

**INSIDE:**

*Marsh to cut jobs as woes worsen  
Crisis continues for industry*

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# Business Insurance®

November 15, 2004

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NEWSPAPER

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## Spitzer opens benefits front

PHOTO: AP/WIDE WORLD



Mr. Spitzer

By **DOUGLAS McLEOD**  
and **GLORIA GONZALEZ**

**NEW YORK**—The second target in New York Attorney General Eliot Spitzer's war against alleged broker misconduct may be small, but its clients aren't.

After taking on brokerage giant Marsh & McLennan Cos. Inc., Mr. Spitzer on Friday filed a fraud and antitrust lawsuit against Universal Life Resources Inc., a San Diego-based life and disability broker with \$25.3 million in 2003 revenues, and its owner, Douglas P. Cox.

Like the earlier Marsh lawsuit, the suit against ULR charges the broker with steering business to insurers that paid it secret override commissions. In addition, the suit charges

### Compensation Crisis

ULR with extracting other undisclosed fees that underwriters passed on to policyholders through higher premiums and actively concealing the payments from clients.

The clients allegedly defrauded include Ashland Inc., Dell Inc., Marriott International Inc., Safeway Inc., United Parcel Service Inc., Viacom Inc. and other well-known companies, according to the complaint.

The suit also cites three insur-

ers—UnumProvident Corp., MetLife Inc. and Prudential Financial Inc.—for participating in the alleged schemes.

"Today's case demonstrates that the corrupt practices first laid bare in the Marsh suit are present in additional sectors of the industry," Mr. Spitzer said in a statement announcing the suit against ULR. "Secret payoffs and conflicts of interest that infected the market for property and casualty insurance have taken root in the employee benefits market as well."

ULR representatives could not be reached for comment.

Unum, Prudential and MetLife representatives said the insurers are cooperating but declined to com-

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### Late News

#### Hartford, ZFS take action over commissions probe

Hartford Financial Services Group Inc. has fired two officials in its Los Angeles property/casualty underwriting unit for failing to "fully cooperate" with New York Attorney General Eliot Spitzer's probe of broker compensation practices. Hartford did not name the employees. Meanwhile, Zurich Financial Services Group has suspended several employees in its U.S. specialty business following an internal review of business practices in the wake of Mr. Spitzer's investigation. ZFS said that it had been conducting a review of "certain business practices with insurance brokers," which "includes a careful look at Zurich's relationship with Marsh & McLennan Cos. Inc." ZFS declined to give details on the employees.

#### Suit challenges California comp treatment regs

A lawsuit filed last week challenges new California workers compensation regulations allowing insurers and employers to direct injured workers into medical provider networks. The regulations implementing reforms signed into law in April go too far by allowing employers and insurers to take away an injured employee's doctor midtreatment, the lawsuit against the state Division of Workers' Compensation alleges. Two injured workers and the California Applicants' Attorneys Assn. filed the suit.

#### Platinum commutes contract over worries

Platinum Underwriters Holdings Ltd. will commute a retrocessional reinsurance contract over concerns about the level of risk transfer contained in some insurance and reinsurance contracts. Chief Executive Officer Gregory Morrison said that an aggregate excess-of-loss retrocessional contract obtained by Platinum would have produced a \$22 million benefit on the reinsurer's income statement and balance sheet. However, while the contract "contained ample risk transfer," it would not likely have caused an economic loss to its retrocessionaire, said Mr. Morrison. "Due to the current climate of heightened concern" over reinsurance and insurance

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## Anthem/WellPoint deal clears major roadblock

By **GLORIA GONZALEZ**

With Anthem Inc. and WellPoint Health Networks Inc. clearing a key hurdle to their proposed merger, multistate employers will soon have another option for their benefit programs, but there are questions about the deal's impact on premiums.

While some observers hail the greater negotiating leverage the combined entity would have with providers, others express concerns that, following California's lead, other states may demand financial concessions in exchange for approving the deal. Such concessions, they say, could, ultimately, be reflected in pricing.

The companies last week reached an agreement with California Insurance Commissioner John Garamendi, under which he will approve the proposed merger—which he for months

has opposed—in exchange for financial and regulatory oversight concessions.

California's regulatory approval was seen as the last obstacle to a roughly \$16.4 billion deal that would create the largest managed care organization in the United States. The combined organization will serve more than 28 million members through its Blue Cross or Blue Cross & Blue Shield operations in 13 states and its non-Blues operations in other states. The new entity, to be named WellPoint Inc., would surpass the membership of large, national firms such as UnitedHealth Group Inc. in Minneapolis, which has 22 million members; Hartford, Conn.-based Aetna Inc., 13.6 million members; and Philadelphia-based CIGNA Corp., 9.9 million members.

The arrival of another player to the national account market

See **MERGER/page 36**

## Broker turmoil to reshape ties

By **DOUGLAS McLEOD**  
and **RUPAL PAREKH**

**NEW YORK**—The widening investigation into broker compensation practices will change relationships

### Compensation Crisis

Inside:

#### Regulatory rethink

The commission scandal may alter reform efforts **PAGE 37**

#### Marsh to weather storm

Marsh is strong enough to survive its troubles **PAGE 38**

#### World of changes

Aon's top exec expects a global push for transparency **PAGE 38**

#### Settlement soon?

Marsh and Eliot Spitzer will try to settle charges quickly **PAGE 39**

among risk managers, brokers and insurers, potentially creating more competition in the marketplace and bringing risk managers and underwriters closer together, market observers predict.

As large brokers disclose more information about the fees and commissions that they collect for their various services, clients will be in a better position to judge the value of those services and compare the cost of obtaining services from their brokers against other options, observers say.

In some cases, brokers forced to end profit-based contingent commission agreements may be less willing to provide underwriters with the volume of detailed information about client risks that they have in the past, potentially pushing insurers to develop closer direct bonds with policyholders, some predict.

"This is getting at some pretty fundamental issues about the relationship between brokers, insurers

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### Spotlight report

## BERMUDA MARKET REPORT

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### LARGEST POLICYHOLDER- OWNER FACILITIES

Ranking on page 16

### LARGEST RENT-A-CAPTIVE FACILITIES

Ranking on page 22

# Retailer settles bias suits

## Abercrombie to pay nearly \$50 million

**NEW ALBANY, Ohio**—Abercrombie & Fitch Co. on Tuesday said it has agreed to pay nearly \$50 million to settle three related class action lawsuits that accuse the clothing retailer of systematically discriminating against its minority and female employees.

New Albany, Ohio-based Abercrombie made the announcement in its third-quarter earnings results. Details of the proposed settlement remain confidential, with preliminary approval pending.

All three suits were filed in a U.S. district court in Northern California, and several civil rights groups supported the actions. One lawsuit

was brought on behalf Latino, Asian-American and African-American workers, another on behalf of female employees and a third by the Equal Employment Opportunity Commission.

"Abercrombie recruits, hires and maintains a disproportionately white sales force," one suit charges. "To the extent that it hires minorities, it channels them to stock room and overnight shift positions and away from visible sales positions."

The estimated number of individuals who will qualify as class members is uncertain, according to plaintiffs' lawyer Martin J. D'Urso, of the Philadelphia-based firm

Kohn, Swift & Graf P.C.

Abercrombie in its earnings statement verified it will "pay an aggregate amount of slightly less than \$50 million to the class and for attorney's fees, costs and expenses to carry out the settlement" and stated that the company as a result "accrued a nonrecurring charge of \$32.9 million." The retailer did not return calls seeking comment on how it would fund the settlement.

Abercrombie reported net income of \$40.1 million for the third quarter, down 20.5% from the same period last year.

—By Rupal Parekh

# Insurers paid \$19.6 billion on 9/11 losses, study says

By MARK A. HOFMANN

There is no guarantee that the "unique combination of benefits" that emerged to compensate victims of the Sept. 11, 2001, terrorist attacks would be available to victims of a similar future attack, according to a study released last week by the RAND Corp.

That could mean a greater reliance on the tort system to compensate victims, said Lloyd Dixon, a senior economist at the Santa Monica, Calif.-based RAND Institute for Civil Justice and co-author with Rachel Kaganoff Stern of "Compensation for Losses from the 9/11 Attacks." The study was released at a Capitol Hill briefing on Nov. 8.

Victims—individuals and businesses—received about \$38.1 billion in compensation. More than half—\$19.6 billion—came from private insurance, and more than 85% of the insurance payments went to business, Mr. Dixon said. An additional \$15.8 billion came from governmental sources, including Social Security and unemployment benefits. The final \$2.7 billion came

from charity.

"The piece that's missing here is tort," said Mr. Dixon. He said that although lawsuits have been filed in connection with Sept. 11, so far no one has received a tort-related payment.

That could change if there is another attack, Mr. Dixon said. "There is really no ongoing program" to compensate victims of terrorism, he said. Unless the United States adopts such a program, the tort system could become the primary recourse for victims, he said.

The report itself notes that the Sept. 11 attacks resulted in "a unique combination of benefits" that may not be replicated should a similar attack occur. For example, even with the Terrorism Risk Insurance Act in place, the take-up rate for terror coverage has been "spotty," according to the report. It adds that the "availability and use of terrorism insurance" if TRIA expires, as planned, on Dec. 31, 2005, will be even more uncertain.

In addition, "while the government programs put in place after 9/11 create a precedent for pro-

grams that might be adopted after a future attack, there is no guarantee that similar programs will be adopted in the future," the report says. In fact, various efforts to expand the post-Sept. 11 Victim Compensation Fund to apply to other terrorist attacks retroactively, such as the Oklahoma City bombing of 1995, have failed.

Finally, the outpouring of charity in the wake of the attacks was unprecedented, and no one knows whether a future attack would be met by equal generosity, according to the report.

That would leave the tort system as a means of compensation, said Mr. Dixon. While limiting tort options could reduce transaction costs, it could also reduce incentives for businesses to take adequate precautions against terrorism, he said.

*Copies of "Compensation for Losses from the 9/11 Attacks" can be downloaded at [www.rand.org](http://www.rand.org). Hard copies of the report, which cost \$30 each, can be ordered from the Web site or by calling 877-584-8642.*

## MANAGED CARE ORGANIZATIONS' NINE-MONTH RESULTS

Ranked by net income. Dollar figures in millions.

Company	Net income 2004	Percent increase (decrease)	Revenues 2004	Percent increase (decrease)
Aetna	\$1,944.4	64.8%	\$14,735.8	9.1%
UnitedHealth Group*	1,850.0	40.2	26,710.0	25.4
Kaiser Permanente	1,300.0	35.2	20,900.0	9.5
CIGNA	913.0	63.9	13,800.0	(3.3)
WellPoint Health Networks	910.2	27.1	17,300.0	14.2
Anthem	775.6	37.0	14,000.0	12.0
Coventry Health Care	245.4	26.5	3,900.0	15.7
Humana	232.9	43.2	9,570.0	9.0
PacifiCare Health Systems	231.2	8.6	9,117.2	9.9
WellChoice	186.6	20.4	4,339.6	7.7
Health Net	128.2	(11.4)	8,880.0	5.6

\* Includes net income and revenues for Oxford Health Plans, which merged with UnitedHealth on July 29. Source: Company reports

# Health care pricing trending downward

## Cost hikes not as high in 2005

By GLORIA GONZALEZ

Group health care plan premium increases will continue to moderate into 2005 as managed care companies price their products in line with easing medical cost trends.

Medical cost increases are currently seen in the 8% to 10% range, with managed care companies pricing their products at or slightly above the trend rate. This represents a significant shift from previous years, when employers experienced higher premium increases due to medical cost increases ranging from 14% to 18%.

"The underwriting cycle has moderated, and I think these companies are in a better position to stabilize and be more consistent going forward," said Joseph Marinucci, credit analyst with New York-based Standard & Poor's Corp. "For the most part, we expect pricing to correlate more or less with (the cost) trend."

Several factors have contributed to declining medical cost trends, analysts say, including the introduction of consumer-directed health plans and reduced prescription drug costs stemming from increases in

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## Managed care Nine-month RESULTS

Most of the major managed care companies posted gains in net income in the first nine months compared with the prior-year period (see chart). This improved performance stemmed from a combination of factors, including a continued slowdown in the growth of medical costs and managed care companies' efforts to maintain pricing discipline, analysts note.

## Inside Business Insurance

### Professional liability issues of interest

PLUS' recent conference drew a near-record crowd. **Page 4**

### Push for reimportation may slow after next year

The push to legalize reimportation may decline when the Medicare drug benefit begins in 2006. **Page 4**

Cover photo: David Skinner

### Maryland seeking health care captives

Maryland officials want to promote the state as a captive domicile for medical malpractice liability risks. **Page 6**

### Anthem/WellPoint deal may help employers

Bigger isn't always better when it comes to service, one of this week's editorials says. **Page 8**



### U.K. companies not ready for capital rules

New capital adequacy regulations may catch many companies unprepared. **Page 33**

## Online

• *Business Insurance* has compiled past *BI* articles and other resources on New York Attorney General Eliot Spitzer's investigation of industry practices.

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

• New **Opinion Poll** for readers: Will employers benefit from the wave of mergers in the managed care industry?

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

# Several brokers not caving on commissions

## Warn loss of income would hit results

By DOUGLAS McLEOD

Several U.S. insurance brokers have reported receiving tens of millions of dollars of contingent commissions during the first nine months of this year and have not yet followed the lead of their larger competitors in agreeing to halt the practice.

While Marsh & McLennan Cos. Inc., Aon Corp., Willis Group Holdings Ltd. and Arthur J. Gallagher & Co. have all agreed to stop collecting contingent commissions, several other large bro-

kers have not made such commitments and warn in third-quarter financial filings that the loss of the commissions could adversely affect their future results.

Most of the brokers also report that they are cooperating with subpoenas and other requests for information from New York Attorney General Eliot Spitzer—who launched the first probe of brokerage compensation practices—or from regulatory and law enforcement agencies in other states.

Brokers disclosing information related to the compensation in-

quiries include:

- Hilb, Rogal & Hobbs Co., which reported \$39.4 million in contingent and volume-based override commissions and \$459.7 million in total revenues for the first nine months. Noting that it is not possible to predict the outcome of state inquiries into broker compensation, Hilb said that any decrease in these commissions would have a "negative effect" on its results.

- Brown & Brown Inc. of Daytona Beach, Fla., which reported a \$700,000 increase in mostly profit-driven contingent commissions through the first nine months of 2004. The filing did not report the total collected, but a brokerage offi-

cial last month said that the figure amounted to more than \$30 million so far this year.

"We have not chosen to discontinue receiving contingent commissions," the brokerage said in its third-quarter report, adding that the elimination or reduction of the commissions could have "a material adverse impact on our results."

- USI Holdings Inc., which reported \$17 million in contingent commissions and \$298.1 million in total revenues for the first nine months. The broker said that it does not expect contingent agreements to continue in their current form, but that it also expects to collect such commissions in 2005 under agreements in place this year.

- Hub International Ltd., which reported \$19.9 million in contingent commissions and volume overrides and \$256.5 million in total revenues for the first nine months. Any prohibition of contingent commissions could have an adverse effect on Hub's results and liquidity, the broker cautioned.

Gallagher, meanwhile, reported collecting \$31.7 million in contingent commissions under 590 agreements with 197 insurers during the first nine months of this year. The broker reported \$1.12 billion in gross revenues for the period. Gallagher has announced it will cease taking contingent commissions starting Jan. 1, 2005.



## Rules would allow pension payouts in phased retirements

By JERRY GEISEL

**WASHINGTON**—Newly proposed federal regulations that would allow older employees moving to reduced work schedules to receive a portion of their earned pension benefit opens the door wider to phased retirement programs.

The regulations, released last week by the Internal Revenue Service and the Treasury Department, would amend current rules that now bar defined benefit plans from making payments to participants who have not separated from service and have not reached normal retirement age.

Instead, the proposed rules would permit the distribution of a partial benefit to those cutting back on the number of hours they work, so long as numerous conditions were met.

In general, the benefit that would be payable before full retirement would be proportionate to the reduction in the number of hours worked by an employee. For example, if an employee cut back the number of hours by 20%, the individual could receive 20% of his or her earned benefit.

The proposed rules, though, set numerous conditions that would have to be satisfied for pension distributions to be made under a phased retirement program.

Those conditions include:

- Employees receiving the benefits would have to be at least age 59½.

- The pension benefit would have to be payable as an annuity and not as a lump sum.

- Employees would have to reduce their working hours by at least 20%.

The phased retirement programs would have to be voluntary and offered on a nondiscriminatory basis. An employer could not, for example, limit the availability of a phased retirement program to highly compensated employees. Additionally, the programs could be not be offered only to so-called key employees, who are generally top corporate executives.

The employer would have to put in place a program to track the number of hours worked by employees opting for phased retirement programs. The amount of the partial benefit would have to be adjusted if the actual num-

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## Reimportation push may ease when Medicare adds Rx benefit

By JERRY GEISEL

**WASHINGTON**—Next year could be critical in the drive to ease rules that make it illegal to reimport lower-cost prescription drugs from Canada, several experts say.

"I feel strongly if it doesn't happen in 2005, then it won't happen," said Jack Rodgers, a managing director in the Washington office of PricewaterhouseCoopers L.L.P.

Speaking last week at a PwC-sponsored health care conference in Washington, Mr. Rodgers predicted that the intense political pressure elected federal officials now feel from constituents about the high cost of prescription drugs would ease in 2006, when Medicare participants become eligible for prescription drug coverage.

The major push for the reimportation of prescription drugs from Canada, where costs are substantial-

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### 2004 PLUS International Conference

## Panel debates extent of harm from commissions scandal

By DAVE LENCKUS

**SAN DIEGO**—At least one regulator does not view the contingent commission scandal as a wholesale indictment of the entire insurance industry.

But attorneys at a session during the recent Professional Liability Underwriting Society conference disagreed over whether the alleged damages that the scandal has caused to insurance buyers and investors merit class-action status for such plaintiffs.

PLUS held its 17th annual International Conference earlier this month in San Diego. The regulator and attorneys made their comments during a session designed to elicit outsiders' views of the insurance industry.

New York Attorney General Eliot Spitzer last month sued Marsh & McLennan Cos. Inc. and its Marsh Inc. retail brokerage unit, charging

that the broker steered clients to insurers paying it the highest contingent commissions. Mr. Spitzer also charged that the defendants colluded with several insurers to rig bids on client programs to create the appearance of competition.

