the coveted spot of most productive broker among the world's 10 largest brokers is the sum of two intersecting events—expense reduction and service quality enhancement.

For BB&T, both are going in the right direction. "There's no magic formula—just doing things better and better," Mr. Reece said.

More than 20 years into heading BB&T's Raleigh, N.C.-based insurance operations, Mr. Reece previously worked in the firm's banking network. In fact, BB&T has been his sole job since graduating from North Carolina State University, not to mention a passion.

Known for his open, easygoing manner, the outdoorsman (and an ambassador for Trout Unlimited) approaches business much the same way as he does trying to hook a 20-pound bass—with patience.

"We have what I'd call old-fashioned expense control here. We always ask: 'Is it just nice to pay for something or really necessary?' A lot of times, we find that it really isn't necessary, and this helps to develop good expense discipline. I'd like to think our people are pretty thrifty," he said.

Last year, BB&T generated nearly $1.08 billion in revenue with a staff of 4,402 employees. Divide the latter into the former and out pops an enviable metric—$245,020 in revenue per "thrifty" employee, making the brokerage the most productive among the world's 10 largest brokers in the 2011 *Business Insurance* ranking.

Founded in 1922, BB&T is a wholly owned subsidiary of Branch Banking & Trust Co., a large, publicly traded financial services company. Its tentacles stretch across much of the United States, although its densest presence is in the country's heartland.

The broker touts more than 100 agency locations and more than 150 locations in all for insurance operations. Its services include personal and commercial lines, employee benefits, life and financial planning, surety and commercial bonds, and title insurance.

Services to clients for personal lines and small business lines adhere to a centralized operating structure—a factor in the firm's enhanced productivity, Mr. Reece said.

"We took a total quality management approach to driving higher quality levels throughout our agencies, and came to the conclusion that a centralized approach, where everything is managed out of one building (in Greensboro, N.C.), would generate improved productivity, and it certainly is," he said. "We've been able to reduce transactional and operating expenses, which gives us more financial wherewithal to invest in the sales and services sides at our agencies. We're moving the numerator into the denominator by reducing our costs, putting this into client service, which results in more sales and, ultimately, generates more revenue."

This may not sound like a magic formula, but it isn't smoke and mirrors either. A key element of BB&T's successful centralized approach is its Insurance Services Client Center in Greensboro. At the center, a staff of more than 250 handles personal lines client service and processing, flood insurance and family risk management, among other services.

On the commercial side, the staff takes care of similar services, other than flood. The staff also provides complete claims-handling services, systems support, quality assurance and administrative services. The work is not for the fainthearted—more than 300,000 telephone calls are fielded annually and more than 250,000 policies are serviced each year.

The center also provides training and development to other company employees. "We've got a player-coach model here," said Mr. Reece. "It's a flat organization, where our managers manage but also produce (business). They have their own client portfolios themselves, because we want them out 'touching' the clients. That helps them be better managers, and assists greater productivity now and in future."

The firm's size and financial clout have helped improve technology, yet another factor in its superior productivity, the longtime CEO maintains. "We could always do things better and are always looking for that," said Mr. Reece. "But, other than the client center, we've really made no big strategic shifts in the past year. We're fairly mature, I'd say."

"When you're owned by the public, we owe it to our shareholders to produce as much as we can for them at the least cost," he said. "But, truthfully, we do it more for our clients than anyone."

Mr. Reece

BB&T INSURANCE SERVICES INC.
Raleigh, N.C.
2010 BROKERAGE REVENUE: $1.08 billion
EMPLOYEES: 4,402
REVENUE PER EMPLOYEE: $245,020

'OTHER THAN THE client center, we've really made no big strategic shifts in the past year. We're fairly mature, I'd say.'

H. WADE REECE, BB&T INSURANCE SERVICES INC.

MOST PRODUCTIVE: WORLD'S 10 LARGEST BROKERS

Intermediaries* ranked by 2010 brokerage revenues per employee

		REVENUE/EMPLOYEE			BROKERAGE REVENUES			EMPLOYEES		
	Company	2010	2009	% change	2010	2009	% change	2010	2009	% change
1	BB&T Insurance Services Inc.	$245,020	$231,631	5.8%	$1,078,576,900	$1,081,485,400	(0.3%)	4,402	4,669	(5.7%)
2	Wells Fargo Insurance Services USA Inc.	$219,179	$210,592	4.1%	$1,649,538,000	$1,560,908,000	5.7%	7,526	7,412	1.5%
3	Marsh & McLennan Cos. Inc.	$207,765	$200,796	3.5%	$10,596,000,000[1]	$9,839,000,000	7.7%	51,000	49,000	4.1%
4	Lockton Cos. L.L.C.	$201,329	$197,393	2.0%	$826,857,000[2]	$765,885,000[2]	8.0%	4,107	3,880	5.9%
5	Willis Group Holdings P.L.C.	$194,118	$188,824	2.8%	$3,300,000,000	$3,210,000,000	2.8%	17,000	17,000	NA
6	Jardine Lloyd Thompson Group P.L.C.	$182,944	$157,124	16.4%	$1,137,730,760[3]	$957,983,370[4]	18.8%	6,219	6,097	2.0%
7	Brown & Brown Inc.	$182,920	$185,337	(1.3%)	$966,917,112	$964,862,833	0.2%	5,286	5,206	1.5%
8	Aon Corp.	$179,459	$204,696	(12.3%)	$10,606,000,000[5]	$7,410,000,000	43.1%	59,100	36,200	63.3%
9	Arthur J. Gallagher & Co.	$166,718	$173,952	(4.2%)	$1,789,884,000	$1,711,683,000	4.6%	10,736	9,840	9.1%
10	Hub International Ltd.	$155,424	$160,812	(3.4%)	$761,577,000	$725,262,000	5.0%	4,900	4,510	8.6%

1 Pro forma to include a full year of HSBC Insurance Brokers Ltd. 2 Fiscal year ending April 30. 3 British pound=$1.5452 (2010) fiscal year ending Dec. 31, 2010. 4 British pound=$1.5661 (2009) fiscal year ending Dec. 31, 2009. 5 Pro forma to include a full year of Hewitt Associates Inc. NA=not applicable
Source: *BI* survey

Focus on growth, talent

Growth, pricing and talent are major issues facing insurance brokers, says David McGurn, newly elected chairman of the Council of Insurance Agents & Brokers. Mr. McGurn, who also is a corporate vp of Itasca, Ill.-based Arthur J. Gallagher & Co., says preservation of the private health care system, regulatory issues and attracting the next generation of talent also are key issues for the CIAB.