In the wake of the lawsuit, MMC and Marsh have announced several management changes and layoffs,

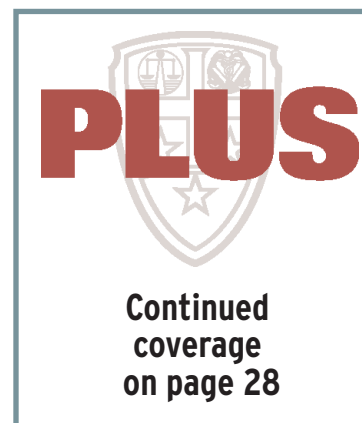
and numerous brokerages have announced they are discontinuing contingent commissions. Meanwhile, Mr. Spitzer's investigation of insurance industry practices continues.

The consensus of the PLUS session, moderated by University of Connecticut Law Professor Tom Baker, was that the concept of contingent commissions should not be lumped together automatically with the illegal practice of bid rigging.

Mr. Baker set the tone when he asked the panel whether there is anything wrong with the concept of contingent commissions or whether the problem rests in how the industry has disclosed the practice to insurance buyers. In his question, he referred to Mr. Spitzer's allegations of bid rigging and steering.

"I think those are multiple ques-

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# Calif. workers comp market to add insurers, ease rates

By **ROBERTO CENICEROS**

**LOS ANGELES**—California employers will have more workers compensation insurers to choose from as capital flows into the state, albeit cautiously, speakers told a business group last week.

Workers comp rates will also trend down, although not dramatically, predicted Bill Mudge, chief executive officer for the newly formed CompWest Insurance Co. The San Francisco-based insurer announced Sept. 27 that the California Department of Insurance had granted it a license.

CompWest filed its application to form just one day after California adopted its most recent round of workers compensation reforms in April. The reforms have finally given California employers and insurers greater control over which medical providers treat employees, addressed litigation over disability de-

terminations and implemented objective-based medicine, Mr. Mudge said.

His company was formed with \$50 million in new capital and will focus on midmarket business, Mr. Mudge said.

Other capital could flow into California as some established insurers expand to offer workers comp coverage in the state. Equity funds could

also back the formation of new workers comp insurers similar to CompWest, Mr. Mudge said.

"Both of those capital solutions

are going to give employers more choice," Mr. Mudge said.

Indeed, four potential workers comp insurers have licenses pending in the state, according to a spokesman for the California Department of Insurance. Two of the applicants are insurers that currently serve multistate employers with operations in California but are looking to write new business in the state. The other two would be new formations, said the spokesman, who declined to identify any of the parties.

In addition, other parties have held preliminary discussions with the insurance department regarding the selling of workers comp insurance, the spokesman said.

Over the past few years, more than 25 insurers that operated in California became insolvent, while others departed from the state, leaving employers with fewer choices.

See **COMP**/page 36



Maryland officials in Baltimore are looking to promote the state as a domicile for health care captives.

## Maryland considers med mal captives to end doctor flight

By **MICHAEL BRADFORD**

**BALTIMORE**—Maryland insurance regulators are hoping to bring some relief to the state's medical liability problems by making it easier for hospitals and other health care providers to form captive insurance companies in the state.

The state does not prohibit the formation of health care captives, but none has located in Maryland. Because the state has no specific captive law, insurers would be under the same regulation and financial requirements as traditional commercial property/casualty insurers. Regulators want to change current law so that captives could be formed in Maryland and treated much as they are in other states that have established themselves as captive domiciles, said Alfred W. Redmer, commissioner of the Maryland Insurance Administration in Baltimore.

The commissioner said a working group is being formed to call on captive insurance experts to "see if there are any reasonable recommendations we can make to modify the existing law. We want to do it on an accelerated basis and have our work done in four or five weeks."

There is a "sense of urgency in that Maryland is in the middle of a medical liability crisis," Mr. Redmer said. Medical facilities already are considering forming captives or risk retention groups or are looking at other alternative forms of coverage, he said, and the insurance administration would like to keep them in Maryland while encouraging others to choose the state as a domicile.

Maryland captives that form in the same state as their parents would be in a better position to hold down costs than if they formed elsewhere and the captives' executives were required to make periodic trips to those locations, Mr. Redmer noted.

"That's a huge advantage" for captives that form in their home

state, agreed James A. Swanke Jr., strategic risk finance practice leader for Tillinghast-Towers Perrin in Minneapolis. There is a big savings if "they're not being forced to get on an airplane and hold meetings in Cayman," for example, a domicile that leads the world in the number of health care captives.

Mr. Redmer's efforts to change the law are a response to a situation he called "the most important issue we have to deal with." The threat of malpractice lawsuits and the high cost of insurance coverage has discouraged doctors from practicing in some specialties and caused others to close their offices, he said.

Many Maryland doctors are being forced to pay one-third more for their coverage at their next renewal. The commissioner in September granted a 33% rate increase to Medical Mutual Liability Insurance Society of Maryland, the state's largest underwriter of malpractice coverage for physicians. The insurer had requested a 44% increase.

Around 40% of 774 Maryland physicians surveyed by the Maryland Medical Society in August and September said they are considering closing their practices, retiring or relocating because of medical malpractice insurance costs and other expenses.

In Baltimore, an obstetrician/gynecologist pays an average of \$115,919 for malpractice coverage written this year by Medical Mutual, according to the Medical Liability Monitor, a Chicago-based newsletter. A general surgeon pays an average of \$53,708 and a physician practicing internal medicine pays \$14,171.

Mr. Swanke said Maryland could be on the right track in its efforts to attract captives and help ease medical liability problems. "I think there is room for more domiciles, particularly those that are trying to find a niche," he said. "If they want to focus on physician groups and hospital groups, they could be successful."



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## Editorial

# Health plan clout may help

WITH CALIFORNIA INSURANCE Commissioner John Garamendi signing off last week on the proposed merger of Anthem Inc. and WellPoint Health Networks Inc., no major obstacles stand in the way of a deal that would create the nation's largest health insurer and managed care organization.

While mergers have been common in the managed care industry over the last decade, none has been close in size to this one.

The combined Anthem-WellPoint entity would have more than 28 million medical members, far more than any other health insurer and second in size only to the federal Medicare program, which has about 40 million enrollees.

In general, we have supported managed care company mergers for a practical reason: the need for the organizations to improve their leverage in negotiating with health care providers.

Indeed, the rapid consolidation of health care providers—especially hospitals—has, in many communities, radically altered the balance of power between providers and the purchasers in favor of the providers.

Consolidation has enabled medical providers to de-

mand and often win big rate hikes when negotiating with purchasers. If the purchasers themselves become much larger through mergers, their increased clout may enable them to pare back provider demands.

How many providers, after all, would present a take-it-or-leave-it rate hike to a health insurer of the size of a combined Anthem-WellPoint?

That said, we approach the Anthem-WellPoint merger with some trepidation, based on the consolidation in another segment of the insurance industry—the brokerage business.

Each time one insurance broker swallowed up another, buyers heard how that consolidation would be in their best interests, with the acquiring brokers' greater size giving them more clout with insurers.

Mergers did enable brokers to gain more clout, but as the still-unfolding scandal over contingent commission arrangements shows, some of them used that leverage in ways that benefited only themselves and resulted in their customers paying higher, not lower, premiums.

We hope that will not be the case here and that this megamerger will be one where the customer truly benefits. We will be watching carefully—as will the employer community—to see whether that is the case.

# Buyers, beware pledges

RECENT DECLARATIONS BY large insurance brokers that they will end the practice of collecting contingent commissions are welcome, but they should also give risk managers pause.

As we have argued in the past, contingent commissions, even when they are not abused, can easily give rise to the appearance of a conflict of interest and, therefore, they should not be part of modern-day insurance transactions.

So, on their face, the commitments by Marsh, Aon, Willis and others to end the practice should go some way toward restoring risk

managers' trust in their brokers.

The announcements, however, have often been accompanied by rather vague statements about ensuring "appropriate compensation" for services and allusions to "new business models."

Given the decidedly inappropriate compensation that was allegedly part of the old business models employed by some brokers, risk managers would be right to be wary of any extra charges applied by brokers to insurers or policyholders.

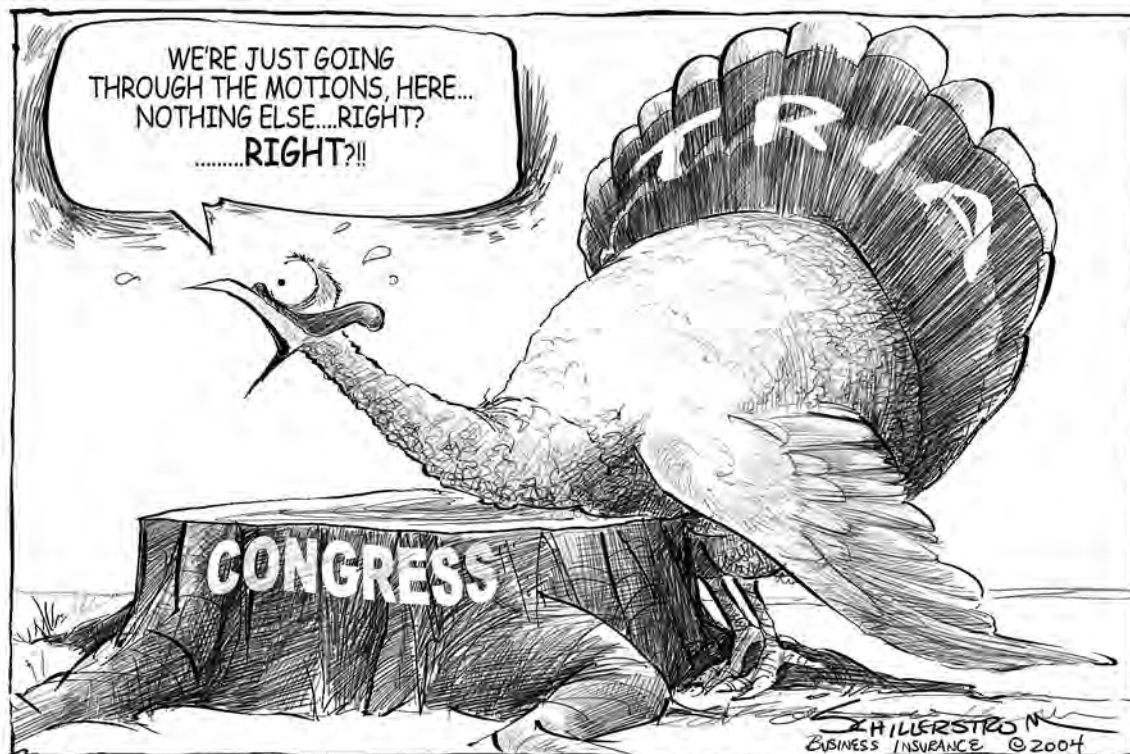
Presumably, the brokers are intending to charge fees for services that they believe they are not ade-

quately compensated for through traditional commissions and fees.

Given the huge question mark that now hangs over the past practices of several insurance brokers, any new fees must be completely transparent and justified in the eyes of policyholders. If there is any question as to the validity of the charges, risk managers, as a group, must forcefully reject them.

In the interests of securing a fair price from service providers and in elevating governance issues in the insurance industry generally, the time for vacillating over broker compensation issues must be over.

## Schillerstrom



## Letters to the Editor

### Confusion surrounds contingent commissions

To the editor: The accounts of New York Attorney General Eliot Spitzer's recent activities as related in the daily press did nothing but confuse me. Staged bidding wars designed to deceive insurance buyers are certainly wrong by any standard. But contingent commissions also seemed to be condemned as if they were newfound evidence of an alien infiltration. I failed to get the connection.

For that reason, I had been looking forward to reading a clear explanation of these matters by an acknowledged expert in the field of insurance. I was delighted to find that Paul Winston had decided to hold forth on the subject in "Industry Actions Invite Nightmare" (*BI*, Oct. 25).

I read, I pondered, but the mystery remains. I read that the paying of commissions to encourage a flow of business is "an ethically bankrupt system." It creates "a clear conflict of interest." "Insurance brokers have a duty to represent the interests of their clients," and when the brokers are compensated by the seller, "that duty and trust has been fouled."

This all began when I was confused by the reference, in the daily press, to contingent commissions. After reading Mr. Winston, it appears that any form of payment by the insurance companies to their agents is an abomination. Mr. Winston seems to be going far beyond Mr. Spitzer's accusations to make a case for the elimination of commissions entirely. In an ideal world, that might make some sense, but beyond the universe of huge premiums, big-time brokers and experienced risk managers, it presents more than a few problems.

So I will ask the question that I had hoped someone would answer. What does Eliot Spitzer see as wrong with contingent commissions? Obviously, by their response to his accusations, there are many insurance company executives and officers of brokerage firms who think Mr. Spitzer might be on to something serious, but what is it?

A great many insurance agents and brokers who always served their clients well and faithfully have been pleased to earn commissions paid by their companies. Some fortunate ones even accepted contingent commissions. Were they criminals? They never saw these as "kickbacks." If they perceived there was a "conflict of interest," it did not adversely affect their treatment of clients.

Contingent commissions have sometimes been a subject of discussion between those companies that offer them and the agents or brokers who agree to accept them. The point argued is not whether such compensation affects the placement of business. No one, in my judgment, has ever demonstrated that such commissions have any ef-

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# Spotlight

## Bermuda Market Report

Spotlight Editor: Michael Bradford

### Property rate decreases foster moves to casualty market

By CAROLYN ALDRED

Lower property insurance and reinsurance rates are increasing casualty capacity in Bermuda as underwriters on the island seek to take advantage of the still buoyant casualty insurance market.

While several of the more recent entrants to the Bermuda market have written casualty business since they were formed, of late they have been increasing their casualty writings, market participants say.

And even some long-time Bermuda players that were set up as monoline property catastrophe reinsurers have become significant writers of casualty business.

**'As rates for property have eased, reinsurers have moved more heavily into casualty.'**

Donald Thorpe  
Fitch Ratings

"There's a trend toward writing more casualty business among the previously property-based startups and also among the more established reinsurance companies in Bermuda," said Donald Thorpe, a senior director of Fitch Ratings in Chicago.

Many of the insurers and reinsurers that were established to take advantage of the sharp rate increases that followed the Sept. 11, 2001, terrorist attacks primarily focused on property insurance and reinsurance, though several also wrote some casualty business. Those that were established after Hurricane Andrew in 1992 for several years almost exclusively wrote property catastrophe coverage before diversifying to varying degrees.

"As rates for property have eased, reinsurers have moved more heavily into casualty," said Mr. Thorpe.

One of the most prominent property cat reinsurers that set up in the wake of Hurricane Andrew, RenaissanceRe Holdings Ltd., now writes

See CAPACITY/page 24



PHOTO: DAVID SKINNER

### Startups, unlike older peers, not stepping toward M&A

By JUDY GREENWALD

Don't expect the Bermuda reinsurers and insurers formed after the Sept. 11, 2001, terrorist attacks to either merge or be acquired, at least not in the immediate future, say observers.

Many say they do not expect these new companies to follow the lead of the Bermuda property catastrophe reinsurers created in the wake of 1992's Hurricane Andrew. Of the eight formed at the time, only three remain independent entities today.

The differences between those property cat reinsurers and the newer companies—in terms of their size, geographical reach and product mix—all mean they are unlikely to either merge or be acquired, at least for the next 12 to 18 months, say observers.

But that could change if and

when the market softens considerably, as companies seek to provide an adequate return to their investors, some say. "It is, historically,

**Of the eight property catastrophe reinsurers created in the wake of 1992's Hurricane Andrew, only three remain independent entities today.**

one of the ways that companies have deployed excess capital," said Donald Thorpe, senior director at Fitch Ratings in Chicago.

Eight Bermuda companies were formed to write property catastrophe risks in the wake of Hurricane Andrew: Centre Cat Re, Global Cap-

ital Re, IPCRe, LaSalle Re, Mid Ocean Re, PartnerRe, Renaissance Re and Tempest Re. Of these, only IPCRe, PartnerRe and Renaissance Re are still independent, and only IPCRe essentially continues with its original marketing strategy of focusing on property cat business.

Several companies were set up in the months following the Sept. 11 attacks. They include: Allied World Assurance Co. Ltd., Arch Re Ltd., Aspen Insurance Holdings Ltd., AXIS Specialty Ltd., DaVinci Reinsurance Ltd., Endurance Specialty Insurance Ltd., Goshawk Reinsurance Ltd., Grand Central Re Ltd., Montpelier Re Holdings Ltd. and Olympus Reinsurance Ltd.

The differences between the property cat reinsurers and the newer companies make it unlikely the post-Sept. 11 companies will be involved in M&A activity, at least

See DEALS/page 18

### Hurricanes' frequency mitigated severity on reinsurers

#### Separate storms spread impact

By MICHAEL BRADFORD

Bermuda reinsurers, despite seeing the size of their profits sheared by a handful of hurricanes this season, are happier to have faced four storms instead of just one.

If a single major storm had generated the same amount of losses as the four hurricanes that hit the United States this year, Bermuda's reinsurance community would be in worse shape. Instead, primary insurers were forced to shoulder re-entions across several events instead of just one, cushioning reinsurers' net payout.

**'The pure number of losses will serve to kind of alleviate the reinsurers' losses.'**

Michael Barry  
Fitch Ratings

"A series of storms is a series of deductibles," said Michael Barry, managing director at Fitch Ratings in New York. Therefore, "reinsurers have less exposure" from four storms rather than one giant hurricane that would have produced the same amount of losses, he said.

"The pure number of losses will serve to kind of alleviate the reinsurers' losses," Mr. Barry said.

"A \$15 billion to \$20 billion vertical event would have caused more disruption than four hurricanes," agreed Jeffrey L. Radke, president and chief executive officer of PXRE Group Ltd. in Bermuda. "The re-entions that the primary companies are carrying are high," he added, and came into play several times rather than once with a single storm.

See HURRICANES/page 12

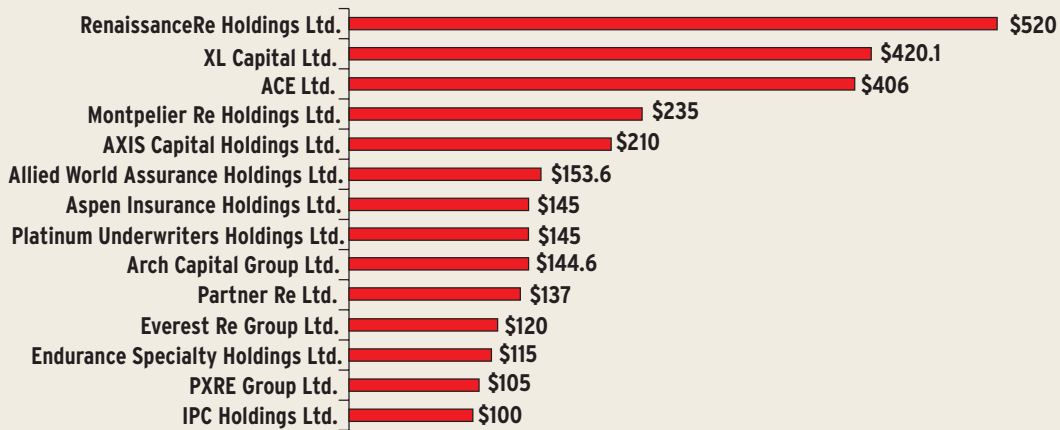
Largest policyholder-owned alternative risk facilities  
page 16

Bermuda fine-tuning insurance regulations  
page 20

Largest rent-a-captive facilities  
page 22

## STORM LOSSES PILE UP FOR BERMUDA REINSURERS

Net losses, in millions of dollars, from Atlantic and Pacific windstorms in 2004



Source: Company statements

# Hurricanes: Storms' impact spread out

Continued from page 10

Even though four storms can hurt less than one, Bermuda reinsurers still took a large hit, reporting losses that could total as much as \$3 billion from the hurricanes and the series of typhoons that swept Japan this year. As a result, industry sources say, the slide in property catastrophe rates has been arrested. And while rate hikes are not expected to be significant, property coverage won't be getting cheaper at year end renewals, they add.

For Bermuda reinsurers, that's good news.

"Our general feeling is that on (Jan. 1), on the reinsurance side, we will see firming in pricing, particularly on wind-exposed" accounts, said Andrew Cook, chief financial officer at AXIS Capital Holdings Ltd. in Pembroke, Bermuda.

"We feel pretty confident that rates in 2005, in general, will at least be at 2004 levels," said Mr. Radke. "On property cat business in the U.S., that is substantially better than our expectation had been, which was down 10%."

There will be some spotty increases next year, according to Mr. Radke. An "optimistic" outlook would be that rates will rise by as much as 5% in areas where storm-related losses were significant, he said.

**The windstorm losses and other factors, such as poor returns on equity, mean that 'to keep the industry healthy, rates have to go up....Anyone who thinks the price is not going to go up, that's a little bit naive.'**

James P. Bryce  
IPC Holdings Ltd.

Given the size of the storm losses, property reinsurance prices are certain to increase, said James P. Bryce, president and CEO of reinsurer IPC Holdings Ltd. in Bermuda.

The storm losses and other factors, such as poor returns on equity, mean that "to keep the industry healthy, rates have to go up," Mr. Bryce remarked. There remains uncertainty, he said, as to the "degree of who pays how much. It really will be case by case."

But, Mr. Bryce said, "anyone who thinks the price is not going to go up, that's a little bit naive."

Others agree that Bermuda's property reinsurers will raise the price of their coverage because of the storm losses, but don't see a market-wrenching increase.

In Florida, "there may be an increased cost of securing reinsurance," said Robert DeRose, assistant vp at A.M. Best Co. in Oldwick, N.J. But otherwise, losses from the storm "are not going to cause a significant hardening in the property market or the property catastrophe market," he added.

It's impossible to guess how hard Bermuda's insurance community would have to have been hit by the storms to trigger a market-hardening response, Mr. DeRose said. "You would need a crystal ball to answer that," he said, because it would partly depend on how much capital rushed into the market after the catastrophe.

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KEVIN COSTELLO ROB BYLER SCOTT ROE SANDRA DUNCAN VANCE SAWAMURA JEFF ALEXANDER

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PHOTO: NY TIMES

# Hurricanes: Storms' impact spread out

Continued from page 12

"Our sense right now is that, indeed, the storms served more to mitigate the price decreases we were seeing in property" rather than to cause them to rise, said Mr. Barry of Fitch.

This is, after all, "the property cat business," Mr. Barry said, and reinsurers are skilled at their pricing strategies. "Pricing is not just a short-term phenomenon," he said, and reinsurers have enjoyed some "calm years" in the

Florida market before 2004.

The appearance of catastrophe bonds also helps hold down prices, Mr. Barry said, because "reinsurers are very aware that companies could tap the capital markets" to cover their catastrophe risks instead of buying reinsurance. "It's almost as if there is another meaningful competitor," he said.







Competition also comes from a source new to Bermuda's property catastrophe market.

Max Re Ltd., a unit of Hamilton-based Max Re Capital Ltd., in September formed a property division to begin writing insurance and reinsurance for large multinationalals.

The new unit will write property limits of \$25 million as a midlayer excess coverage for large clients, said Keith S. Hynes, executive vp and CFO at Max Re Capital.

The unit was one that came about partly because of demand from Max Re customers, Mr. Hynes

Bermuda reinsurers' share of losses from the four hurricanes that slammed the United States this year was diminished by the fact that separate deductibles and retentions applied to each occurrence.

			
GE Commercial Insurance	GE CyberComp	GE ERC	GE ERC Healthcare
			
GE Frankona Re	GE Global Asset Protection Services	GE Global Life & Health	GE Global Property & Casualty
			
GE Industrial Risk Insurers	GE Medical Protective	GE Reinsurance	GE Westport

**'The hurricanes have caused property pricing in the markets we are in to stabilize.'**

*Keith S. Hynes  
Max Re Capital Ltd.*

said, not because the insurer views it as one that will generate huge returns.

"We see it as a fairly low-growth business," he said, though the unit may write more business than originally anticipated because property prices have stabilized after the hurricanes.

As for windstorm risks, "we're neutral on them," Mr. Hynes said. Accounts with a higher concentration of locations in areas where storms are frequent will generally pay higher rates than others with fewer properties in those places, he said.

The amount of coverage the new unit writes will partly depend on market pricing, Mr. Hynes said. "The hurricanes have caused property pricing in the markets we are in to stabilize," he said, and Max Re won't shy from risks where it can charge appropriate rates, even in windstorm areas.

John Charman, president and CEO at AXIS, said in a Nov. 4 earnings call that Bermuda's newest insurers and reinsurers, the so-called Class of 2001, weathered the storms well. "We have, in my view, dealt successfully with the first big industry test," he stated.

The investment community and others have waited on such a test as major storm losses, Mr. Charman said, and the Bermuda market withstood it well. His own company was able to produce a third-quarter profit, even though it was a small percentage of its 2003 earnings for the period, and that proves that AXIS' diversified book of business and disciplined underwriting are working, he said.



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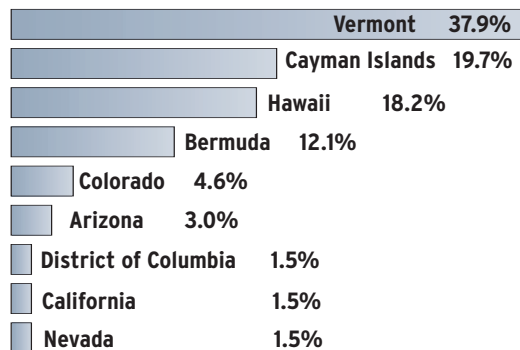


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### ONSHORE & OFFSHORE

Policyholder-owned facilities by domicile



Source: BI survey

### LARGEST FACILITY MANAGERS

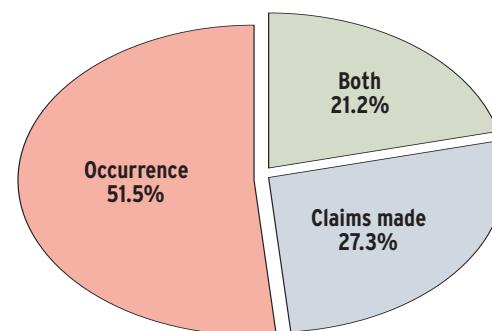
Ranked by number of policyholder-owned facilities

Management company	Facilities
Beecher Carlson (RiskCap)	29
Marsh-Captive Management Services	14
USA Risk Group of Vermont Inc.	5
Kensington Management Group Ltd.	5
OIL Management Services Ltd.	3

Source: BI survey

### LIABILITY TRIGGERS

Coverage forms used by policyholder-owned facilities



Source: BI survey

## Largest policyholder-owned alternative risk facilities

Ranked by 2003 gross premiums written

Rank	Facility	Domicile	2003 gross premiums written	2003 participants	Business conducted by participants	Risks insured	Management company/Address	Telephone/Fax/Web site	Contact
1	Associated Electric & Gas Insurance Services Ltd.	Bermuda	\$1,003,974,000	490	Utility and related energy industries	D&O, excess liability, employment practices, excess workers compensation, fiduciary liability, professional liability, property	AEGIS Insurance Services Inc. 10 Exchange Place, Jersey City, N.J. 07302	201-521-1200 Fax: 201-521-9555 <a href="http://www.aegislink.com">www.aegislink.com</a>	Gilbert Gould, senior vp
2	Oil Insurance Ltd.	Bermuda	\$422,177,000	81	Chemicals and mining, oil and gas exploration and production, petrochemicals, utilities	Control of well and third-party pollution liability, physical damage to property	OIL Management Services Ltd. ACE Tempest Re Building, 30 Woodbourne Ave., Third Floor, Pembroke, HM 08, Bermuda	441-295-0905 Fax: 441-295-0351 <a href="http://www.oil.bm">www.oil.bm</a>	Douglas A. Kline, senior vp/COO
3	Raffles Insurance Ltd.	Cayman Islands	\$126,474,964	234	Contractors, distributors, manufacturers	Auto liability, auto physical damage, general liability, workers compensation	Kensington Management Group Ltd. P.O. Box 10027APO, Grand Cayman, Cayman Islands, B.W.I.	345-946-2100 Fax: 345-946-2110 <a href="http://www.rafflesinsurance.com">www.rafflesinsurance.com</a>	Michael Gibbs, president-Kensington Management Group Ltd., Jennifer Beard, executive vp-Captive Resources L.L.C.
4	Oil Casualty Insurance Ltd.	Bermuda	\$93,332,000	77	Chemicals and mining, oil and gas exploration and production, petrochemicals, utilities	D&O liability, excess general liability	OIL Management Services Ltd. ACE Tempest Re Building, 30 Woodbourne Ave., Third Floor, Pembroke, HM 08, Bermuda	441-295-0905 Fax: 441-295-0351 <a href="http://www.ocil.bm">www.ocil.bm</a>	John C. Thomson, senior vp/COO
5	American Contractors Insurance Group	Bermuda	\$92,875,000	35	Construction contractors	Auto liability, general liability, workers compensation	ACIG Insurance Co. 12222 Merit Drive, Suite 1660, Dallas, Texas 75251	972-702-9004 Fax: 972-687-0603 <a href="http://www.acig.com">www.acig.com</a>	William S. McIntyre, chairman
6	Affinity Insurance Ltd.	Cayman Islands	\$64,733,773	149	Contractors, distributors, manufacturers	Auto liability, auto physical damage, general liability, workers compensation	Kensington Management Group Ltd. P.O. Box 10027APO, Grand Cayman, Cayman Islands, B.W.I.	345-946-2100 Fax: 345-946-2110 <a href="http://www.affinityinsuranceltd.com">www.affinityinsuranceltd.com</a>	Michael Gibbs, president-Kensington Management Group Ltd., Tom Ullrich, senior vp-Captive Resources L.L.C.
7	Churchill Casualty Ltd.	Cayman Islands	\$58,966,662	103	Contractors, distributors, manufacturers	Auto liability, auto physical damage, general liability, workers compensation	Kensington Management Group Ltd. P.O. Box 10027APO, Grand Cayman, Cayman Islands, B.W.I.	345-946-2100 Fax: 345-946-2110 <a href="http://www.churchillcasualty.com">www.churchillcasualty.com</a>	Michael Gibbs, president-Kensington Management Group Ltd., Sam Meccia, senior vp-Captive Resources L.L.C.
8	American Excess Insurance Exchange, Risk Retention Group	Vermont	\$45,843,910	20	Health care systems	Excess hospital professional liability	Premier Insurance Management Services Inc. 150 Dorset St., Suite 238, South Burlington, Vt. 05403	802-863-4400 Fax: 704-733-4700 <a href="http://www.premierinc.com">www.premierinc.com</a>	Randy Gore, vp-marketing
9	Temporary Services Insurance Ltd.	Cayman Islands	\$43,390,197	109	Temporary employment companies	Workers compensation	Kensington Management Group Ltd. P.O. Box 10027APO, Grand Cayman, Cayman Islands, B.W.I.	345-946-2100 Fax: 345-946-2110 <a href="http://www.tempsinsurance.com">www.tempsinsurance.com</a>	Michael Gibbs, president-Kensington Management Group Ltd., Luan Lee, vp-Captive Resources L.L.C.
10	Nonprofits' Insurance Alliance of California	California	\$37,400,000	4,303	Tax-exempt nonprofit organization	Auto liability, D&O, general liability, social service professional liability	Alliance Member Services P.O. Box 8507, Santa Cruz, Calif. 95061-8507	800-359-6422 Fax: 831-459-0853 <a href="http://www.niac.org">www.niac.org</a>	Susan Bradshaw, vp-marketing and member/broker services

Source: BI survey

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# Deals: Startups' approach makes M&A unlikely

Continued from page 10  
for now, say observers.

The class of '93 companies were mainly focused on one line of business, while the new companies have set themselves up as multiline, multilocation companies, said Sheila Nicoll, Olympus Re's president and chief underwriting officer. "It seems to me that makes M&A harder," Ms. Nicoll said.

"The dynamics of the market and business in Bermuda are substantially different from what they were six to 10 years ago," said Nigel Clark, president of Carvill (Bermuda) Ltd., a reinsurance intermedi-

ary. "Property cat is property cat," while the post-Sept. 11 companies "have a sort of multiline, multigeographical, multidiscipline" type of approach, with some of the same business but working in different layers, said Mr. Clark. "It doesn't make it quite such an easy decision" to merge, he said.

"I think there's really pre-third-quarter and post-third-quarter thinking," said James P. Bryce, president and chief executive officer of IPCRe. "I think, prior to the third quarter, where market conditions seemed to be softening, M&A was looked at as a possible avenue to

fuel future growth. But, I think, with the loss activity with the hurricanes and the typhoons," there is "probably less pressure to look at growing through mergers and acquisitions, and probably more opportunities to grow through rates," Mr. Bryce said.

The new companies' size is a factor as well, say observers. The '93 companies were much smaller, making them more easily digestible, noted Mr. Bryce.

Reserves are another complication. It takes time for the new companies' reserves to mature on medium- and long-term casualty busi-

ness, said Mr. Bryce. "You need time to get credibility on the results, and that, obviously, makes it much more difficult to put an evaluation on those books of business."

Bermuda companies also may be reluctant to take on other companies' problems, said Kenneth J. LeStrange, chairman and CEO of Endurance. "I think all the class of '01 have exhibited a great deal of conservatism when it comes to legacy liability issues and the potential through acquisition of making them your own," he said.

"There is no financial driver" to

these deals, said Keith S. Hynes, executive vp and chief financial officer of Hamilton, Bermuda-based Max Re Capital Ltd. "The valuation differences between these companies are fairly narrow," he said. "No one has a strong currency to make an acquisition."

Furthermore, M&A activity may not necessarily adequately address the issue of excess capital, say some observers. David T. Foy, executive vp and CFO of Guilford, Conn.-based White Mountains Insurance Group Ltd., noted that merging a company with excess capital with another such company "just makes it a bigger company with excess capital."

John Ward, chairman of the Cincinnati-based Ward Group said that, though a good acquisition can achieve good returns on equity, "I think the experience in a lot of deals in a lot of industries" is that M&As fall short of delivering that.

**'The dynamics of the market and business in Bermuda are substantially different from what they were six to 10 years ago.'**

*Nigel Clark  
Carvill (Bermuda) Ltd.*

But some observers believe that, driven by the need to achieve good returns on equity, a trend toward merging will develop. "I think it's reasonable to expect there will be some consolidation," said Laline Carvalho, an analyst with rating agency Standard & Poor's Corp. in New York. "How quickly that will happen, I think, is a question mark," she added.

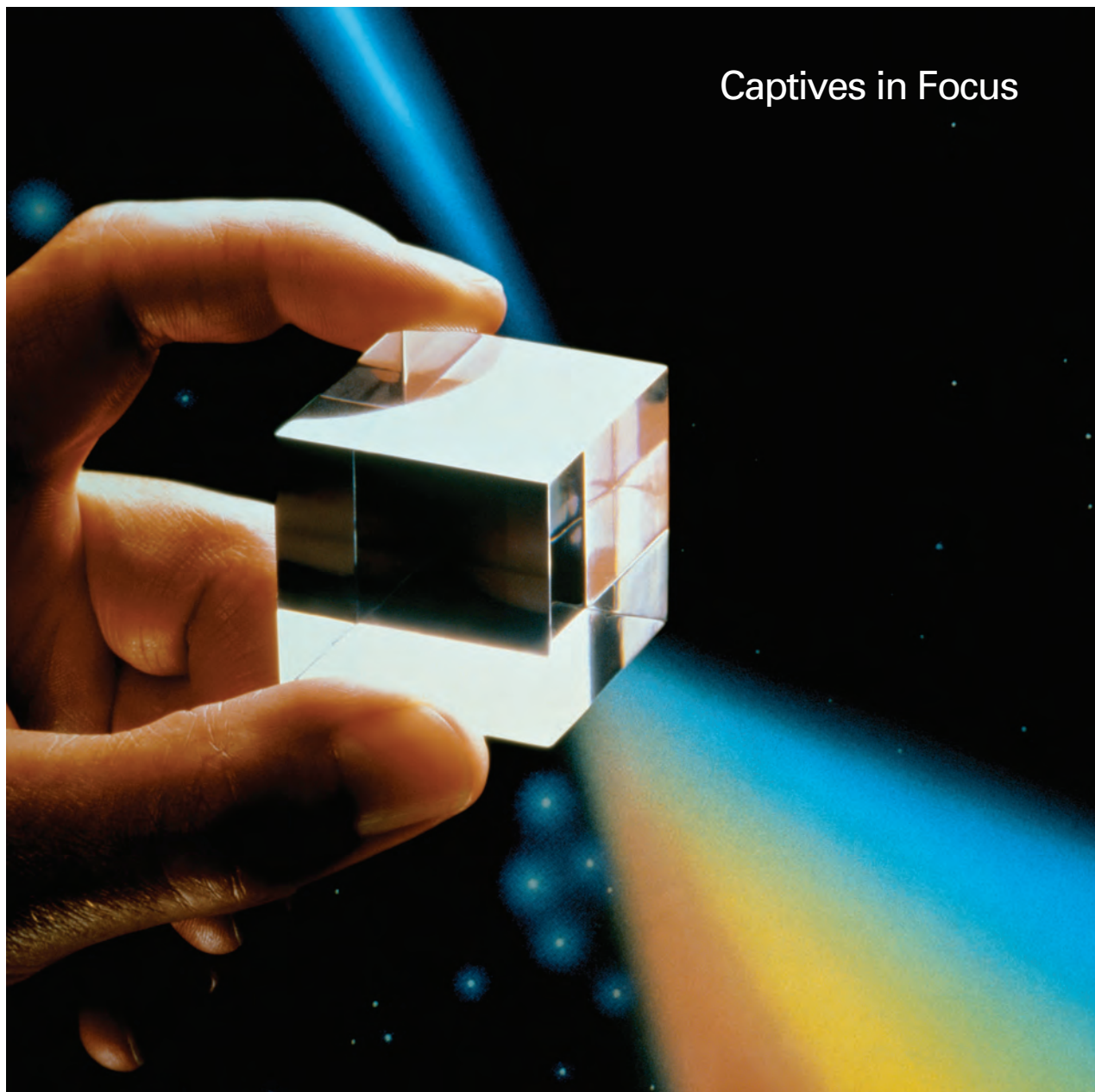
The market's softness will be a factor, said Ms. Carvalho. As prices move downward, there will be more pressure on companies to return capital to their shareholders, she said.