Q: What are the greatest challenges for the council and its members?

A major challenge for members is growth. The economy has made it very difficult for our clients to grow organically, which also makes it difficult for our members to grow. Growth is a must.

The other challenge is soft pricing, which has impacted revenues and the need to find new business. We don't know how long the soft market will continue, but the council's latest commercial property/casualty survey indicates that, in general, rates are flattening and may be moving slightly higher. January renewals may tell a different tale.

A big internal challenge is attracting and cultivating talent. There is an age gap between existing agency leadership and the next generation of leaders that is a result of the difficulty in attracting new talent into our industry. There is also a pending knowledge gap resulting from a lack of good formalized training that supports not only the technical insurance skills needed but also the consultative sales process.

Q: What regulatory and legislative matters are a concern for the CIAB, and how do you expect to deal with them?

Our No. 1 federal legislative priority continues to be the preservation of the private market for employee benefits. Our parochial concern is preserving broker compensation, and we continue to push for a legislative and regulatory solution that would remove broker commissions from the medical loss ratio equation. But more broadly, our members are hearing directly from their clients that there is anxiety about the future of maintaining current benefit packages, should their market competitors opt to exit the health benefit marketplace once state exchanges are fully operational. Clients are consistently telling our members that they won't be the first to exit the market, but probably won't be the third, either. Of course, that has huge implications for the future of our business, and also the viability and solvency of the government exchanges.

We continue to push for passage of the National Assn. of Registered Agents and Brokers Reform Act to streamline licensing of nonresident agents and brokers, and remain hopeful that consensus among all stakeholders will enable a bill to be dropped in the Senate soon.

On the federal regulatory front, we're completely supportive of the new director of the Federal Insurance Office, Mike McRaith, and his efforts to build an office that achieves the goals and spirit of data collection without regulatory duplicity and international harmonization of insurance regulatory regimes.

We continue to monitor the states' implementation of the surplus lines reform provisions of the Nonadmitted and Reinsurance Reform Act. We are disappointed that it has not gone as smoothly as hoped, as the requirements of the law were very simple: that the home state of the insured would have sole regulatory authority over that surplus lines placement. Instead, we've ended up with multiple methods for compliance among the states. While the implementation of sweeping changes like this is never easy, we believe that once we get past some of these early bumps in the road, the reforms will benefit all those involved in the surplus lines marketplace: brokers, carriers and, most importantly, our clients.

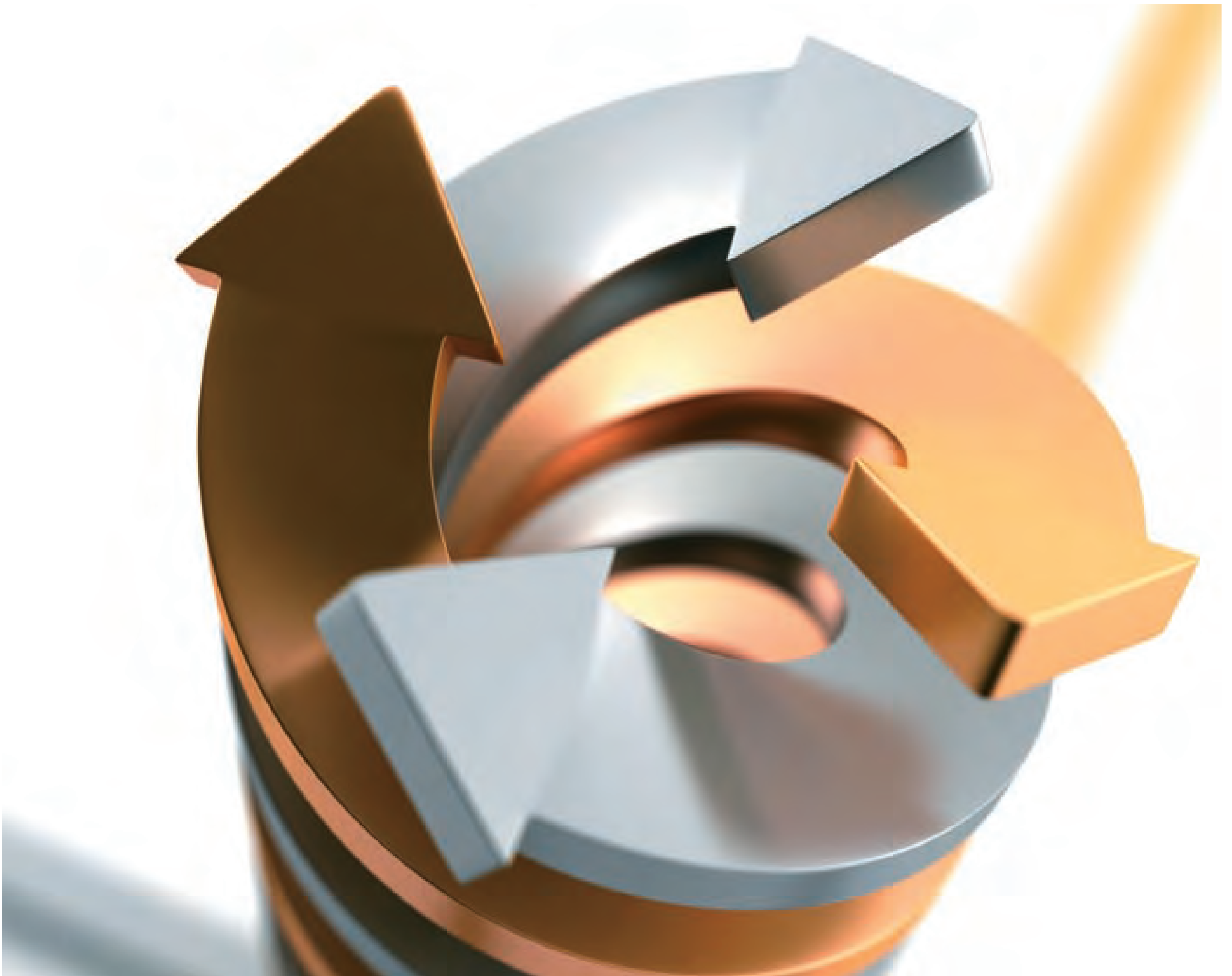
Q: How can the brokerage industry attract the brightest young people?

Actually, I believe we are getting better at attracting the best and the brightest. Many of our members have summer internships for undergraduates and entry-level programs that have become very attractive to college graduates. Also, the Foundation for Agency Management Excellence, the council's 501(c)(3) charitable foundation, has been giving more scholarships to students enrolled in insurance and risk management programs throughout the United States and beyond. These scholarships help the industry by bringing awareness to a potential career that was previously unknown to these students.

There are so many different areas of insurance that the brokerage community should be able to attract young people from almost every educational background. The career opportunities are immense.

Q: What career-building advice would you give a person entering the brokerage business?

Develop more insurance knowledge than your competitor, and understand and network the insurance underwriting community better than anyone. Treat your clients as your No. 1 priority and, with a little luck, you will be successful.



Lack of organic growth boosts M&A activity

By Roseanne White Geisel

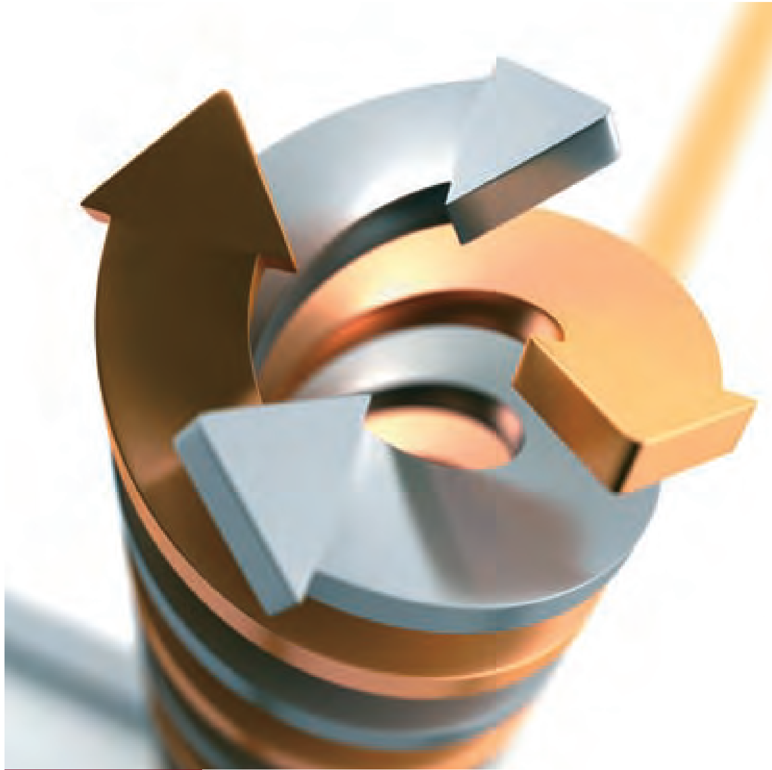
After sitting on the sidelines of the mergers and acquisitions playing field in 2009 and early 2010, insurance brokers eager to score external growth are getting back into the game, brokers and M&A specialists say.

M&A activity picked up midway through 2010, increased this year and looks to continue on pace through 2012, they say.

The transaction arena will yield some solid teams, as sellers strong enough to wait for improved market conditions and buyers with an eye for quality join forces.

"Deal activity begets deal activity," said Timothy J. Cunningham, principal and co-founder of OPTIS Partners L.L.C., a Chicago-based insurance industry consultant. "As the active buyers have come back, everyone is getting back in the game."

The reason for the increased activity is the need to pursue external growth in a market in which organic growth is difficult to achieve, noted John Wepler, president of Marsh Berry & Co. Inc. in Willoughby, Ohio. "Acquisition is not optional," he said. For that reason, 2011 is "the most robust mergers and



192

So far this year, there have been 192 broker M&As, according to SNL Financial.

acquisitions market (Marsh Berry has) ever experienced," he said.

Mr. Wepler cited figures from SNL Financial L.C.: In 2007, there were 261 broker M&As. That increased to 296 in 2008. In 2009, when the Great Recession was under way, the number of M&As dropped to 180. In 2010, there were 207 deals.

So far this year, there have been 192 broker M&As, according to SNL Financial, a number Mr. Wepler projected will surpass 250 by year's end.

Mr. Cunningham also noted a rebound. Using a benchmark of reported or announced deals, OPTIS Partners tracked 289 M&As in 2008, 173 in 2009 and 192 in 2010. With 273 deals through the third quarter of this year, he said this year's total likely will exceed 2008. 2011 "is coming back like gangbusters," Mr. Cunningham said.

Both internal and external growth are necessary for success in the current economy, brokers and consultants say. Brokers that were strong but interested in being acquired to thrive in the future have waited while the markets have been weak.

"Valuations of public brokers came down, equity firms didn't have credit for leveraged transactions, and banks were focusing on their core business" in 2008 through 2010, said Marsh Berry's Mr. Wepler. "So it wasn't a good time to sell. A number of deals collapsed. But the pendulum swung too far," he said, and brokers began to look for deals that would support their businesses.

One such broker is Hub International Ltd.

"Acquisitions are a focus for Hub right now and will continue to be in the future in this slowly improving economy, because many businesses have stopped shrinking and it's a smart time to be seeking new opportunities," said Clark Wormer, director of mergers and acquisitions for Chicago-based Hub.

Arthur J. Gallagher & Co. in Itasca, Ill., strives "to grow organically as a company because we're a sales organization," said Bill Bohstedt, corporate vp of mergers and acquisitions for the retail property/casualty side of the broker's business. "We complement that with finding merger partners," Mr. Bohstedt said.

Another broker back in the M&A market is Burns & Wilcox Ltd., based in Farmington Hills, Mich. The wholesaler was built through acquisition, noted Chris Zoidis, vp of corporate development and director of its special risk division. "We're looking to do a lot more acquisitions in 2012," Mr. Zoidis said. "We think there's going to be a lot more opportunities."

The managing general agent, underwriting manager and wholesale brokerage segments of the industry are "still very fragmented," he said. "Small independent local brokers that for the last few years thought the market would turn around and go back to 2006 levels of revenues and earnings have come to realize that the hard market is not coming back anytime soon, so now they are ready to sell," Mr. Zoidis said.

Acquisition "is an important part of growth, but we also want to grow organically," said Norman Malter, president of Chicago-based Mesirow Insurance Services Inc. "We haven't done a transaction in a few years because we haven't had the right fit," he said.

But now the management committee of Mesirow Insurance, a unit of Mesirow Financial Holdings Inc., is interested in acquisitions and would like to establish a presence outside Illinois, Mr. Malter said.

Alliant Insurance Services Inc. will announce one or more transactions before year's end, and additional deals in 2012, said Greg Zimmer, the broker's president and chief financial officer. Mr. Zimmer said internal growth remains the broker's primary strategy in a market in which "the only way a firm can grow is to take market share from others." Alliant is "not a serial acquirer," he said. "We really look for our spots."