Jim Amen, a partner with Stamford, Conn.-based Philo Smith & Co., a boutique investment bank that specializes in insurance, also predicted that M&A activity will correlate with premium growth. Once growth slows and companies are "not quite satisfied" with their rate of return, "you may see the duplication of what happened in the past, the Bermuda companies coming together," Mr. Amen said.

Some of the companies are already looking for places to deploy their capital, and if they do not get an adequate return, acquiring a book of business or another company is an option, said Keith Lennox, a senior financial analyst with Oldwick, N.J.-based A.M. Best Co., who noted he has not yet seen any indications of this occurring. "Until the market really starts to soften, we're not going to have a real good feel for what's going to happen," Mr. Lennox said.

David Platter, managing director at New York-based Sagent Advisors Inc., a financial advisory firm, said

See **DEALS**/page 20



## Captives in Focus

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# Bermuda fine-tuning some insurance regulations

By MICHAEL BRADFORD

Bermuda regulators are tightening their authority a bit in one of the periodic adjustments to the island's law governing the insurance marketplace.

Several amendments to the Insurance Act are moving through the Bermuda Parliament and, once approved, are expected to be signed by Gov. John Vereker. While no drastic changes affecting insurers, reinsurers, brokers and

others in the Bermuda market are being considered, the amendments will require a few operating changes.

"This is kind of routine with us," Jeremy Cox, Bermuda's supervisor of insurance, pointed out. The amendments are "a kind of tweaking in certain areas," he said.

Under one amendment, the Bermuda Monetary Authority will require written information more quickly from companies significantly affected by financial or op-

erational problems. While regulators generally receive verbal notification soon after problems surface, Mr. Cox said, the amendment would require a written explanation within 14 days instead of 21.

Loss adjusters and auditors are also getting some added attention in the proposed regulatory changes.

Mr. Cox said that the amendments will explain more clearly the BMA's power to revoke the li-

censes of loss reserve specialists. The amendments also establish what information the auditors of insurers, reinsurers and others in the market are required to communicate to regulators.

The changes affecting auditors, as well as some other amendments, are "bringing us consistent with other areas of the BMA," which the insurance division joined in 2002, Mr. Cox said.

The amendments also provide "guidance notes" for those service

providers under the authority of the insurance division, Mr. Cox said. "This will better define our expectations and the roles and responsibilities for these individuals."

"I think our legislation, for the most part, is in pretty good shape," Mr. Cox said. A number of amendments in recent years have strengthened the legislation and given the insurance division improved abilities to regulate the market, he said.



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## Deals: M&A unlikely

Continued from page 18

he believes M&A activity is still 12 to 18 months away. He noted that most of the Bermuda reinsurers that started up after Sept. 11 were funded by private equity firms, which are now in the process of realizing their return on investment through public offerings and, in some cases, secondary offerings.

"That process has not yet finished," Mr. Platter said. "There'll be some fundamental selling still taking place by the founding owners of these businesses as they move on from this particular investment. Their time frame is always a three- to six-year type of time frame, and we've moved into that zone."

Once that process is complete, though, and the companies are appropriately structured, "you'll see more M&A activity come into play," Mr. Platter predicted. Companies that have been in business for three or four years will "start to look at the next phase of existence and may want to affiliate with other companies," he said, whether they are reinsurer-reinsurer combinations, reinsurer-primary combinations, U.S. or offshore companies.

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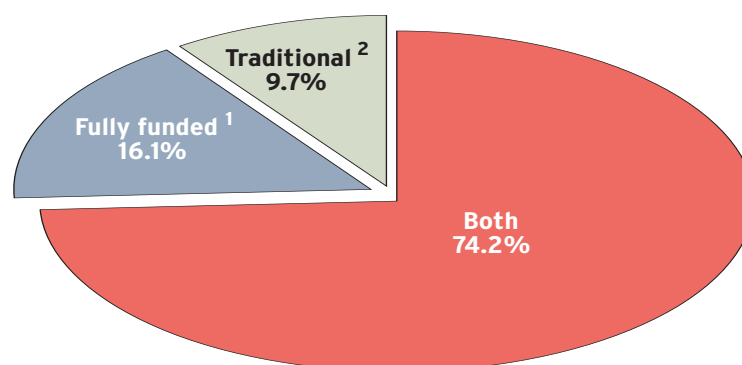
## LARGEST RENT-A-CAPTIVE MANAGEMENT COMPANIES

Ranked by number of facilities managed

Management company	Facilities
Allegro Insurance & Risk Management Ltd.	14
Atlantic Security Ltd.	4
AIG Insurance Management Services Inc.	2
Quest Management Services Ltd.	2

Source: BI survey

## TYPES OF RENT-A-CAPTIVE PROGRAMS



1 In fully funded programs, the rent-a-captive issues a policy and funds it up to the aggregate limit. 2 Traditional programs are written through a fronting company rather than by the rent-a-captive.  
Source: BI survey

# Largest rent-a-captive facilities

## Ranked by 2003 gross premiums written

Rank	Facility	Domicile	2003 gross written premium	Estimated 2004 gross written premium	2003 participants	Estimated 2004 participants	Risks insured	Management company/ Address	Telephone/Fax/ Web site	Contact
<b>1</b>	Guardrisk Insurance Co. Ltd.	South Africa	\$274,204,000 <sup>1</sup>	\$337,334,400 <sup>2</sup>	254	291	Life, nonlife	Guardrisk Holdings Ltd. Alexander Forbes Place, 90 Rivonia Road, Fourth Floor, Sandton, 2146, South Africa	27-11-669-1199 Fax: 27-11-669-1931 www.guardrisk.co.za	Andre Gideon Jordaan, financial director; andregj@guardrisk.co.za
<b>2</b>	Universal Re-Insurance Co. Ltd.	Bermuda	\$181,074,324	\$205,000,000	110	125	All lines	Atlantic Security Ltd. Windsor Place, 18 Queen St., Hamilton, HM 11, Bermuda	441-295-5425 Fax: 441-295-5444	Hal Forkush, president; hforkush@asl.bm
<b>3</b>	Uberrimae Fidei Insurance Co. Ltd.	Bermuda	\$100,000,000 <sup>3</sup>	\$55,000,000	8 <sup>3</sup>	12	All lines	Independent Management Ltd. P.O. Box HM 2070, Hamilton, HM HX, Bermuda	441-295-1646 Fax: 441-292-8062 www.img.bm	Francis J. Carter, president; fcarter@img.bm
<b>4</b>	Universal International Reinsurance Co. Ltd.	Bermuda	\$97,932,856	\$125,000,000	55	70	All lines	Atlantic Security Ltd. Windsor Place, 18 Queen St., Hamilton, HM 11, Bermuda	441-295-5425 Fax: 441-295-5444	Hal Forkush, president; hforkush@asl.bm
<b>5</b>	North Rock Insurance Co. Ltd.	Bermuda	\$78,000,000	\$35,000,000	70	70	NA	CNA Risk Services Ltd. Continental Building, 25 Church St., Hamilton, HM 12, Bermuda	441-295-6015 Fax: 441-295-1702 www.cnabermuda.bm	Thomas R. McMahon, vp; thomas.mcmahon@cna.bm
<b>6</b>	Lansdowne Insurance Co. Ltd.	Bermuda	\$75,000,000	\$100,000,000	53	60	Property/casualty	Allegro Insurance & Risk Management Ltd. Burnaby Building, 16 Burnaby St., Hamilton, HM 11, Bermuda	441-295-8495 Fax: 441-292-1196	Andy McComb, president; andy.mccomb@allegro.bm
<b>7</b>	Alternative Re Ltd.	Bermuda	\$73,900,000	NA	73	117	Auto liability, general liability, property, products and completed operations, workers compensation	Wessex House, 45 Reid St., Hamilton, HM 12, Bermuda	441-278-9245 Fax: 441-278-9249	Gavin P. Coltery, president/COO; gavin.coltery@- alternative-re.bm
<b>8</b>	Hurst Holme Insurance Co. Ltd.	Bermuda	\$57,919,833	\$85,000,000	20	22	Property/casualty	IAS Group 44 Church St., Hamilton, HM 12, Bermuda	441-295-3688 Fax: 441-296-1457 www.ias.bm	David P. Pickering, president; dpp@ias.bm
<b>9</b>	Artex Insurance Co. Ltd.	Bermuda	\$50,000,000	\$50,000,000	50	55	Auto liability, general liability, workers compensation	Artex Underwriting Managers Ltd. Sofia House, 48 Church St., P.O. Box HM 2000, Hamilton, HM HX, Bermuda	441-296-6429 Fax: 441-292-8231 www.rent-a-captive.com	Peter J. Mullen, president; peter_mullen@ajg.com
<b>10</b>	Richmond Insurance Co. Ltd.	Bermuda, Barbados, Gibraltar, Ireland	\$49,119,746	NA	NA	NA	NA	AIG Insurance Management Services Inc. 29 Richmond Road, Hamilton, HM 08, Bermuda	441-295-2121 Fax: 441-292-7969	Ralph Rathjen, executive vp

NA Not available 1 Fiscal year ending 3/31/04 (South African rand = \$0.1399) 2 South African rand = \$0.1632 (10/28/04) 3 Estimated  
Source: BI survey

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# Capacity: Property rate easing fosters shift to casualty

Continued from page 10

about one-third of its business in casualty lines, according to a spokeswoman for the Pembroke, Bermuda-based reinsurer.

According to RenaissanceRe's latest quarterly financial statement, the reinsurer wrote \$98.8 million in property catastrophe premiums in the third quarter of 2004 and \$33.4 million in specialty premiums. The specialty business includes catastrophe-exposed workers compensation business, surety and terrorism coverage.

Arch Reinsurance Ltd. has also expanded its casualty book, said

Marc Grandisson, president of the Hamilton, Bermuda-based reinsurer. Arch Re, which was established in 2001, has written "close to \$1 billion of casualty business during the last three years," he said.

Although the reinsurer has written casualty business since its formation, weakening property rates have made casualty underwriting more attractive during the past year, said Mr. Grandisson.

Arch Re's revenues now comprise about 50% casualty reinsurance, 35% property reinsurance and 15% specialty business, he said.

**'There is a hope that the hurricane losses will stabilize property rates and maybe divert some people away from expanding their casualty writing. But it is too early to tell.'**

Jonathan Gale  
Catlin Insurance Co. Ltd.fc

And as some U.S. casualty rates begin to weaken, Arch will likely

write more non-U.S. casualty business, particularly in Europe, where rates are still firm, Mr. Grandisson said.

Arch Re's casualty book is currently made up of about 60% U.S. business and 40% non-U.S. business, he said.

Endurance Specialty Holdings Ltd. also expects to increase its casualty business, said William M. Jewett, president of White Plains, N.Y.-based Endurance Reinsurance Corp. of America, the Bermuda-based company's U.S. unit.

Endurance, which also was set up after the Sept. 11 attacks,

has written excess workers compensation reinsurance and casualty clash reinsurance since its formation.

However, the company has recently increased its casualty reinsurance underwriting and, like several other Bermuda startups, has opened underwriting operations in the United States and London to access business that requires a greater degree of contact with brokers and clients, including casualty business, he said.

"On an absolute basis, Endurance's casualty underwriting has increased, and I still think there are further market opportunities for growth in casualty," said Mr. Jewett.

The Bermuda-based companies are well positioned to expand their casualty business, despite the long-tail nature of the business, said Arch's Mr. Grandisson.

"If you hire the right staff and expertise, you can write the business," he said. "It's a management issue. We keep track of the rates and have an understanding of the rate level that is appropriate for each line of business. If prices are driven down below those we are prepared to accept, we will turn the business away," he said.

Mr. Thorpe of Fitch, though, says reinsurers must keep in mind the significant differences between short-tail property business and casualty business.

"There are increased infrastructure requirements for casualty underwriting. Books of business take far longer to settle, and liabilities remain on an underwriter's books for longer, particularly for reinsurers," he said.

Further expansion in to casualty lines by property reinsurers may be limited, said Jonathan Gale, underwriting director for Catlin Insurance Co. Ltd. in Bermuda, which writes both property and casualty business.

"There is a hope that the hurricane losses will stabilize property rates and maybe divert some people away from expanding their casualty writing. But it is too early to tell," he said.

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# Drugs: Medicare cover may ease reimportation push

Continued from page 4

ly lower compared to the United States due to Canadian price controls, now comes from seniors, noted Sandy Lutz, director of PwC's Health Research Institute in Dallas.

Once the elderly get prescription drug coverage through the expansion of Medicare, interest in the reimportation issue will wane, Ms. Lutz predicted. In all, the expansion of the law will benefit about 40 million enrollees, most of them elderly, who now lack prescription drug coverage.

Turning to another area—health savings accounts—the PwC consul-

tants said the accounts offer a significant potential to make consumers better users of health care services, which could slow down the rate at which the costs of health care services and products are increasing.

While HSAs are too new to provide conclusive evidence—the federal law authorizing HSAs became effective only on Jan. 1 of this year—somewhat similar consumer-driven health care plans such as health reimbursements arrangements have been around long enough to show the cost savings potential of the plans, Mr. Rodgers

said.

Both HRAs and HSAs are linked to high-deductible health insurance plans. Employees draw upon their HRAs or HSAs to pay expenses not covered by the high-deductible plans. If an employee burns through an HRA or HSA quickly, he or she will be directly exposed to health care bills, because there typically is a fairly large gap between the account balance and the point at which high-deductible plan coverage kicks in.

That exposure to costs could change employee health care purchasing decisions. "If someone else

pays for the groceries, you probably buy different groceries," said Ron Bachman, a principal in PwC's Atlanta office.

Indeed, employers that have set up HRAs, which the Internal Revenue Service approved more than two years ago, have seen changes in the way employees purchase prescription drugs, the PwC consultants said.

For example, an employee who begins to use a new prescription drug might ask for only a 30-day rather than a 90-day supply, so he or she doesn't have to throw out 60 days' supply of the drug if the prod-

uct turns out to be ineffective, Mr. Bachman said.

Similarly, an employee with joint pain might be more inclined to determine whether ibuprofen, an inexpensive over-the-counter product, works as well as a prescription drug such as Celebrex, which may cost between \$80 and \$100 a month, Mr. Bachman said.

While many employers see consumer-driven plans as making employees better consumers of health care services, some health care providers have a different view of the plans.

Indeed, the plans are "frightening" to some hospitals, Mr. Rodgers said. Providers are worried that they might have to absorb more bad debt because health plan enrollees, rather than the health plan or employer, will be responsible for paying a greater share of billed services, he said.

"There are some positives and negatives as these plans spread through the market," Mr. Bachman said.

**While many employers see consumer-driven plans as making employees better consumers of health care services, some health care providers have a different view of the plans.**

The health care market also could be shaken by other developments, most notably a proposal by President Bush that would allow health insurers to sell a given policy in all other states after it had been approved by any one state.

That could result in insurers getting approval for their policies in states with relatively few requirements for the levels and kinds of expenses that the policies must cover and then marketing those policies nationwide.

"You open up the market to new products," Mr. Bachman said, adding that financial services providers such as banks might be more inclined to move into the health insurance market if health insurance policies could be sold across the country after being approved by just one state.

"Perhaps that would create more competition" in the market, he said.

President Bush's proposal, though, would require congressional approval before it could be put into effect.

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## Scandal: Not widespread

Continued from page 4

tions and multiple issues," replied Dave Diehl, a deputy commissioner with the California Insurance Department.

Mr. Diehl blamed the media for what he characterized as its tendency to "smash these things together and say it's all one thing."

He posed his own question that suggested that the problem is isolated and not systemic.

"Is the practice itself bad, or are there a few bad apples in the process that make it bad for everyone?" he asked.

"Contingent commissions have been around since, like, dirt," said Mr. Diehl, maintaining that that form of broker compensation should not be characterized as a new "Ponzi scheme."

So if such commissions are illegal, that "means all of us in the United States were turning a blind eye" to them, Mr. Diehl observed.

Still, if the commissions are legal, that "is no excuse for bid rigging so you can get more money," he said.

Mr. Diehl lamented that the scandal has created another problem for insurance buyers.

Referring to investigations under way by attorneys general in other states and the task force that the National Assn. of Insurance Commissioners has created to examine the issue, Mr. Diehl said, "This distracts us all from our core business of paying claims."

The panel's capital markets representative, Leandro S. Galban Jr., said, "it's difficult to tell" how the investment community will re-

act to the scandal.

But, "personally, I think the view is that bid rigging is not systemic," said Mr. Galban, vice chairman-investment banking with Credit Suisse First Boston L.L.C. in New York. "It just happened. Management was blindsided by it."

"This too shall pass," probably within the next year as authorities set their sights on other targets, said attorney Gandolfo V. DiBlasi, a partner with Sullivan & Cromwell L.L.P. in New York.

In the meantime, the investor and shareholder lawsuits filed against various brokerages and insurers as a result of Mr. Spitzer's lawsuit should not be given the class action status they seek, Mr. DiBlasi said.

He said too many people knew about the incentive compensation contracts that brokerages had with insurers to argue that that practice deceived and hurt insurance buyers.

"This is a situation where you have to look at each case," he said.

An attorney with a law firm representing plaintiffs in several lawsuits filed against brokerages and insurers allegedly involved in the scandal disagreed.