At Marsh & McLennan Agency L.L.C., "We don't time it to some economic event," said Dave

Eslick, chairman and CEO of the Marsh Inc. subsidiary. "We make long-term, very important strategic decisions," he said. "An agency will sell to Marsh if we can show some organizational leadership to the ownership of the agency; if we can show that we can do more for their current clients, give them a great chance of gaining market share, a future for their up-and-coming leadership, and the capital to invest in growth."

The goal, he said, is to grow acquisitions' value-added capabilities and boost organic growth.

In most instances, buyers are seeking partnerships rather than a seller with one foot out the door.

"We want the leadership to be engaged and join us," said Gallagher's Mr. Bohstedt. "We are not interested in being an exit strategy."

Mesirow's Mr. Malter agreed. "We want to acquire to partner," he said. "We're looking for principals who want to stay." Because of that desire to partner, "the cultural fit" is a top priority, he said.

"The No. 1 thing we look for is the quality of the people," said Burns & Wilcox's Mr. Zoidis. "That trumps everything else. We're bringing in talent."

"Buyers are looking for brokers that play a more consultative role," Marsh Berry's Mr. Wepler said. "They are looking at the culture of new business production, sales forces and sales meetings." Also important "is a favorable age dispersion of employees."

Another important consideration for buyers is a seller's specialty.

Mr. Zimmer said Alliant is highly specialized, and "we offer expertise and advantaged products" for special industry groups. For example, he said, Alliant has 200 people in its public-entity practice. "When we walk into a public agency, we know their business," he said. "If you know an industry better than your competitors, and you have a better product to offer, you grow internally."

Any firm acquired "needs to be clearly in sync" with that strategy, Mr. Zimmer said.

On the seller side, two key motivating factors are the investment in resources that the market demands for growth and crafting a succession plan, brokers and consultants said.

These reasons are "why a local or regional broker may want access to markets we have on a nationwide basis, the technology and expertise," said Alliant's Mr. Zimmer.

"Agencies that are well-positioned in infrastructure will fare much better going into the future," said Mr. Malter. "Insurance buyers look for specialized people, specialized products and specialized infrastructure," he said. Smaller agencies might need to be acquired to meet those demands, he said.

Many independent agencies "are owned by (baby) boomers," who are near retirement age, said Gallagher's Mr. Bohstedt. They may want to join another firm to recoup some of their investment at this point in their lives, he said. They also may perceive that without an influx of resources, they will plateau and their employees won't have a career path, he said.

Marsh & McLennan Agency's Mr. Eslick said that on the employee benefits side of the business, opportunities are plentiful to acquire smaller brokers that are selling because they are unsure of their roles once more provisions of the Patient Protection and Affordable Care Act are implemented, such as state exchanges.

OPTIS' Mr. Cunningham said brokers usually are sold for a multiple of their annual earnings before interest, taxes, depreciation and amortization. The range is five to seven times EBITDA, he said. Generally, 60% to 70% is guaranteed and paid at the closing, with the balance paid in an "earn-out," which is based on future performance after the acquisition is complete.

'INSURANCE BUYERS LOOK FOR specialized people, specialized products and specialized infrastructure.'

NORMAN MALTER,
MESIROW INSURANCE SERVICES INC.

The quickened pace of mergers and acquisitions in the brokerage industry is expected to continue at least through 2012 when there is a chance that the capital gains tax rate will increase to 20% in 2013. The 15% rate, signed into law by President George W. Bush, was scheduled to sunset this year, a factor in the increase in deals that began in the second half of last year. It was renewed until 2013, so consultants say they see M&A activity staying strong at least until then.

Additionally, Mr. Wepler said, aggregate property/casualty premiums have increased about 2% year-to-date, and that improvement helps brokers' bottom lines, which in turn fuels M&A activity.

"Insurance companies have a gun to their heads," Mr. Wepler said. "They are going to have to start raising rates" to increase profits.

In Mr. Wepler's opinion, market conditions have forced "everyone in the value chain to be better at what they do and add more value to customers."

Economy offers chance to attract new talent

By Roseanne White Geisel

With the nation's economic recovery still in slow gear, insurance brokers have more opportunities to hire promising new talent and prepare them for a more robust market in the future, brokers and consultants say.

In order to use this time advantageously, brokers must know how to sell the industry and themselves, and develop programs that will ensure the success of new hires.

"The economy has had an effect on supply and demand," said Eric Hutcherson, Marsh Inc.'s New York-based managing director and human resources leader for the U.S. and Canada division. "Candidates interested in investment banks and investment management functions have become available" to the insurance brokerage marketplace as those financial services firms have curtailed hiring.

It's easier to find stellar candidates with the decreased hiring by investment banks, concurred Scott Cooper, vp and head of human resources for Aon Risk Solutions in Chicago.

Bobby Reagan, president and CEO of Reagan Consulting Inc. in Atlanta, agreed. "The pool of potential candidates is up," he said.

"Some brokers have pulled back" on hiring, Mr. Reagan said, while the view of others is that "it takes a lot of candidates a couple of years to get up to speed. By the time the (property/casualty) market picks up, they'll be ready to go."

> **'IT TAKES A LOT OF CANDIDATES** a couple of years to get up to speed. By the time the (property/casualty) market picks up, they'll be ready to go.'
>
> **BOBBY REAGAN**
> REAGAN CONSULTING INC.

Mr. Cooper said Aon never stopped recruiting during the downturn, just slowed the pace. The pipeline is important because even the brightest new hires need time before they are ready to do the work clients need, he said.

Brokers that want to hire acknowledge there is a major obstacle: The insurance brokerage industry usually does not top a graduate's list of places to launch a career.

Young people finishing their educations "have to make strategic decisions about where they are going to go," Mr. Hutcherson said. "We have to be sharp about what value propositions we articulate."

"I think the challenge is to sell (young candidates) on how exciting a career it can be. When they hear insurance, they don't see it from a broker's perspective, with all of its complexity," said Tracey Wik, vp of leadership, corporate training and communications for Arthur J. Gallagher & Co. in Itasca, Ill.

Gallagher uses its internship program to introduce college students to the industry, which Ms. Wik said offers "a great career path" but "not one that people would naturally fall into."

As students face a constrained job market, candidates are viewing their skills more broadly, Mr. Hutcherson said. That broader view means more candidates may see the potential of using their talents in the brokerage industry. It also means those job seekers would consider working in many different business sectors, so brokers are competing more with other employers to hire the best and the brightest, he said.

The brokerage industry and the individual companies in it "need to refine (their) message to attract and to retain" high-quality employees, he said.

At the forefront of that message is "the wide variety of things you can do to be successful in the industry that are going to impact the lives of people all over the world," Mr. Hutcherson said.

"We help good companies keep bad things from happening; and when bad things do happen, we make them financially able to handle it and make good decisions," he said.

Aon's Mr. Cooper said today's world provides the industry a great opportunity to sell itself. "Everywhere around us are issues of risk" and their inherent complexities, he said. The other issue is people, particularly the current health insurance concerns many businesses and individuals have as a result of reforms. "How the industry brands (those issues) to attract people is very important," he said.

It's crucial to articulate the message that draws young people to the industry, said Ms. Wik, because entry-level employees are "the lifeline of the future" and "must be groomed to be the leaders of tomorrow."

In 2009, Reagan Consulting conducted a study of 100 successful young producers. Working nationwide, "we had seen (brokerages) bring in young people successfully," Mr. Reagan said. "We wanted to show how it can work and that it does work," he said.

Additionally, Mr. Reagan said, "We wanted to help develop successful recruiting, hiring and training techniques."

The study, done with support and sponsorship from

is, people have to have strong analytical skills" to sort through risk management situations and risk financing solutions.

Once those problems are analyzed, they must be able to explain them to others. "It's very important for people in our businesses to have strong written and oral communication skills to make complicated concepts simple," whether they are speaking with a CEO, risk manager or HR executive, Mr. Hutcherson said.

Aon's Mr. Cooper added that high energy and productivity are vital traits. "The industry is fast-paced, and you've got to keep up with it," he said. Equally important is the ability to work well on a team.

The Reagan Consulting study also found that "some of the most effective recruiters develop an internship program," which provides "a low-risk, low-expense opportunity" to size up future job seekers, Mr. Reagan said.

"Matched with that is creating an environment in which (young producers) can succeed," he said. That environment should include a training program and mentoring. When a group of new hires trains together, it enables them to help each other and learn from each other. "Team young producers with more experienced producers," Mr. Reagan said.

the Council of Insurance Agents & Brokers, also helped push the message to young job seekers that opportunities await in the brokerage industry, Mr. Reagan said.

The study found that that an excellent grade point average alone does not directly correlate to success. Rather, Mr. Reagan said, candidates have to be "wired the right way" for the industry, and those right out of college can be as successful as those with a few years of experience.

The study of the young professionals generated a list of key markers of future success. In addition to good academic performance, a candidate must be outgoing, competitive, involved in extracurricular activities with some leadership roles, possess effective communication and people skills, and have the ability to "juggle a lot of balls," Mr. Reagan said.

Other brokers expanded on that list.

"We're looking for people who do well in a sales environment," said Gallagher's Ms. Wik. That potential is shown by community activity, campus leadership, the ability to build relationships and how well a person presents himself or herself, she said. A person interested in the brokerage environment also must "get over the fear of rejection or have a healthy sense of 'it's not about them.'"

Marsh's Mr. Hutcherson said, "I think the baseline

Mr. Hutcherson considers Marsh's training program and mentors among the benefits the broker offers. Research shows that employees' greatest inspiration comes from their colleagues. In addition, he said, Marsh's size and scope means it has "the ability to reinvent people's careers inside our four walls."

Agencies that have launched young success stories also found it most effective to focus them on a class of business or practice group. New hires gain expertise and credibility faster using that approach, Mr. Reagan said.

Graduates hired at Aon also are given the chance to explore whether they are best suited to brokerage, account management or an analyst role, Mr. Cooper said.

Ms. Wik foresees social media as playing an increasing role in linking Gallagher to college students and spreading the word about its internship and career opportunities.

Also important, she said, is for the brokerage industry "to include diverse populations sooner" by developing programs to introduce the industry to students in high school and in the first two years of college.

"The future pipeline has to be invested in so we never run thin on the bench," Mr. Hutcherson said. "We never stop investing in future talent."

Agency and brokerage mergers and acquisition are on the upswing as buyers recover from the hangover left by the depressed economy of recent years. But with this new demand comes a need for caution on the part of both buyers and sellers, with particular emphasis on value. Timothy J. Cunningham, a principal with OPTIS Partners L.L.C., explains.

As deals pick up, stay focused on value

By Timothy J. Cunningham

Following utterly dismal years for merger and acquisition activity in 2009 and 2010, this year is shaping up to be one of the best on record. It's possible that we'll see more announced deals in 2011 than the nearly 300 that closed in 2008. This new momentum will likely continue into 2012 and beyond.

If you are a seller, this is cautionary good news. Competition is robust, with traditionally active buyers back in the game.

But these buyers have been joined by a big wave of new buyers, some of whom are backed by private equity, others of whom are strategic, private buyers. Thus, if you are a private buyer competing with the "big boys," you'll want to be wary of increased competition and price creep.

Why this amount of deal activity? The environment is better now, despite the hangover from the past few years. We see evidence of economic recovery, albeit slow and choppy. We also see a possible firming of the property/casualty insurance market in the near future. If this occurs, buyers will benefit from future lift.

There is also evidence of pent-up demand. Due to the perfect storm created by the economic crisis and the prolonged soft insurance market, many buyers sat on the sidelines in 2009 and 2010. As a result, sellers were sidelined as well, creating a reasonably strong inventory of prospects who are now contemplating their alternatives.

Active buyers—public, bank-owned and large, private equity-backed firms—have struggled as much with organic growth as the rest of the industry. For these buyers, an alternative to organic growth may be growth through acquisition, with the resulting increased earnings as the primary driver of their value. As these active buyers acquire additional agencies, they also benefit from leveraging the discount or spread between the earnings or EBITDA multiples they use to value a target agency and the multiples at which the buyers are valued.

Value can be tricky, though. There is evidence that earnings-based multiples have expanded a bit recently. As sellers contemplate the financial consideration they might receive in a transaction, they may find that their earnings margins are down due to the previously referenced "perfect storm." With margins down, value may be down even if the earnings multiples are up modestly.

Thus, we just aren't seeing agency values equal to those of the glory days of five and six years ago. By the same token, potential sellers should not be deluded by some of the stratospheric multiples paid recently by strategic acquirers. A one-off event does not constitute a trend.

Conversely, middle-market buyers, especially those who are privately owned, should be careful not to get caught up in deal fever brought on by the recent flurry of activity. It's easy to fall into the trap of thinking that, with all the transactions closed by active buyers and others, now is the time to go on a buying spree.