The lawsuits merit class action status because they allege the defendants violated their fiduciary duty to clients and because the alleged bid rigging led to higher prices for all insurance buyers, not just those accounts that were directly hurt by the illegal practice, said Mark Soloman, a partner with Lerach Coughlin Stoia Geller Rudman & Robbins L.L.P. in San Diego.

2004 PLUS International Conference

## HIPAA violations covered under liability policies

By DAVE LENCKUS

**SAN DIEGO**—Business can tap a variety of professional liability insurance policies to cover claims that arise from violations of a federal health information privacy law, a panel of experts says.

Specially tailored insurance products are designed to respond to claims filed against businesses that violate the Health Insurance Portability and Accountability Act of 1996, which does not shield employers, health care providers and those groups' service providers from civil damages as well as the law intends, the experts say.

But defendants already could be covered by one or more of their existing professional liability insurance policies, such as employment practices, fiduciary, directors and officers or errors and omissions liability insurance, the experts say.

The panel pointed out the coverage possibilities during a session at the Professional Liability Underwriting Society's 17th Annual International Conference in San Diego earlier this month.

Among other things, HIPAA was designed to reduce health care fraud and abuse and ensure the privacy of health care information. A

variety of measures to safeguard protected health information were required as of April 2003.

Protected health information under the act includes not only medical records but also other information—such as an individual's date of birth and Social Security number—included in those records, noted Carrie A. Brodzinski, a vp and product manager for executive liability and bond coverages at St. Paul Travelers Cos. Inc. in Hartford, Conn.

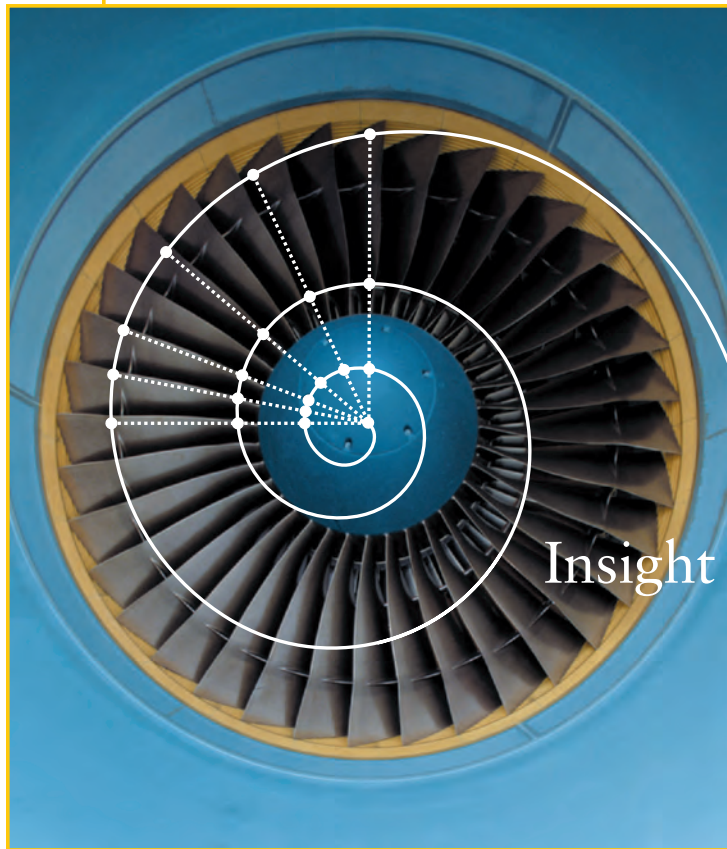
Businesses that violate HIPAA are subject to civil and criminal penalties, but there is no private right of action for individuals whose health care information has not been protected, noted Ms. Brodzinski and attorney H. Douglas Hinson, a partner with Alston & Bird L.L.P. in Atlanta.

Regardless, there are ways around the private right of action restriction, and the panelists said they expect to see a large number of HIPAA-related complaints.

Those complaints likely will result in litigation charging organizations with violations of individuals' right of privacy under state case or statutory law, Mr. Hinson said.

The panelists said that businesses that face

See HIPAA/page 30



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# HIPAA: Variety of policies may cover claims

Continued from page 28

such claims could turn to one of several policies for coverage:

- EPLI. Triggering EPLI coverage depends on whether a plaintiff had "a reasonable right of privacy," Ms. Brodzinski said. "With HIPAA, you do have that right."

Some HIPAA liabilities also might be addressed by the Americans with Disabilities Act, noted Kenneth W. Ross, a senior vp at Willis of New York Inc., a unit of Willis Group Holdings Ltd. That is important because virtually all EPLI policies expressly cover alleged ADA viola-

tions, he explained.

But some EPLI policies may respond to invasion of privacy claims only if they are linked to specifically covered acts, such as wrongful termination, Ms. Brodzinski said.

- Fiduciary liability. Some policies may exclude claims that are related to HIPAA violations, Ms. Brodzinski noted. Still, organizations could turn to this insurance to cover the civil fines and penalties arising from HIPAA violations, she said.

But Mr. Ross said that risk managers should clarify when purchas-

ing the coverage whether it would cover fines.

- D&O. HIPAA requires companies to create the position of corporate privacy officer, and D&O policies cover duly elected and appointed officers, Mr. Ross noted.

But risk managers should examine whether their policies specifically exclude coverage for privacy officers, he said.

In addition, some exclusions might extend to losses arising from personal injury claims such as invasion of privacy, he said.

- E&O. Service providers for em-

ployers and health care providers should examine whether their E&O policies exclude any claims arising from violations of the Employee Retirement Income Security Act or related rules and regulations, which would include HIPAA, Mr. Ross said.

E&O policies also might exclude coverage for personal injury claims, he said.

Defendants also could turn to their general liability insurance policies, most of which cover employee benefits liabilities, Mr. Ross said.

Another source of coverage is fidelity insurance, Mr. Ross said. Fidelity policies could cover extortionists' demands for money in exchange for not releasing private health information they obtained from organizations by hacking into computer systems, he said.

Risk managers should understand a potential problem with having coverage under multiple policies, Mr. Ross asserted. A claim could spark a coverage battle among an organization's various insurers over which one must shoulder the primary responsibility for the loss.

"This is an evolving area," Mr. Ross said. "It's definitely not a black and white area—it's definitely gray."



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## 2004 PLUS International Conference

# Meeting draws big numbers

The Professional Liability Underwriting Society attracted a near-record 2,038 attendees to its 17th annual international conference, held Nov. 3-5 in San Diego. The attendance figure fell slightly below the record of 2,100, which was set last year.

The conference featured 17 sessions on a variety of professional liability insurance issues, ranging from the status of the directors and officers liability insurance market to invasion-of-privacy risks created by the Health Insurance Portability and Accountabil-

ity Act to emerging cyber risks.

Next year's conference is scheduled for Nov. 13-16 at the Marriott Copley Place in Boston.

Additional information about PLUS and its conference is available by contacting either Scott Billey, director of operations, or Kristine Baruth, chapter and events planner, at 800-845-0778. Mr. Billey also can be contacted at [sbilley@plusweb.org](mailto:sbilley@plusweb.org); Ms. Baruth can be reached at [kbaruth@plusweb.org](mailto:kbaruth@plusweb.org).



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## Between the Lines

Compiled by Joanne Wojcik



### Jockeys mount coverage challenge

About a dozen jockeys, stomping mad at racetrack owners for not providing adequate accident insurance, have been barred from participating in this year's Churchill Downs Fall Meet in Louisville, Ky.

The jockeys were ejected Nov. 7 after they declined to accept mounts for last Wednesday's and Thursday's races.

"The recent catastrophic accidents involving jockeys Remi Gunn (paralyzed at Churchill Downs-owned Ellis Park in Henderson, Ky., in August 2003), Michael Rowland (killed at Turfway Park in Florence, Ky., earlier this year), Gary Birzer (paralyzed at Mountaineer Park in West Virginia), and most recently Anthony D'Amico (seriously injured at Churchill Downs) are bitter reminders of the lack of adequate insurance provided jockeys riding in the state of Kentucky," asserts a notice posted on the Web site of the Jockey's Guild, the union that represents professional jockeys.

While jockeys' injuries are covered by workers compensation in five states—California, Idaho, Maryland, New Jersey and New York—racetrack owners in Kentucky typically provide insurance limits of just \$100,000 to pay for jockeys' on-the-job injuries. Jockeys are also eligible to participate in the guild-sponsored health benefit program, but it does not cover racetrack injuries because they are work-related.

PHOTO: THOMAS E WITTE/ICON SMI

**A jockeys' union says Kentucky racetracks have inadequate coverage for riders.**

### Lawbreaker aspires to be lawmaker

A candidate for the Pennsylvania Legislature, whose name was removed from this year's ballot because he was convicted of insurance fraud in 2001, is fighting to clear his name.

According to the Pennsylvania Supreme Court, Michael J. Cavanagh was not eligible to run in this November's election under a provision in the state's constitution that bars anyone convicted of an "infamous crime" from seeking or holding public office.

But Mr. Cavanagh, who was convicted in 2001 of submitting a fraudulent claim for \$1,373 in auto repairs to Allstate Insurance Co. in 1998 after a 1996 motor vehicle accident, has filed an appeal of his conviction.

It's the second time Mr. Cavanagh's political aspirations have been stymied. He was forced to set aside an earlier campaign for a county commissioner seat while he served his two-month sentence for the insurance fraud conviction.

### Friends or foes?

In the controversial world of workers compensation regulation, an insurance commissioner can be your friend one minute and your adversary the next.

Speaking before a business group last week in Los Angeles, California Insurance Commissioner John Garamendi praised a fellow panelist, policyholder attorney Nicholas P. Roxborough, for once joining with other constituents to help the commissioner formulate workers compensation reform ideas.

PHOTO: LA TIMES

But later, when an audience member asked the commissioner about Indian tribes that sell controversial workers comp policies and claim they have sovereign immunity from state regulation, Mr. Garamendi turned on Mr. Roxborough and even feigned striking him.

As it turns out, Mr. Roxborough represents a group of tribes locked in a legal battle with Mr. Garamendi.

But soon after the mock display of animosity, the two quickly joined forces again. They declined, though, to provide any details of a possible settlement.

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

### 2004 PLUS International Conference

## Cyber risks not well understood

By DAVE LENCKUS

**SAN DIEGO**—The cyber risk insurance market's slower-than-anticipated growth during an environment of mounting risk stems in part from friction between risk managers and information technology security officers and from reinsurers' uncertainty about cyber risks, according to a panel of experts.

The panelists assessed the market during a session at the Professional Liability Underwriting Society's 17th Annual International Conference in San Diego earlier this month.

A cyber risk insurance market that would produce at least \$2 billion of gross written premiums in 2005 is "wishful thinking," said Michael C. Lamprecht, the cyber risk national practice leader at the Chicago-based Gallagher CyberRisk Services division of Arthur J. Gallagher & Co.

The coverage currently generates \$140 million of gross written premiums annually, but Mr. Lamprecht said he expects double-digit premium growth for several years.

Organizations generally can obtain up to \$100 million of limits, but \$150 million of capacity sometimes is available, he said.

The main buyers include technology companies, financial institutions, health care providers and multimedia companies that generate between \$500 million and \$1.5 billion of sales annually, he said. The coverage typically is too expensive for smaller companies, and larger organization generally self-insure the risk, he said.

Market penetration has been slow in part because of a disconnect between risk managers and IT security officers, said Tracey Vispoli, the Warren, N.J.-based vp-worldwide financial fidelity manager at Chubb &

Son, a Chubb Corp. unit.

IT security officers understand the risk their organizations face, but they tend to view the need for insurance as an indictment of their ability to perform their jobs effectively, she said.

While risk managers are well versed in risk avoidance, they "are not comfortable" with their understanding of cyber risks, she said.

The two sides are beginning to collaborate, though, she said. That cooperation is fostered when the IT security officer understands that the purchase of cyber risk insurance is designed to complement information security efforts, Ms. Vispoli said.

The market's future also will depend on whether more reinsurers become comfortable with covering cyber risk, said Sandy Hauserman, a New York-based senior vp and the environmental practice leader for reinsurance intermediary Guy Carpenter & Co. Inc., a subsidiary of Marsh & McLennan Cos. Inc.

Reinsurers need more education about the risk, Mr. Hauserman said.

They want to know more about how rates are determined by the few insurers that have the expertise to underwrite cyber insurance, he said.

Reinsurers also want to see how risks are evaluated. They would like to feel confident that policyholders that suffer cyber attacks have business recovery plans that would bring them back online quickly, which would minimize losses, he said.

"There's so little understanding among reinsurers and the area is so untested that the decision to get on a risk has to go up to the upper management" at reinsurers, he said.

Some buyers also do not clearly understand the risk, the panelists said.

Organizations without any Web-

based commerce "don't think they have any risk," which is a mistaken notion, Gallagher's Mr. Lamprecht said.

Other panelists agreed.

"The Internet poses new risk—risk we don't have a lot of experience with," said insurer attorney Paul Janaskie, a partner with Shaw Pittman L.L.P. in Washington.

Risks include those stemming from the loss of electronic data as well as from business shutdowns after denial-of-service attacks by extortionists, he said.

The panelists agreed that organizations increasingly face the decision of whether to protect their Web sites by paying extortionists' cash demands.

Mr. Lamprecht said that 95% of the companies he has seen attacked have met the extortionists' demands, which generally range between \$10,000 and \$50,000. The remaining 5% that refused have lost millions of dollars in business when the extortionists disabled the organizations' Web sites, he said.

In addition, organizations that outsource their backroom operations face far greater risk than they realize, Chubb's Ms. Vispoli asserted.

A successful cyber attack against an outsourcing service provider still poses reputational risk for an organization, Ms. Vispoli said.

Plus, "true liability" still rests with the organization if the attack creates a service interruption or leads to the disclosure of private health information protected by the Health Insurance Portability and Accountability Act of 1996, she said (see story, page 28).

Concerns over HIPAA-protected information "is getting more serious buyers in the door," Ms. Vispoli noted.

# Business Resources

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## Beijing requires facilities to buy med mal coverage

By MICHAEL BRADFORD

**BEIJING**—A Chinese city government agency, tired of waiting for health care providers to purchase medical malpractice liability insurance, is forcing public facilities to buy the coverage.

The Beijing Municipal Health Bureau has ordered hospitals and other public medical care operations in the capital to buy the coverage and use an independent third party to mediate medical liability disputes between the facilities and patients. The order took effect earlier this month.

Since 1998, the bureau has encouraged health care facilities to buy coverage, but few did because premiums are high and available coverage limits are not, according to Liqiang Zhao, chief representative of Wanxiang-Horton Insurance Group Ltd., a Beijing-based insurance broker.

There are more than 60 large health care facilities in Beijing and around 700 smaller ones that would be affected by the order, said Mr. Zhao. They employ around 100,000 health care practitioners, many of whom are uninsured, he noted. While the government has protection from lawsuits, the city's health care facilities and individual providers can face claims.

While malpractice lawsuits are not frequently filed in Beijing, awards generally are high by Chinese standards, Mr. Zhao said, with the highest at around \$350,000 in 2002.

Among the few insurers writing

medical malpractice coverage in China are PICC Property & Casualty Co. Ltd. and Ping An Insurance (Group) Co. of China Ltd., Mr. Zhao pointed out.

Interest in underwriting Chinese risks remains high among foreign-owned insurers, and one U.S. industry expert believes Chinese officials have taken a step in the right direction but can do more to bring malpractice and other coverages to businesses and residents in the country.

The health bureau's move is "positive recognition that insurance is essential in a wide variety of areas in Chinese society," said David Snyder, vp at the American Insurance Assn. in Washington. "That said, Chinese insurance regulators continue to be unfriendly in encouraging foreign insurance participation."

Very high capitalization requirements and restrictions on operating across wide geographic areas are hampering the expansion of foreign insurers that could bring capacity to the country, Mr. Snyder said.

Things could change, though, he pointed out, because the capitalization requirement and other obstacles to foreign insurers in China are matters of discussion between the Chinese and U.S. governments.

And, Mr. Snyder noted, the need for greater insurer involvement could increase as Chinese officials issue more coverage mandates. "I rather expect you will see more of this as they recognize the social value of insurance," he said.

## Many insurers unready for U.K. capital rules

By PETA MILLER

**LONDON**—Many U.K. insurance companies will fail to meet new risk-based minimum capital adequacy requirements coming into effect at the end of this year, according to a member of the firm that helped develop the rules.

The new solvency standards are expected to boost by £2.5 billion (\$4.64 billion) the amount of capital the industry needs overall, predicted Nigel Gillott, a London-based partner at Watson Wyatt Worldwide, speaking at a conference in London titled "Threats to the London Market," which was sponsored by the Assn. of Lloyd's Members.

As a result of the requirements, Mr. Gillott said, some weaker U.K. insurers will have to cut back business, while stronger companies will be able to write more.

The Financial Services Authority issued Consultation Paper 190, "Enhanced Capital Requirements and Individual Capital Assessments for Nonlife Insurers," in July 2003, proposing to take a more risk-based approach to insurers' capital requirements in an effort to reduce financial failures.

The rules, which take effect Dec. 31, will impose new capital requirements on all nonlife insurers registered in the United Kingdom.

Those requirements will far exceed the minimums mandated by European Union directives. Previously, U.K. insurance regulators set requirements for insurers by multiplying minimum E.U. capital requirements two or three times, depending on the line of business.

Under the new regime, though, each insurer will be required to calculate an enhanced capital requirement, a risk-based calculation of the minimum capital required to support its underwriting operations.

The ECR will be determined by multiplying the firm's assets, liabilities and net premium volume by percentage risk weights according to its asset and business classes.

For example, for net premium volume from commercial property damage and theft business, the capital charge factor will be 10%, whereas employers liability business calls for a factor of 14%.

Each insurer will have to report its ECR privately to the FSA and use that ECR to help form its own

assessment of its overall capital adequacy. The FSA will then take the company's individual capital assessment, or ICA, into account in issuing individual capital guidance, or ICG, to the firm about the amount of capital it believes should be held.

About 15% of U.K. companies, excluding Lloyd's of London, will not meet the ECR requirement, while 30% of them will not meet the capital requirement resulting from the ICA/ICG stage, Mr. Gillott predicted. In addition, 40% of U.K. companies "will have to do something to reduce the risk downwards," he said.

Overall, the industry will need an extra £2.5 billion of capital to meet the requirements, but not all companies will opt to set aside the additional funds, he continued.

"Some weaker companies will write less business, and some stronger ones will write more," said Mr. Gillott of Watson Wyatt, which worked with the FSA on the proposals for insurers' capital adequacy requirements.

He noted that Lloyd's will not be in an obviously better position than the rest of the U.K. market to meet the new FSA solvency standards.

"Most Lloyd's businesses have done nothing, and there is a great rush to pull everything together at the moment," Mr. Gillott added, although he noted that this was caused partly by the later publication of requirements for the Lloyd's market. The FSA proposals for the Lloyd's market appeared separately in Consultation Paper 04/7, published in April.

The Lloyd's market is in the same position as other U.K. insurers, though, with managing agents having to work on ICAs. But the process is more difficult at Lloyd's, Mr. Gillott said, because the structure of that market is more complicated.

Mr. Gillott declined to estimate the percentage of Lloyd's companies that will be in compliance by Dec. 31, saying the data is not available.

A question from the floor was raised as to how the U.K. insurance industry would be able to give shareholders a sufficient return on capital under the new requirements when it has not been able to do so at current capital levels.

Mr. Gillott responded, "The hope is insurers will become more professional and you will not have people underpricing and damaging the industry."



## World Updates

### Munich Re posts profit for first nine months

Munich Reinsurance Co. recorded a profit of 1.53 billion euros (\$1.86 billion) for the first nine months of 2004, up from a loss of 487 million euros (\$534.4 million) for the comparable period last year. The 2003 nine-month loss stemmed mainly from investment writedowns. The German reinsurance giant said that, despite estimated windstorm losses of 550 million euros (\$669.3 million) in the third quarter, it posted a profit of 365 million euros (\$444.2 million) for that period, compared with a profit of 42 million euros (\$46.1 million) for the prior-year period.

### HSE issues standards on stress management

The United Kingdom's Health and Safety Executive has published a set of standards aimed at helping employers manage the risk of stress in the workplace. The standards, which are not regulations, include guidelines on the demands that should be placed on employees, the level of support employees should receive in doing their jobs and how employers should manage operational change. The HSE said in a statement that it estimates that more than 13 million working days are lost annually to work-related stress. The standards can be viewed at [www.hse.gov.uk/stress](http://www.hse.gov.uk/stress).

### Cat losses hold down Hannover Re profits

Hannover Reinsurance Co. posted a profit of 191.1 million euros (\$237.3 million) for the first nine months of 2004, down 25.5% from the comparable period last year. Contributing to the decline was a third-quarter net loss of 20.4 million euros (\$25.3 million), compared with a profit of 94.2 million euros (\$117.0 million) for last year's third quarter. The quarterly net loss stemmed largely from natural catastrophe losses of 358.6 million euros (\$445.3 million), the reinsurer said in a statement. Gross written premiums fell by 19.1% in the first nine months of 2004, to 7.18 billion euros (\$8.92 billion).

### Briefly noted

**Willis Group Holdings Ltd.** is acquiring London-based insurance broker and group benefits consultant Opus Holdings Ltd. from buyout firm Bridgepoint Capital Ltd. Opus has revenues of about £13 million (\$24.1 million), Willis said in a statement.... Reinsurance intermediary R.K. Carvill & Co. Ltd. has launched a division, **Carvill Re**, to focus on the company's business in the London reinsurance market.

## Two AIG units acquiring RSA's business in Japan

**TOKYO**—Two units of American International Group Inc. have agreed to buy Royal & SunAlliance Insurance Group P.L.C.'s Japanese business.

American Home Assurance Co. and AIU Insurance Co. are paying around \$169.5 million for the business, which is expected to generate annual premiums of about \$103 million. The business will be handled by existing branches of American Home and AIU Insurance.

London-based RSA said in a statement that the purchase, subject to regulatory approval, will be a cash transaction and that the price is "principally for the goodwill of the business."

The purchase will allow the AIG companies to expand their personal accident, commercial property, inland marine and other writings across Japan, according to a statement by Robert Clyde, president of the AIG companies in Japan. In the first nine months of 2004, AIG

wrote about \$2.37 billion in gross premiums in Japan and Korea, the New York-based company said.

Simon Lee, RSA's chief executive officer of international business, said in the statement that the sale ends the "main restructuring process" for the insurer's international business, which began in 2002.

Meanwhile, RSA posted a net loss of £163 million (\$294.9 million) for the first nine months of 2004, compared with a restated net loss of £208 million (\$345.7 million) for the comparable period last year. A spokeswoman for the London-based insurer said that loss for the first nine months of 2004 was attributable to short-term fluctuations in the insurer's investments. The group's net written premiums for the first nine months of 2004 dropped 26.3%, to £3.78 billion (\$6.84 billion), due to the reorganization and the disposal of units.

—By Michael Bradford and Sarah Veysey

## Products & Services

### Lexington expands terrorism risk products

**NEW YORK**—Lexington Insurance Co., a subsidiary of American International Group Inc., has introduced a suite of insurance products to help protect businesses against terrorism exposures such as losses due to chemical or biological attacks.

The program, LexHomeland Protector, offers a variety of products to provide broad terrorism coverage for property/casualty risks. The program includes property terrorism coverage that can be purchased on a stand-alone basis or within a property policy, and it protects against terrorist attacks committed by U.S. or non-U.S. citizens. Some of the other products include LexVenue

Liability Protector, which provides general liability coverage, including accidental death and dismemberment, insuring those killed in a terrorist attack. It also covers sports stadiums, museums and other venues that hold more than 1,000 occupants. Also, the LexCyberSecure product insures losses due to computer attacks caused by cyberterrorists.

Another feature of the LexHomeland Protector is the biochemical attack endorsement called LexBioChem Shield, which is an optional component of Lexington's property policy with terrorism coverage and the stand-alone terrorism policy. It provides coverage for cleanup and business interruption due to a biological or a chemical attack, which may have been committed domestically by U.S. or non-U.S. citizens.

The limits available for LexVenue Liability protector reach \$25 million for commercial general liability and up to \$10 million for accident and health, the available limits for LexCyberSecure reach \$25 million and the LexBioChem Shield limits are up to \$10 million.

For more information, contact Charles Benda, practice leader-Lexington Homeland Security Practice, in the New York office at 212-770-3745 or at [homelandprotector@aig.com](mailto:homelandprotector@aig.com).

### The Hartford launches medical equipment cover

**HARTFORD, Conn.**—The Hartford Financial Services Group Inc. has introduced a coverage program for medical diagnostic equipment.

The program is available to owners of high-end medical diagnostic equipment such as CAT scans and MRIs. It intends to protect equipment owners from the exposures they face, offering a

stand-alone policy that includes medical breakdown and all-risk protection for the equipment. It also features business extra expense and expedited expense coverage, which covers the loss of income and other expenses during the replacement or repair of equipment; and automatic coverage for computer equipment losses due to physical damage or site control systems.

The available capacity for this program is \$10 million.

More information can be obtained by contacting Lauren Berry, assistant vp of marine operations, at 860-547-3497 or at [lauren.berry@thehartford.com](mailto:lauren.berry@thehartford.com).

### Chubb offers liability coverage for law firms

**WARREN, N.J.**—Chubb Corp. is offering a new coverage program for law firms to add protection from lawsuits that may stem from services the firms provide outside the legal arena.

The ChubbPro Lawyers Professional Liability Insurance intends to protect lawyers from exposures they face from acting as notaries public, government affairs advisers, fiduciaries and others. The policy includes broad definitions of claims, losses, insureds and professional services. It also includes a claims-made policy form with an extended claim-reporting period that allows law firms to report claims even after the expiration of a policy period. The policy also provides for the defense of any covered claims and allows the policyholder to choose its own defense counsel.

The Warren, N.J.-based Chubb's program has \$25 million in capacity and the available limit is up to \$10 million, depending on the size of the company.

For more information, contact James L. Rhyner, worldwide lawyers professional manager for Chubb Specialty Insurance, at 908-903-5183 or at [jrhyner@chubb.com](mailto:jrhyner@chubb.com).

# Professional MarketPlace

#### ANNOUNCEMENT

## Commonwealth Insurance Company



Annie Leong, CIP



Brian L. Aston



Diana Stocco, CIP

Mr. Ronald G. Schwab, President and Chief Executive Officer of Commonwealth Insurance Company is pleased to announce the following appointments: **Annie Leong**; Assistant Vice-President Claims Division to Vice-President Claims Division, **Brian L. Aston**; Assistant Vice-President Claims Division to Vice-President Claims Division and **Diana Stocco**; Assistant Vice-President Claims Division to Vice-President Claims Division.

Ms. Leong's career spans over 23 years with Commonwealth in the Claims Division. Having concentrated the past 15 years on casualty claims, Ms. Leong has proven successful in handling every type of claim Commonwealth has encountered. While assuming greater responsibilities over the years, Ms. Leong's knowledge, experience and education have played a key role in the growth of the Claims Division.

Mr. Aston joined Commonwealth in 1997 after 25 years of experience as an independent adjuster. During the past seven years, Mr. Aston has dedicated his experience, knowledge and skills to energy claims, predominantly in the

areas of oil and gas. This promotion recognizes his commitment and expertise in the field. Mr. Aston will continue to enhance the success and growth of the company through his increased responsibility in the Claims Division.

Ms. Stocco joined the company 24 years ago and has held positions in both the Reinsurance and Claims Divisions. Ms. Stocco has been instrumental in the claims aspects inherent in the growth of Commonwealth in the U.S. casualty arena. Through her tenure Ms. Stocco has dedicated herself to leadership and professionalism. This promotion recognizes her invaluable contributions to the Claims Division.

Commonwealth Insurance Company commenced operations in 1950 and is a major writer of all classes of commercial property, casualty, oil, gas, petrochemical and marine insurance through brokers in Canada, United States and abroad. Commonwealth is a wholly owned subsidiary of Northbridge Financial Corporation which is traded on the TSX (NB).



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#### ANNOUNCEMENT

#### EDUCATION

### Florida State University



offers an online master's degree in Risk Management and Insurance (concentrations in Property & Liability or Financial Services). This affordable and flexible program can be completed via Internet access from any location. For more information on the May 2005 sequence, visit [www.cob.fsu.edu/grad](http://www.cob.fsu.edu/grad)

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## Results: Cost hikes moderating

Continued from page 3

generic and over-the-counter drug usage.

Despite moderating premiums, however, employers will continue to explore other methods to further curb health care costs, which continue to outpace inflation, analysts say.

"Employers are still looking at alternatives to bring costs down," said Sally Rosen, senior financial analyst at A.M. Best Co. in Oldwick, N.J.

These methods may include the increased adoption of consumer-driven plans or the continued scaling back of benefits, according to analysts. Several insurers are now aggressively marketing health savings accounts—which were authorized under a 2003 law—as part of the consumerist movement, they say.

### A few disappointments

Although most of the managed care companies reported increases in net income in the first nine months, Los Angeles-based Health Net Inc. continues to struggle due to the ongoing impact of higher-than-expected health care costs, workforce reduction expenses and declining membership. The company posted net income for the first nine months of \$128.2 million, down 11.4% from the prior-year period, while its membership fell 4% to 3.7 million in the last 12 months.

Health Net is beginning a turnaround that will take several years to complete, analysts say. The company's biggest challenge is in its Northeast segment, where it faces stiff regional competition from Hartford, Conn.-based Aetna

Inc., Indianapolis-based Anthem Inc. and Minneapolis-based UnitedHealth Group Inc., they say.

"There will be further attrition in the membership," said Douglas Meyer, senior director at Fitch Ratings in Chicago. "That's going to put pressure on their costs as well," he said.

In its third-quarter earnings release, Health Net officials said the company's commercial enrollment declines in the Northeast were a direct result of pricing increases designed to eliminate less profitable accounts and improve profit margins.

Philadelphia-based CIGNA Corp. is also encountering problems as sharp membership declines continue to have an adverse impact on its 2004 revenues. Revenues dropped 3.31% to \$13.8 billion in the first nine months of 2004 as a 16%

membership plunge continues to pressure premiums and fees.

CIGNA, though, is a little further along in its turnaround than Health Net, although the company needs to make sure its expenses remain consistent with its reduced membership, Mr. Meyer said.

"They're making progress, but they're continuing to see membership loss," he said.

CIGNA said its ability to retain clients has improved in the second half of 2004 and while it expects membership to decline 8% to 9% in the first quarter of 2005, the company believes its efforts will lead to stable membership for the rest of 2005.

Membership for most of the other major managed care companies remained flat to modestly higher in the first nine months of 2004.

"Membership for the industry as a whole has been constrained by the limited job growth and the economy," Mr. Meyer said.

Several companies have been

able to boost membership by aggressively pricing their products in an attempt to take business from other companies. Several analysts said they expect this trend to continue in 2005 because most companies are increasingly confident in their ability to gauge cost trends and price their products accordingly.

And some companies will continue to look to acquisitions to grow membership, analysts say.

This year, UnitedHealth Group Inc. has completed several acquisitions, including its purchase of Trumbull, Conn.-based Oxford Health Plans Inc., while Anthem Inc. has moved closer to finalizing its merger with Thousand Oaks, Calif.-based WellPoint Health Networks Inc. (see story, page 1).

"M&A activity is part of the industry dynamic right now," Mr. Marinucci said. "We're going to continue to see it going forward. The industry will continue to consolidate."

# Professional MarketPlace

#### LEGAL NOTICE

### Anglo American Insurance Company Limited ("Anglo")

#### NOTICE UNDER THE SCHEME

NOTICE IS HEREBY GIVEN that following approval of an Amending Scheme of Arrangement dated 20 August 2004 (the "Scheme") by the requisite majority of Anglo's Scheme Creditors under Section 425 of the Companies Act 1985 of Great Britain, sanction by the English Court and the making of a permanent injunction order ("the Section 304 Order") under Section 304 of the United States Bankruptcy Code by the Bankruptcy Court, the provisions of the Scheme became effective on 20 October 2004 (the "Amending Scheme Effective Date").

The Bar Date for the purposes of the Scheme is 11:59 pm Greenwich Mean Time on 31 January 2005. Unless they have agreed the quantum of their claim with the Scheme Administrators under Part 2 of the Scheme before the Bar Date, Scheme Creditors **MUST submit a Claim Form and full Supporting Information to the Scheme Administrators** in accordance with Part 8 of the Scheme, so as to be received by them before the Bar Date. Scheme Creditors who do not make such a submission before the Bar Date will not be entitled to receive any payments under the Scheme in respect of Scheme Claims which are not already established at the Amending Scheme Effective Date.

If you are a Scheme Creditor or believe yourself to be a Scheme Creditor of Anglo and have not received by 19 November 2004 a letter including a claims form notifying you of the Bar Date please contact the Scheme Administrators as soon as possible by email at [angloamericaninsurance@kpmg.co.uk](mailto:angloamericaninsurance@kpmg.co.uk) or in writing to the Scheme Administrators at Anglo American Insurance Company Limited, c/o KPMG LLP, 8 Salisbury Square, London, EC4Y 8BB.

In addition, if you are a Scheme Creditor or believe yourself to be a Scheme Creditor of Anglo and are subject to insolvency proceedings of the type referred to in Section 1(1) of the Third Parties (Rights Against Insurers) Act 1930 you are required immediately to inform us the Scheme Administrators of this fact and provide a copy of the Amending Scheme documentation and Claim Form received to those of your creditors who have or might have claims against them which are insured by Anglo.

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## Merger: Green light

Continued from page 1

is generally seen as a positive for large, multistate employers, because it would give them another option for their benefit programs and more negotiating leverage with health care providers—key factors in reducing health care costs.

"From a large employer point of view, that would be a positive," said Helen Darling, president of the Washington-based National Business Group on Health. "More concentration and consolidation in the health insurance industry allows employers to have more clout. We don't like them to have a monopoly, but we like them to be strong."

Large, national employers "might see increased competition, so that can only be good" for them, said Douglas Meyer, senior director at Fitch Ratings in Chicago.

But John Ward, chairman of the Cincinnati-based Ward Group, said that the combined company would also have greater leverage in negotiating with clients, adding, "It's safe to say that the premiums would be higher for the ultimate consumer than if these two organizations had not combined."

Employers are concerned about potential premium increases related to the financial concessions featured in the California settlement, particularly if other states make similar demands, said Lisa Gish, executive director of the Evansville, Ind.-based Tri-State Business Group on Health.

Indianapolis-based Anthem and Thousand Oaks, Calif.-based WellPoint agreed to pay \$150 million—in addition to a previously announced payment of \$115 million—to fund health care improvements in California. The companies also agreed to invest additional money on a dollar-for-dollar basis if executive compensation tops \$265 million.

"I think the concern is... what the impact will be on rates," Ms. Gish said. "We just can't afford to see arbitrary hits to the premium line based on other states' negotiations."

Employers, though, are somewhat optimistic that the merger could result in operational efficiency and technological improvements that they may benefit from.

"In theory, there should be increased economies, and that should be passed on to the employers," Ms. Darling said.

The companies' ability to integrate their operations is a key concern about the merger, though, analysts say.

"Combining two different organizations with different cultures is always a challenge," said Joseph Marinucci, credit analyst with New York-based Standard & Poor's Corp. "There is a certain degree of uncertainty regarding their ability to make this go smoothly."

The merger of Anthem and WellPoint is expected to be completed in the first quarter of 2005, or possibly sooner if the companies are able to quickly resolve outstanding regulatory issues.

Although the required approvals from other states were secured before Mr. Garamendi's initial denial

of the merger, several state regulators now say they are reviewing the transaction in light of the California settlement.

For example, Eileen Mallow, assistant deputy commissioner for the Office of the Commissioner of Insurance of Wisconsin in Madison, said it was premature to discuss any possible financial concessions similar to those in the California settlement, but no such concessions were featured in the department's original order.

A spokesman for the Missouri Department of Insurance in Jefferson City said the department does not plan to reopen its review to demand financial concessions similar to those featured in the California deal. "Those sorts of sweeteners are not typical," the spokesman said.

Officials in Texas and Oklahoma said the deal reached with California is unlikely to cause them to reconsider approving the transaction, although they are holding off on final decisions until the full details of the California agreement are received and reviewed.

"There most likely will be no effect in Oklahoma," said Karl Kramer, assistant general counsel for the Oklahoma Department of Insurance in Oklahoma City.

Regulators in West Virginia, Illinois and Georgia said they are reviewing the transaction and declined to comment on whether they will seek financial concessions. Georgia Insurance and Safety Fire Commissioner John Oxendine suspended his approval of the merger in July.

"We are reviewing these new developments and evaluating their impact on Georgia consumers," the commissioner said in a statement. "Our review will conclude as soon as practically possible."

Even if the other state regulators demand financial concessions, however, those negotiations are unlikely to derail the merger, analysts say.

"I think there will be additional concessions made, but they clearly got over the biggest hurdle," Mr. Marinucci said.