Instead, work first to define your acquisition strategy. Then design a plan for implementation and determine if that plan is a prudent use of capital and other resources. Will the capital and other resources provide an adequate return? Will a similar investment of resources in an organic growth strategy provide a better return at lower risk, a slower pace notwithstanding? Consider the impact of the human capital required to roll out an acquisition strategy. Also, think of other opportunities that might be missed if attention is devoted to deal-making.

Key factors to consider when examining an acquisition target are culture, fit and sustainability of earnings. Always value a deal based on the target's earnings, never as a multiple of revenue.

Lastly, manage and share risk and reward through an earn-out or subsequent performance-based measures. But use caution: It can be impossible to completely manage a high-risk transaction or damaged target through structure and terms.

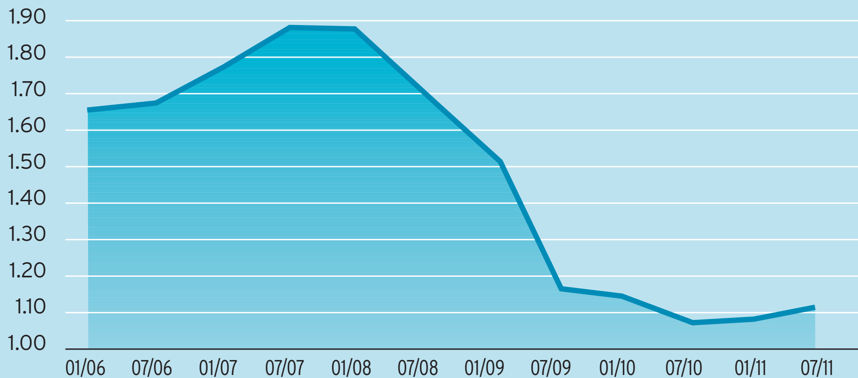
A guiding principle embraced by prudent advisors and conveyed to clients is that sometimes the best acquisition is the one you never do. Do not be lulled into complacency by the increased number of transactions, and do not attempt to win the bidding war. Those in the active-buyer group make offers on only a tiny percentage of the candidates they review—and they close an even smaller percentage of the offers they make.

If you are a potential seller, then, plan ahead for your exit by positioning the firm to maximize your value. If you are a buyer, define your strategy first and then stick with your plan. And always be prudent with your resources.

Timothy J. Cunningham is a principal with Chicago-based OPTIS Partners L.L.C. He can be reached at cunningham@optisins.com.

PROPERTY VALUES

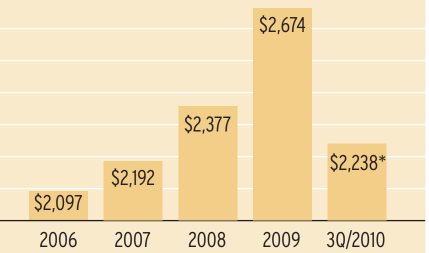
All properties, national index, in the Moody's/REAL Commercial Property Price Index



Source: MIT Center for Real Estate, Real Capital Analytics Inc.

BANKS IN INSURANCE

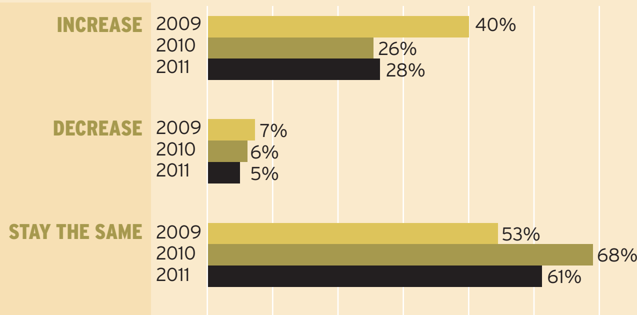
Insurance brokerage income per bank employee, 2006 through third quarter 2010



*Annualized for full year
Source: Michael White Associates L.L.C.

LEGAL DISPUTES

Ninety-two percent of U.S. respondents and 85% of U.K. respondents expect the same or more legal disputes this year, led by technology/communications and engineering/construction.



Source: Fulbright & Jaworski L.L.P. survey of 405 in-house counsel in the United States and United Kingdom

EMPLOYMENT IN INSURANCE

Employment in insurance, 2001-2010, in thousands

	Life health and medical [1]	Property/ casualty [1]	Reinsurers	Agencies and brokers	Total industry*
2001	807.7	591.3	31.4	597.9	2,233.7
2002	791.1	590.0	31.7	616.0	2,233.2
2003	789.0	608.6	31.0	628.5	2,266.0
2004	764.4	604.4	29.8	643.3	2,258.6
2005	761.9	595.0	28.8	650.1	2,259.3
2006	787.4	597.4	28.0	659.9	2,303.7
2007	784.0	586.1	27.0	675.3	2,306.8
2008	797.6	571.2	27.9	669.1	2,305.2
2009	799.7	550.2	27.5	650.8	2,264.1
2010	807.3	533.1	27.1	638.3	2,238.0

* Total includes other insurance-related activities not reflected in the chart.
1 Establishments primarily engaged in underwriting insurance policies.

Source: U.S. Department of Labor, Bureau of Labor Statistics.

PRODUCTIVITY CHANGES

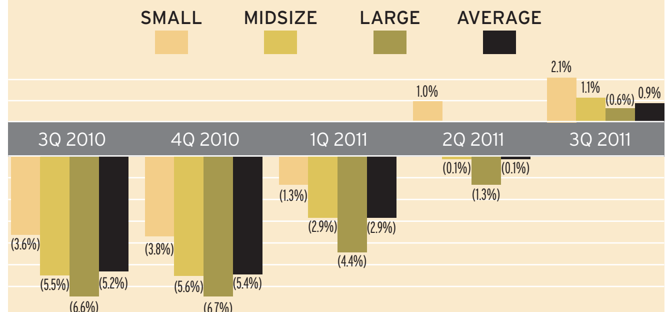
Except nondurable manufacturing, unit labor costs increased in all categories in the second quarter of 2011 as real hourly compensation fell. Year-over-year productivity increased across the board.