"I think the approval process with the remaining states will go smoothly," Mr. Ward said. "I would not expect that most of the other states would be that stubborn or difficult to deal with, but there may be some token concessions."

The Anthem/WellPoint merger highlights the consolidation trend in the managed care sector, analysts say.

While further consolidation is expected, analysts differ on how much of a factor the Anthem and WellPoint merger will be in influencing future M&A activity in the sector.

"The fundamentals of the business suggest further consolidation, but I don't see Anthem/WellPoint having a material impact on the pace of consolidation," Mr. Meyer said.

"My hunch is that it probably will lead to more activity because the combination will result in such a powerhouse that there needs to be a reaction in the industry," Mr. Ward said. "It's too big a deal to be ignored."

## Letters to the Editor

Continued from page 8

fect at all on placement decisions. Conversely, I have expressed my willingness to forgo such contingent commissions if the amount saved would be used by the carrier to hire a really effective underwriter to work with my firm.

So far, Mr. Spitzer has only made charges and has not yet provided any proof. Certainly, the business of soliciting sham bids is clearly wrong, and those responsible should be punished. I am just having trouble connecting the dots. At this time, I see no connection between the sham insurance bids and contingent commissions. I believe it would be a mistake to assume that such a connection exists before

it is demonstrated.

I don't think that what Mr. Winston calls "an ethically bankrupt system" has served the public so badly. Nor do I think there is a simple response to Mr. Spitzer's allegations. For one, I certainly do not look forward to negotiating fees with someone to handle my homeowner's insurance.

Is it being implied that an insurance buyer would be better off going only to direct writers where no such conflicts could exist? Then the employees charged with buying insurance by the client are put in the position of the broker and would be subject to being corrupted by the aggressive insurer. Don't risk managers have enough trouble?

The present system has never been touted as perfect. Experienced

risk managers know how to deal with its idiosyncrasies effectively. A totally successful Spitzer could flip them out of the frying pan and into the fire.

One final observation: Lawyers charge fees for their services, and the cost of their professional liability insurance is high. Insurance and real estate agents and brokers are paid by commission, and the cost of their insurance is somewhat less. Could this be an indication of the kind of box that is being pried open?

If we seek a perfect system, there is no guarantee that someone might not be able to imagine one that is even more perfect and pursue a remedy through the courts.

**Charles A. McAlear**  
New Orleans

## Phased: Pension payouts OK'd

Continued from page 4

ber of hours worked did not match the scheduled reduction.

Benefit experts say the proposed regulations will be a boost for phased retirement programs by removing a key impediment—the inability to receive a pension benefit—while working on a reduced schedule.

"The rules move us in a very good direction," said Ari Jacobs, a consultant with Hewitt Associates Inc. in Norwalk, Conn.

"I applaud the government for taking the initiative in this area," added Judy Mazo, a senior vp in the Washington office of The Segal Co.

That initiative began more than two years ago, when the IRS asked for public comment on issues related to phased retirement and defined benefit plans.

Specifically, the IRS wanted to know if there could be any situations in which distributions should be permitted from a defined benefit plan before an employee reaches normal retirement age and continues to work on a reduced schedule.

The IRS call for comments came as employers increasingly believe that they will need phased retirement programs to retain older, tal-

ented employees who want to cut back on their work schedules but don't want to be financially penalized for doing so.

Indeed, nearly 70% of employers responding to a Hewitt survey last year reported that phased retirement programs would be a very important part of their human resources strategy within the next five years.

For employers, phased retirement programs increase the likelihood that they can retain valuable employees who want something in between the extremes of full-time employment and complete retirement.

"Employers want to keep that knowledge base," said Jack Abraham, a principal in the human resources unit of PricewaterhouseCoopers L.L.P. in Chicago.

Correspondingly, phased retirement gives employees who are eligible for retirement the ability to work less and provides a smoother transition from full-time employment to retirement.

But the current ban on pension distributions to employees on reduced work schedules is a real impediment to employers who want to offer such programs, experts say.

"There are many employers who would be interested in implement-

ing these programs but have been unable to do so because of the restrictions associated with pension distributions before normal retirement," said Pam Scott, a principal with Towers Perrin in New York.

While welcoming the proposed rules, experts said they wish the rules would go further, mainly by lowering the current age requirement for eligibility. "That really limits the eligibility pool," said PwC's Mr. Abraham, acknowledging, though, that federal pension law may bar a lower eligibility age.

Others note that certain administrative requirements in the proposed rules—such as how employers would have to keep track of hours worked by those in phased retirement programs—are too complex.

"The administration of the programs is more stringent than what most employers could handle under their current practices," said Scott Macey, a senior vp with Aon Consulting in Somerset, N.J.

In all, employers will have to balance the opportunity to offer these programs with the administrative requirements that would be imposed, said Valerie Paganelli, a consultant in the Seattle office of Watson Wyatt Worldwide.

## Comp: Market adding insurers

Continued from page 6

While California's reforms could now attract more insurers, other factors could slow their entrance into the market, the speakers told a breakfast meeting of the Santa Monica Bay and Los Angeles chapters of the Young Presidents Organization, whose members are company executives.

Some insurers remain cautious about re-entering the state after having suffered losses in California, Mr. Mudge said. Additionally, past insolvencies exacerbated a shortage of experienced management teams whom investors could trust to successfully operate an insurance entity.

"When you look at who can put together a management team that

has credibility and experience, there are not many in California," Mr. Mudge said.

While some new insurers are emerging, many of California's insured employers are not likely to see substantial price decreases because of the influence of the State Compensation Insurance Fund on the market, California Insurance Commissioner John Garamendi told the breakfast meeting.

SCIF insures 55% of California's employers but is bureaucratic and plagued with problems, charged Mr. Garamendi, who is embroiled in a legal battle with the state insurer over its regulation.

New competition will help push SCIF to improve, but employers should take the case to Gov. Arnold

Schwarzenegger, who appoints its directors, Mr. Garamendi said.

Because California's reforms are not fully implemented, there are still several unknowns, including the potential for new litigation, the speakers agreed.

To protect themselves, risk managers should work closely with their brokers and attorneys to ensure that the policies they purchase meet their needs before problems arise, said Nicholas P. Roxborough, a policyholder attorney at Roxborough, Pomerance & Nye L.L.P. in Woodland Hills, Calif.

The discussion was moderated by Timothy J. Noonan, president and CEO of Lockton Insurance Brokers in Los Angeles, a unit of Kansas City, Mo.-based Lockton Cos. Inc.

# Spitzer probe prompts rethinking of SMART plan

By MEG FLETCHER

**WASHINGTON**—Federal scrutiny of insurance industry practices in the wake of allegations of bid rigging and fraudulent practices at Marsh Inc. may result in some fundamental regulatory reforms, some observers say.

The failure of regulatory systems to prevent the practices alleged in New York Attorney General Eliot Spitzer's lawsuit against Marsh may mean that current proposals to increase federal participation in insurance regulation are jettisoned in favor of more direct federal regulation of the industry, they say.

While other observers say the previously proposed changes can still work, several acknowledge that those proposals will need to be reformed in light of Mr. Spitzer's investigation.

**'There needs to be a realistic assessment of the efficient blend of regulation and consumer self-protection.'**

*Robert W. Klein  
Center for Risk Management  
and Insurance Research*

The U.S. Senate's Government Affairs Committee's Subcommittee on Financial Management, the Budget and International Security will hold an oversight hearing Tuesday on insurance brokerage practices, including potential conflicts of interest, as well as "the adequacy of the current regulatory framework."

The hearing is in response to the Oct. 14 lawsuit filed by Mr. Spitzer against New York-based Marsh and its parent company, Marsh & McLennan Cos. Inc. That suit alleges, among other things, that Marsh engaged in bid rigging and other fraudulent practices to maximize the contingent commissions it was paid by insurance companies.

While the focus of the hearing will be on broker commissions, speakers also are expected to consider the draft of the State Modernization and Regulatory Transparency Act, a subcommittee spokesman said. The SMART draft proposes the most comprehensive modernization of insurance regulation in nearly 60 years.

Rep. Richard Baker, R-La, chairman of the House Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, released the draft act for comment in August (*BI*, Aug. 30). The SMART proposal upholds the 1945 McCarran-Ferguson Act, which gave states the authority to regulate insurance, unless federal law spells out a pre-emption.

The draft, which was a joint effort with Rep. Mike Oxley, R-Ohio, proposes two major changes, though, that would allow federal authorities to pre-empt state rating laws for commercial and, eventually, personal lines coverages. It also would create a seven-member

group—the "state-national insurance coordination partnership"—that would have narrowly defined powers to resolve conflicts but no regulatory authority.

The SMART draft "is as dead as a doornail," according to statements by J. Robert Hunter, director of insurance for the Washington-based Consumer Federation of America. "The Spitzer investigation reveals that even the most sophisticated buyers of insurance can be duped by insurers and brokers in this often-uncompetitive market," said Mr. Hunter, who will testify at the hearing.

## Compensation Crisis

Instead of persisting with SMART, federal authorities should establish federal minimum standards for insurance industry practices and repeal the McCarran-Ferguson Act, he said.

Mr. Hunter also recommends that federal authorities reauthorize the Federal Trade Commission to at

least study the insurance industry.

"The Spitzer investigation seems to take a lot of wind out of the sails of the supporters of the SMART act," said Florida State Sen. Steven A. Geller, D-Broward County, who is also president of the National Conference of Insurance Legislators. NCOIL opposes that act and believes that state regulation is more responsive to consumers' needs.

Mr. Spitzer's allegations highlight the inadequacies of the SMART draft, according to the Washington-based American Insurance Assn.

According to an AIA spokeswom-

an, the "AIA believes that the current draft of the (SMART) proposal does not incorporate a strong regulatory enforcement mechanism."

AIA, as an organization, "was concerned about this long before the New York litigation situation" and would suggest that there be "a careful review of this provision."

"As it is currently drafted, the SMART Act leaves front-line enforcement at the state level. The bottom line is that once you establish federal standards, you must also establish a federal enforcement mechanism," the AIA spokeswoman

See **REGULATIONS**/next page

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# Marsh strong enough to withstand assault

By JUDY GREENWALD

**NEW YORK**—Marsh & McLennan Cos. Inc. is under siege, facing numerous lawsuits and the potential loss of customers, but industry analysts believe it can emerge intact.

MMC's strong cash flow and position as the world's largest insurance brokerage should permit it to survive and even flourish, say observers.

"I think, at the end of the day, Marsh is a great name, and it has a good chance of pulling through this with the same basic businesses that they went into this with," said John Ward, chairman of the Cincinnati-based Ward Group. "It will take discipline to pull this off, but I think it's doable."

"Marsh will remain a profitable and viable entity" in its current form, particularly since New York Attorney General Eliot Spitzer has made it clear he does not plan to bring criminal charges against the company, said Steve Ader, associate director at Standard & Poor's Corp. in New York.

A settlement with Mr. Spitzer, though, which is expected in the coming months, could cost hun-

dreds of millions of dollars, and it is unclear how many other states may seek compensation as well (see story, page 39).

In addition to Mr. Spitzer's suit alleging bid rigging and fraudulent use of contingent commission arrangements, the company has been inundated with shareholder and client-related lawsuits, and suits alleging violation of the Employee Retirement Income Security Act (ERISA, Nov. 1, Nov. 8). MMC's available limits under its D&O liability program would cover only a portion of the damages shareholders are seeking (BI, Nov. 1).

MMC announced last month it would stop taking from insurers contingent commissions that it called market services agreements, which produced \$845 million in revenue for Marsh last year, though it said it would seek to collect about \$230 million in outstanding contingent commissions it says it is still owed by insurers.

In the first nine months of 2004, Marsh's net income slid 28.6%, to \$856 million, mainly because of the \$232 million charge against third-quarter earn-

## Compensation Crisis

ings to fund a reserve for a potential settlement of Mr. Spitzer's suit.

MMC has had problems with creditors as well. In a Securities and Exchange Commission filing last month, the company said it is renegotiating terms of \$2.8 billion of backup bank financing. The filing said the Spitzer suit may prohibit MMC from borrowing under the facilities. The lenders have agreed to waive the issue until Dec. 30, under certain conditions, including that MMC not repurchase any of its stock. MMC said it expects to achieve its goal to amend or replace the facilities by the cutoff date.

MMC also will lay off about 3,000 employees to cut \$400 million in annual costs (see story, page 1).

Observers cite MMC's strong cash flow as a factor in its favor. Last year, it generated \$1.9 billion

of cash flow from operations, spent \$1.2 billion in stock repurchases and paid \$631 million in dividends. This year, for the nine months ended Sept. 30, cash flow totaled \$1.4 billion, it repurchased \$510 million in shares and paid \$502 million in dividends. It had \$577 million in cash and cash equivalents as of Sept. 30.

MMC "could easily absorb a several hundred million dollar settlement," said Mr. Ward. While its cash flow has been adversely affected, the company is "still a good franchise, and with the announced layoffs, they hope to save a lot and generate earnings" to help absorb the cost of the settlement and the loss of contingent commissions, he said.

"It also appears, by dodging the criminal charge, their creditors have been perhaps more willing to restructure debt and work with them," Mr. Ward said.

Wayne Bopp, an analyst with Fifth Third Investment Advisors in Cincinnati, said cutting dividends is one option. "That's not anyone's first choice, but clearly that's a potential source of funds," he said. Funds could also come from

the money MMC has spent to buy back shares, he said. "The big question is the falloff in earnings, and they're fighting that by firing people to lower their expenses," he said.

Even without contingent commissions, "they will make a good amount of money," said Mr. Ader. "They're the largest insurance brokerage in the world, they have the No. 1 competitive position in the world." While that may diminish as result of the adverse publicity, "they will still have a world-leading position," he said.

Observers also noted the strength of MMC's other businesses. Putnam Investments Inc. is a strong earnings generator and has not been directly affected by the Spitzer charges, although it has had its own issues, said Mr. Ader. And Mercer Inc. has profitability in the "upper tier," he said. "These are three well-positioned subsidiaries that provide some degree of diversification," he said.

Timothy J. Cunningham, a partner in the Chicago-based insurance brokerage consulting firm OPTIS Partners Inc., pointed to MMC's stock, which closed at \$27.68 on Friday—down from a 52-week high of \$49.69 but up from a low of \$22.75—as evidence of Wall Street's faith in the company. "I think if Wall Street had a real sense they would likely not survive, that you'd probably see much more of a fall in the stock price," he said.

Peter Patrino, senior director at Fitch Ratings in Chicago, said despite the prospect of fines and restitution costs, Fitch continues to give Marsh an investment-grade rating of BBB. "We don't believe its long-term credit viability is at meaningful risk."

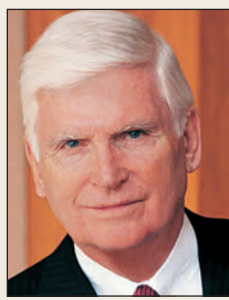
## Scandal will spur changes worldwide, Aon chief says

**LONDON**—The "tremendous black mark" on the insurance industry stemming from the charges leveled by New York Attorney General Eliot Spitzer surrounding contingent commission agreements will force transparency in the industry's business practices worldwide, according to the top executive of Chicago-based Aon Corp.

"There is no doubt in my mind this is not a U.S.-restricted analysis. It will involve markets all around the world," Patrick G. Ryan, Aon's chairman and chief executive officer, told attendees of

an Assn. of Lloyd's Members meeting in London last week.

Responding to a question on why disclosure of the compensation arrangements has taken so long, he said there has, in fact, been disclosure of such commissions. Mr. Ryan said Aon



Mr. Ryan

agreed to disclose the amount of compensation, if asked, but could not give the specific amount because its contingent commissions are not client-specific.

"The appearance of conflict is not necessarily bad, but now it is unacceptable where it has been acceptable" in the past. Last month, Aon said it would stop taking commissions based on volume and profit (BI, Oct. 25).

Asked whether the market will move to a fee-based structure, Mr. Ryan replied that fees are already used in many large risks globally. "Profit commissions for a broker

are a thing of the past," he said. "We have to adjust to what people want."

Dan Glaser, managing director of American International Group Inc.'s London-based AIG Europe (UK) Ltd. unit, who also spoke at the ALM meeting, said AIG will disclose the commissions it pays and request that its brokers communicate them to clients. There is nothing illegal about paying a level of commission on a growth or profit basis, but it heightens the need for transparency and disclosure, he said.

—By Peta Miller

## Regulations: Reform path may change

Continued from previous page

an said. National Assn. of Insurance Commissioners President Diane Koken, the Pennsylvania insurance commissioner, said she was uncertain about the inquiry's impact on federal modernization proposals. While the problems alleged by Mr. Spitzer need to be addressed, that should not be interpreted as a criticism of state regulation, she said. In fact, state regulators—who are closer to consumers than federal regulators would be—are able to respond quickly and in a coordinated way, said Ms. Koken.

Rather than encourage federal oversight, New York Insurance Superintendent Gregory V. Serio recently suggested that the property/casualty insurance industry should follow the lead of the life insurance industry and establish a

voluntary compliance mechanism like The Insurance Marketplace Standards Assn. to encourage ethical conduct. He also will testify at the hearing.

Mr. Spitzer's investigations highlight a need to reassess the regulatory environment for the insurance industry, said Robert W. Klein, associate professor and director of the Center for Risk Management and Insurance Research at Georgia State University in Atlanta.

"There needs to be a realistic assessment of the efficient blend of regulation and consumer self-protection," Mr. Klein said. "It would be easier for a federal regulator to do," but it is not beyond states' capabilities if they used some form of coordinated mechanism with adequate resources, the former NAIC staffer said.

Congress should respond to the

commissions scandal by increasing federal involvement in insurance regulation, but it should be based on a partnership with state regulators, said Kevin P. Hennosy, president of Spread the Risk Inc., a Kansas City, Mo.-based consumer advocacy organization.

Specifically, Congress should establish regulatory standards and states should have to meet those standards in order to keep their "borrowed" authority to regulate and tax insurance operations, he said. If state regulators fail in their role, insurance operations would then be subject to federal antitrust law and FTC oversight, he said.

While the scandal does raise concerns about regulatory issues, Congress should not abandon modernization efforts, said George B. Flanigan, a professor who teaches insurance-related courses at the

Katie School of Insurance and Financial Services at Illinois State University in Normal.

"I don't think the scandal should impact the open-rating concept, which I, as an economist, support," he said. That regulatory concept has worked well in Illinois and could nationally, if Congress adopts that principle, he said. That concept underlies some of the deregulation efforts in the SMART proposal.