	Nonfarm business		Business		Manufacturing		Durable manufacturing		Nondurable manufacturing	
Sector	Q to Q	Y to Y	Q to Q	Y to Y	Q to Q	Y to Y	Q to Q	Y to Y	Q to Q	Y to Y
Productivity	(0.7)	0.7	(0.5)	0.6	(1.5)	2.4	(2.7)	2.7	1.3	3.5
Output	1.3	2.4	1.2	2.1	1.2	4.6	2.2	7.4	0.3	1.8
Hours	2.0	1.6	1.7	1.5	2.7	2.1	5.0	4.5	(0.9)	(1.7)
Hourly compensation	2.7	2.7	3.1	2.7	3.1	2.8	2.4	2.0	4.1	3.7
Real hourly compensation	(1.4)	(0.7)	(1.0)	(0.6)	(0.9)	(0.6)	(1.6)	(1.3)	0.0	0.3
Unit labor costs	3.3	1.9	3.5	2.1	4.6	0.4	5.2	(0.7)	2.7	0.1

Source: U.S. Department of Labor, Bureau of Labor Statistics

P/C RATE CHANGES, BY ACCOUNT SIZE*

On average, commercial property/casualty pricing increased less than 1% in the third quarter of 2011 vs. a 5.2% decline in the third quarter of 2010.



*Small accounts up to $25,000 in annual fees, commissions; midsize accounts, up to $100,000; large accounts, more than $100,000.
Source: The Council of Insurance Agents & Brokers, Barclays Capital Equity Research

BY THE NUMBERS

LEADING U.S. P/C RETAIL BROKERS

Ranked by 2010 commercial retail brokerage revenues from U.S. offices*

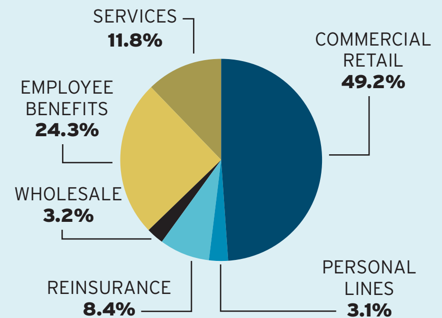
Company	2010 Revenue**	% change
Marsh & McLennan Cos. Inc.	$2,270,000,000	9.2%
Aon Corp.	1,736,000,000	2.3
Wells Fargo Insurance Services USA Inc.	1,150,661,000	9.3
Willis Group Holdings P.L.C.	1,047,000,000	(5.8)
Arthur J. Gallagher & Co.	665,635,000	2.7
BB&T Insurance Services Inc.	557,275,600	0.6
Brown & Brown Inc.	524,116,093	(4.4)
Lockton Cos. L.L.C.	411,237,000[1]	6.4
Hub International Ltd.	309,718,000	1.6
USI Holdings Corp.	242,482,000	(4.1)
Alliant Insurance Services Inc.	234,747,150	4.3
Leavitt Group	103,811,000	(8.5)
Frank Crystal & Co. Inc.	99,440,000	0.7
Integro USA Inc.	80,670,000	27.6
John L. Wortham & Son L.P.	75,539,222	(2.0)
Beecher Carlson Holdings Inc.	71,591,100	1.7
J. Smith Lanier & Co.	65,087,794	(0.3)
Hays Group Inc., dba Hays Cos.	63,700,000	3.4
Hylant Group Inc.	62,417,241	0.1
Insurance Office of America Inc.	58,872,337	4.7

*Companies that derive less than 50% of revenues from commercial retail brokerage are not ranked.
**Excludes revenue from placement of employee benefits.
1 Fiscal year ending April 30.

Source: *BI* survey

AGENTS' & BROKERS' BUSINESS MIX

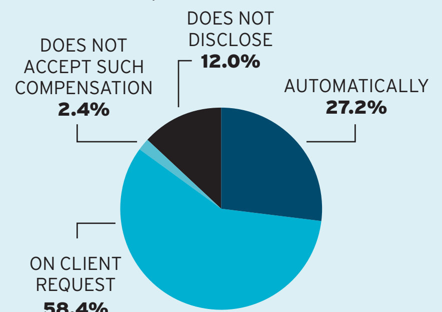
Commercial retail and employee benefits account for about three-quarters of business done by all agents and brokers in the *Business Insurance* directory.



Source: *BI* survey

SUPPLEMENTAL COMPENSATION

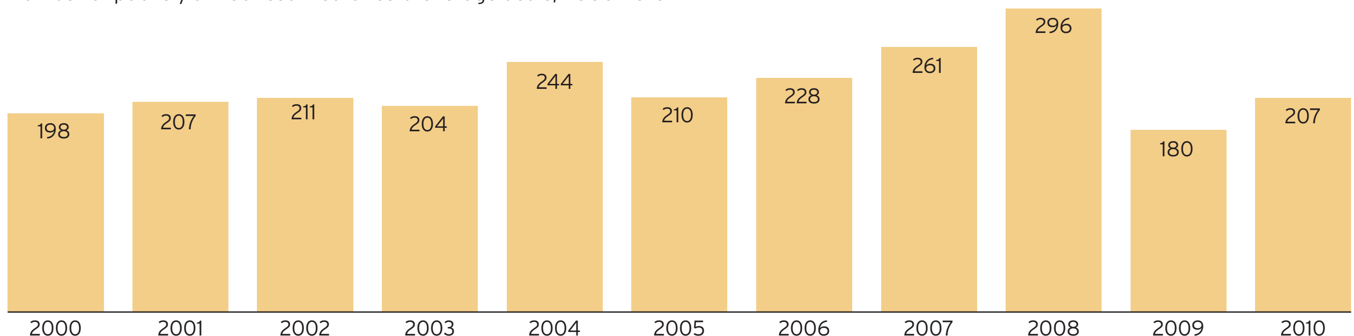
How agents and brokers report compensation arrangements with insurers, among companies listed in the *Business Insurance* directory.



Source: *BI* survey

BROKERAGE DEALS

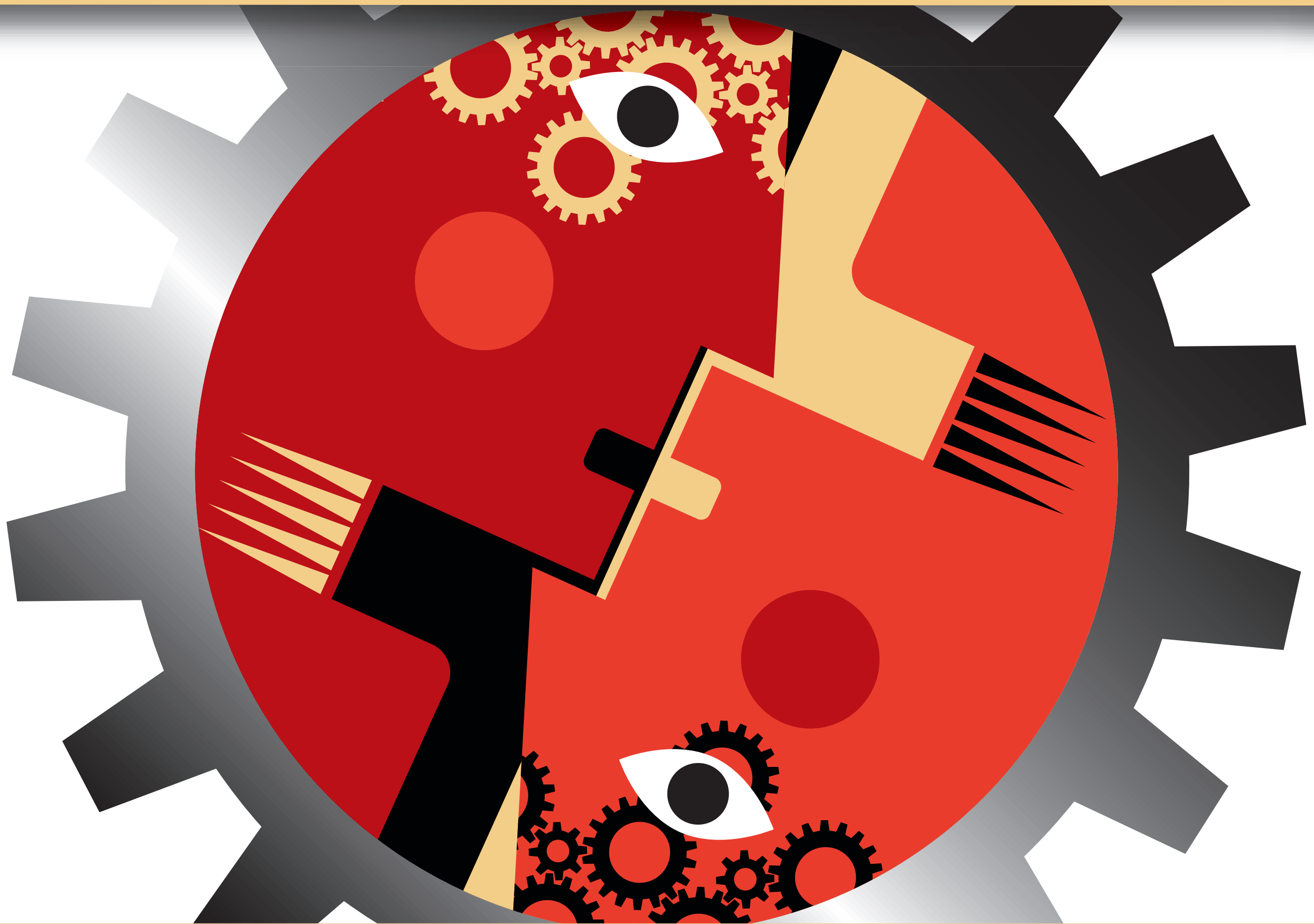
Number of publicly announced insurance brokerage deals, 2000-2010



Source: SNL Financial

Business Insurance®
November 2011

DRIVEN PRODUCERS



THE BUSINESS OF BETTER BROKING

A Supplement to Business Insurance

YOU CAN'T PREDICT ACCIDENTS, BUT YOU CAN SEE COMPLICATIONS COMING A MILE AWAY.

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INDUSTRY:
MANUFACTURING

CUSTOMER:
FURNITURE DESIGNER

CASE OBJECTIVE:
MANAGE UNRELATED COMPLICATIONS OF AT-WORK INJURY

CASE SPECIFICS:

While working, an employee at one of our customers' furniture factories recently had an accident. What seemed like a fairly straightforward claim changed when our VantageComp™ predictive model alerted us early that the man had key triggers for Type 2 diabetes. We were able to get our doctors and other medical staff involved early to craft a plan that treated the injury and helped the employee manage his diagnosis. By combining innovative data analytics with experienced talent, VantageComp led us to the best solution for today and tomorrow.

libertymutualgroup.com/factory

COMMERCIAL AUTO
GENERAL LIABILITY
PROPERTY
WORKERS COMPENSATION
GROUP BENEFITS

Follow Liberty Mutual Insurance.

Responsibility. What's your policy?®

Liberty Mutual.

CONSTRUCTION DIDN'T JUST COME TO A STANDSTILL. IT CAME TO A STAND VERY, VERY STILL.

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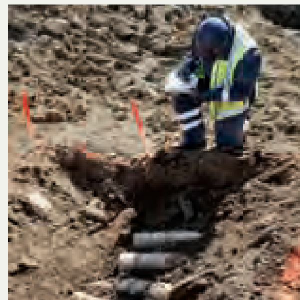
INDUSTRY:
CONSTRUCTION

CUSTOMER:
GENERAL CONTRACTOR

CASE OBJECTIVE:
SAFELY REMOVE EXPLOSIVE ORDNANCE FROM JOB SITE AND RESUME CONSTRUCTION



CASE SPECIFICS:

When our customer's construction crew found unexploded military ordnance on their job site, they needed help. Fast. At Liberty Mutual, we immediately dispatched our loss control consultants to evaluate the situation and assist in creating a plan for our customer to safely remove the explosives. We then reviewed and adjusted their coverages and limits to optimize protection during the hazardous extraction. Work resumed and the job was finished on time and without incident. Fast, adaptive thinking and safe solutions — that's how we help protect your business. To learn more, contact your agent or broker, or go to **libertymutualgroup.com/ordnance**

COMMERCIAL AUTO
GENERAL LIABILITY
PROPERTY
WORKERS COMPENSATION
GROUP BENEFITS

Follow Liberty Mutual Insurance.

Responsibility. What's your policy?®

THE BUILDING PLANS WE EXAMINED DIDN'T CALL FOR CUTTING CORNERS.

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INDUSTRY:
WHOLESALE

CUSTOMER:
LUMBER AND BUILDING SUPPLY COMPANY

CASE OBJECTIVE:
HELP DEFEND CUSTOMER AGAINST AN UNWARRANTED LAWSUIT

CASE SPECIFICS:

When poor workmanship led to the collapse of a dining room floor, the building owner sued the contractor. The contractor, in turn, tried to blame our customer who supplied the materials. At Liberty Mutual we investigated the situation, retained experts, and established that the contractor was solely responsible. We then made sure our customer wasn't held liable for repair costs and that their reputation remained intact, while also sending a message that Liberty Mutual relentlessly protects its customers from unwarranted liabilities. Experience, expertise, and unwavering tenacity — that's how we help protect your business. To learn more, contact your agent or broker, or go to **libertymutualgroup.com/floor**

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