Lawmakers should press ahead with the reforms outlined in the SMART proposal and not be distracted by Mr. Spitzer's allegations, according to the National Assn. of Mutual Insurance Cos. in Indianapolis.

NAMIC has written to both the NAIC and NCOIL, urging them to "remain steadfast in their commitment to the goal of regulatory modernization."

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## Late News

Continued from page 1

contracts, a thorough discussion ensued and "with an abundance of caution," Platinum decided to commute the agreement, "thus eliminating at the source any cause for concern," said Mr. Morrison.

### AXIS realigns operating units

Axis Capital Holdings Ltd. has realigned its operations to create two operating units: AXIS Insurance and AXIS Re. The two units replace the previous five operating units that were based on geographic areas and types of business. For the 12 months that ended Sept. 30, 2004, AXIS Capital's business split was 63% insurance and 37% reinsurance. Dennis Reding has been named chairman of AXIS Insurance. Mr. Reding currently heads the company's U.S. insurance unit. John Charman, president and chief executive officer of AXIS Capital, will assume the additional role of chairman of AXIS Re.

### Ontario insurers, brokers to increase disclosure

Ontario insurance professionals have finalized the details of a voluntary system for disclosing broker compensation arrangements. Under the system, insurance companies will provide full disclosure about how their agents, brokers and other sales staff are compensated by Jan. 1, 2005. Insurers will provide information on whether these intermediaries are paid a salary

and/or a contingent commission and whether the insurer has any ownership or financial links to brokerages.

### First criminal sentence under HIPAA issued

A medical technician at the Seattle Cancer Care Alliance has been sentenced to 16 months in prison, making him the first person to be criminally prosecuted for violating the privacy provisions of the Health Insurance Portability & Accountability Act. Richard W. Gibson will also be required to pay \$15,000 in restitution to a cancer patient whose name, birth date and Social Security number were used to obtain credit cards that Mr. Gibson used to make more than \$9,000 in purchases.

### FSA indicates approval of Aon, Marsh, Willis

The United Kingdom's Financial Services Authority has provisionally approved Aon Ltd., Marsh Ltd. and Willis Group Holdings Ltd. to operate as authorized insurance brokers in the United Kingdom. The FSA, which assumes the regulation of U.K. insurance brokers starting in January, said it had sent "minded-to-authorize" letters to the three brokers "in the light of market and media interest, and at a time when many commercial organizations are considering renewing policies."

### Drop in Merck stock spurs ERISA liability suit

Participants and beneficiaries of Merck & Co. Inc. retirement plans have sued the company, alleging



PHOTO: NY TIMES

violations of the Employee Retirement Income Security Act, after the company's stock dropped on concerns about its drug Vioxx. In their suit, participants and beneficiaries of Merck's Savings and Security Plan—a 401(k) plan—and its Employee Stock Purchase and Security Plan allege that the company and its plan fiduciaries failed to properly manage the plans' assets by investing a sizable portion in company stock; by failing to provide complete and accurate information to participants and beneficiaries; and by failing to avoid conflicts of interest with respect to the plans. Merck pulled Vioxx from the market on Sept. 30, when it was revealed that the drug significantly increased the risk of heart attack and stroke in patients taking it for longer than 18 months. Since then, the company's share price has dropped nearly 41%, closing Nov. 10 at \$26.41.

### ExxonMobil punitives mediation breaks down

Efforts to mediate a dispute involving a \$3.6 billion damages award—\$3.5 billion of which consists of punitive damages—levied on ExxonMobil Corp. by an Alabama court broke down last week. The

award stemmed from allegations that ExxonMobil deliberately underpaid the state royalties from offshore natural gas operations. In late 2003, an Alabama jury hit the oil company with a \$11.9 billion judgment that was later scaled down by a state judge. Earlier this year, the state supreme court ordered the parties to mediate their differences, but those efforts failed and last week the court said ExxonMobil could pursue an appeal.

### Briefly noted

Financially troubled **Delta Air Lines Inc.** will freeze its defined benefit pension plan covering its pilots and set up a less costly defined contribution plan under an agreement ratified by the Atlanta-based airline's pilots....Insurance revenue reported by **bank holding companies** to the Federal Reserve grew to \$20.9 billion during the first six months of this year—up from the \$15.9 billion reported during the same period in 2003, according to the Washington-based American Bankers Insurance Assn. The number of bank holding companies reporting insurance revenue during the first half of this year increased to 1,331 from 1,257 a year earlier, the ABIA reported.

### Check out BusinessInsurance.com

Items in the Late News column originally appeared in *BI's Daily News* feature on [www.businessinsurance.com](http://www.businessinsurance.com). Visit the *BI* Web site to sign up to receive *BI's Daily News* by e-mail.

## Online Poll

[ 11/8-11/12 ]

Do you think the election results will make enactment of federal tort reforms more likely?



**Yes 58.8%**  
**No 33.6%**  
**Do not know 7.6%**

## BI Stock Index

[ 11/8 - 11/12 ]

Up-to-the-minute data for all 87 companies that comprise the *BI* Stock Index can be found at [www.businessinsurance.com](http://www.businessinsurance.com).

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

<b>BI Stock Index</b>	
2240.29	1.46
<b>Dow Jones</b>	
10539.00	1.46
<b>S&amp;P 500</b>	
1184.17	1.54

### Largest gains

SCOR	17.18%
Wellpoint Health Networks	12.40%
EMC Insurance Group Inc.	10.90%
NYMagic Inc.	10.84%
AEGON N.V.	6.46%

### Largest losses

ESG Re Ltd.	-25.00%
Vesta Insurance Co.	-12.25%
UNUM Corp.	-9.79%
Hub International	-3.13%
MetLife Inc.	-2.46%

### Weekly change by market segment

Brokers	0.58%
Insurers/Reinsurers	2.80%
Managed Care Organizations	4.48%

Source: FinancialContent Inc. (<http://financialcontent.com>)

# Marsh deal likely to be quick and costly

## Broker expected to seek broad settlement to resolve Spitzer charges

By JUDY GREENWALD

A settlement between New York Attorney General Eliot Spitzer and Marsh & McLennan Cos. Inc. should come relatively quickly, though the ultimate cost and time frame could depend on how many states get involved in the negotiations.

Any deal to settle Mr. Spitzer's fraud and antitrust lawsuit is likely to have at least three components, based on settlements his office has reached in the past: fines, restitution and a commitment to change business practices in the future, say observers.

And while the eventual cost is difficult to predict, Marsh's \$232 million charge against third-quarter earnings to fund a reserve for a potential settlement is likely a conservative estimate.

A settlement is highly desired by both sides.

"Eliot Spitzer is an extremely clever and aggressive attorney general, and knowing that he has both civil and criminal jurisdictions, he has been very adept at wrangling settlements in whole industry sectors by bringing investigations which could go either civil or crimi-

nal," said Edward J.M. Little, an attorney with Hughes Hubbard & Reed in New York who has negotiated with Mr. Spitzer's office on clients' behalf in the past. Mr. Spitzer has noted that, following Marsh Chief Executive Officer Jeffrey W. Greenberg's resignation, he would limit his criminal investigation to individuals and pursue a civil settlement with the company.

"I'd anticipate (a settlement) within the next two weeks," said Mr. Little.

Wayne Bopp, an analyst with Fifth Third Investment Advisors in Cincinnati, said that Mr. Spitzer "wants to come out and have a press conference and say, 'Look, they've made management changes, they've changed their behavior, they've changed their business model.'"

"Spitzer doesn't want to wait two years to do that. He wants to do that in the next three or four months or so," Mr. Bopp said.

The issue of what parties are involved in a final settlement, though, could cause a delay. California and Connecticut are among states that have launched their own insurance industry investigations, and others are expected to

## Compensation Crisis

follow suit.

Michael Missal, an attorney with Kirkpatrick & Lockhart in Washington, said one factor that could delay settlement is "Marsh's due diligence as to whether or not there are going to be collateral consequences, given that you have 50 different insurance commissioners as well as a significant number of clients. I'm sure they want to gauge what kind of impact a settlement would have on those constituencies," he said.

Mr. Missal noted that if Marsh settles with Mr. Spitzer and California were to say, "You've got to do the same thing for me, it's not much of a settlement. I'm assuming they want to get finality here as much as possible, and so they likely will make sure this is as close to a global settlement as possible."

Edward Fleischman, an attorney with New York-based Linklaters who is a former U.S. Securities and Exchange Commission commis-

sioner, said, "In this instance, I guess everybody wants to get their piece of the pie."

"I guess now the secretary of state of North Dakota figures there's got to be something in it for him, too," Mr. Fleischman said.

Observers say the \$232 million Marsh has already set aside is a conservative estimate. The psychology on reserves is that "you want to set aside some money so that you can tell investors you know there's a problem and you're starting to account for it," said Mr. Bopp. But if a company puts aside a billion, for instance, "Spitzer would feel funny fining them less than a billion," he said.

Furthermore, "whatever Spitzer's number is, you can easily double that to accommodate the class action suits that will follow," Mr. Bopp said.

"It's very hard to predict what the amount is going to be," said Mr. Missal. "My sense is that Marsh is very anxious to put it behind them, and so that likely will drive the number up," he said. "If you look at some of the other settlements his office has received, I think it's probably reasonable to conclude it's going to be hundreds of millions of dollars."

## Suit: Spitzer opens new front

Continued from page 1  
ment further.

ULR has recently been the target of other lawsuits leveling similar allegations. Lawyers representing an Intel Corp. employee filed a proposed class action suit against the broker in a San Diego federal court last month, charging that ULR took secret payments to steer business to certain insurers. United Policyholders, a California consumer group, earlier sued ULR in a California state court for allegedly failing to disclose contingent commission agreements.

Mr. Cox, ULR's president and chief executive officer, has denied these charges and said last month that ULR "maintains proper relationships with its clients and their insurance carriers."

Privately held ULR, with 80 employees, specializes in placing group life, disability and other coverages for Fortune 1,000 companies.

In 2003, ULR generated \$565.6 million in premiums for MetLife, \$214.3 million for Prudential and

\$101.6 million for Unum, the suit says.

While it claimed undivided loyalty to its clients—and included a provision in client contracts stating that it "shall accept no compensation of any kind whatsoever from any insurance company"—ULR generated almost half of its revenue from undisclosed override commissions based on volume, renewal rates and profitability, the complaint charges. The broker also reaped excessive and undisclosed "communications fees" for informational material distributed to employees, the cost of which insurers charged back to insurance plan participants, the suit alleges.

Of ULR's \$25.3 million in 2003 revenues, \$11.5 million came from overrides and \$5.6 million from communications fees, the suit says.

The broker consistently steered business to Unum, Prudential and MetLife to gain override commissions and shut out insurers that would not join "the club," the suit

says. Minnesota Life Insurance Co., for example, refused to make override payments unless ULR disclosed them to clients, and the broker refused to do business with the insurer afterwards, the suit says. Aetna Inc.

**Mr. Spitzer's lawsuit levels fraud, antitrust and other charges and seeks disgorgement of all of Universal Life Resources' profits arising from the alleged illegal activity.**

ended an override agreement with ULR in 2001 and has had "virtually no success" winning new business from the broker since then, according to the complaint.

Mr. Spitzer's suit cites several clients that ULR has allegedly defrauded, including:

- Washington-based hotel opera-

tor Marriott, which bought disability coverage from Unum through ULR in 2003. According to the complaint, ULR rigged the list of three "finalists" competing for the Marriott account by pushing out a low-bidding insurer that had no override agreement with the broker.

- New York-based media giant Viacom, which earlier this year bought group life and accident coverage from Prudential through ULR. According to the complaint, ULR convinced Prudential to state that its benefit communications fee was the same as ULR's—\$10 per employee—when Prudential actually charges only \$3.45 per employee. Viacom hired ULR for the communications job.

- Round Rock, Texas-based computer maker Dell, which hired ULR in 2001 to place employee life insurance coverage. While ULR wanted to place the business with Unum, the insurer said it could submit the lowest bid only if it did not pay the broker a \$120,000 fee called for in a request for proposals. ULR knew that override commissions would make up for the lost fee but also feared that Unum's failure to report

the fee in a U.S. Department of Labor filing on the Dell plan would start "red flags flying" at Dell, the suit says. ULR convinced Unum to make a false filing reporting the \$120,000 payment even though no such payment was made, the suit charges.

Mr. Spitzer's suit levels fraud, antitrust and other charges and seeks disgorgement of all ULR profits arising from the alleged illegal activity.

Industry analysts said the ULR suit is likely to have less impact on the life/health insurance industry than the Marsh suit is having on the property/casualty industry, in part because no benefits broker is as dominant as Marsh is in the property/casualty business.

"Nobody has quite the same significance on the life side," said Rodney Clark, director of financial services for Standard & Poor's Corp. in New York. "Nobody has quite the same pull as Marsh had to be aggressive in terms of these contingent arrangements."

"The allegations are serious, (but) the dollars are relatively minor," said John Ward, chairman of the Cincinnati-based Ward Group.

## Changes: Reshaping relationships

Continued from page 1

and customers," said Stephan Christiansen, senior vp and director of research for Conning Research & Consulting in Hartford, Conn.

The loss of huge contingent commission revenues, meanwhile, contributed to Marsh & McLennan Cos. Inc.'s move last week to lay off 3,000 employees. MMC said the layoffs and other cutbacks would save it about \$400 million a year, or almost half of the \$845 million in contingent commissions it collected last year.

While MMC officials say the layoffs—confined mainly to support staff in its Marsh Inc. brokerage unit—will not affect client service, risk managers are taking a wait-and-see attitude toward the cuts.

Since New York Attorney General Eliot Spitzer sued Marsh last month, the brokerage giant and several of its largest competitors have said they will stop collecting contingent commissions from insurers and will make their compensation more "transparent" to clients.

In Marsh's case, for example, this will mean giving clients full disclosure of retail and wholesale commissions, premium finance compensation and other fees charged on their accounts, the brokerage has promised.

In the past, some of these costs have not always been visible to clients. While buyers might have known of the retail commissions they pay and the overall cost of a placement, they were not always aware of the wholesale commissions, facultative reinsurance commissions and the other amounts their brokers collected, brokerage officials and market observers say. Buyers were seldom aware of the contingent or volume-based override commissions related to their business.

"One of the good things that's going to come out of this is transparency," said John Wicher, speaking of the compensation inquiry that has now widened to include probes by numerous state attorneys general and insurance departments. Mr. Wicher is principal of San Francisco-based merger and acquisition specialist John Wicher & Associates.

Risk managers will now demand a clear accounting of costs on their programs, from retail placement to retrocessions, he said. One result of this may be "disaggregation," with more risk managers weighing the benefits of

keeping certain parts of their placements with their primary broker, he suggested. For an excess and surplus lines risk, for example, a risk manager may be more inclined to use an independent wholesaler with specialist skills than simply channel the business through the retail broker's wholesale subsidiary, Mr. Wicher explained. "That's healthy," he said.

The extent to which buyers do this will depend on their size and specific needs and the sophistication of their risk managers, said Timothy J. Cunningham, principal of OPTIS Partners L.L.C., a Chicago-based insurance brokerage industry consultant.

"How much heartburn does that create for the buyer?" Mr. Cunningham asked about large brokers channeling business to their own wholesale units. "I don't know. For large, sophisticated risk managers, maybe none."

### Providing underwriting data

The possible elimination of contingent commissions—especially those based on the profitability of the business brokers produce—may change longstanding relationships among buyers, brokers and underwriters, Conning's Mr. Christiansen suggested.

While Marsh says it had replaced most profit-based commission deals in recent years with purely volume-related agreements, other brokers have maintained agreements based on profitability.

Under profit-based agreements, brokers have a stake in providing insurers with the most detailed underwriting information available to allow risks to be "properly priced," Mr. Christiansen observed, noting that buyers in these cases may not be getting the lowest possible price. Without that inducement, brokers may be less inclined to provide such extensive data.

"Brokers will have less incentive to make sure insurers are being sufficiently informed," he said.

Insurers, meanwhile, "will not be able to as easily rely on the information provided by brokers" and may develop closer relationships with policyholders to get the data they need, Mr. Christiansen said.

Insurers may also be able to wrap risk management, loss control and other services into the price of their coverage, further cementing

client relationships and giving them a potential advantage over brokers who will have to disclose the cost of such services separately, he added.

Without contingent commissions, brokers may consider themselves underpaid for the current level of services they're providing, and they may either have to raise fees or operate more efficiently, cutting staff and even paring services to maintain profits, Mr. Christiansen said. Risk managers and insurers, meanwhile, may beef up operations to assume some of the load.

Marsh became the first to cut staff last week when it announced its plans to lay off about 5% of its global workforce. The announcement followed the ousting of its chief executive officer and three top-level executives amid Mr. Spitzer's accusations of client steering and fraud.

Newly installed Chairman and Chief Executive Officer Michael G. Cherkasky announced the layoffs while reporting on Marsh's third-quarter earnings, which featured a 94% slump in net income, to \$21 million, from \$357 million in last year's third quarter.

Last week Marsh also announced the resignations of Roger E. Egan, Marsh's president and chief operating officer; Christopher M. Treanor, chairman and CEO of Marsh's Global Placement division; and William Rosoff, MMC senior vp and general counsel.

### Meeting customers' needs

While Mr. Cherkasky said Marsh would continue to provide "excellent client service," news of the hefty layoffs has some of the broker's customers bracing themselves for possible changes in service.

"It's something I'm watching very carefully," said John Phelps, director of risk management for Jacksonville, Fla.-based Blue Cross & Blue Shield of Florida, a Marsh client. While Mr. Phelps said he can now contact a Marsh expert "within minutes" with questions, he expressed concern that such services may carry a fee in the future. "My crystal ball says it's going to be some sort of hybrid," he said.

"Marsh will meet the needs of the customer," Mr. Phelps predicted. "It's just a matter of how."



PHOTO: DOUG GOODMAN

**New York-based Marsh & McLennan says the layoff of 3,000 employees will not affect client services, but risk managers are taking a wait-and-see attitude.**

"We've always been happy with their service, particularly in the Minneapolis office," said David Hennis, director of risk management at Minneapolis-based The Toro Co., which has been a Marsh client for nearly 25 years.

"But it certainly is a concern," Mr. Hennis said in reference to the potential impact of the cutbacks on service. "We'll be making a comparison between now and the 'pre-scandal era,'" he said. "It's all going to depend on where the positions are eliminated."

Ted Jeske, claims and risk manager for Historic Tours of America Inc. of Key West, Fla., a former client of Marsh Inc., anticipates that the large layoff at Marsh "will actually help client service."

Mr. Jeske became a Marsh customer in 1988, when Historic Tours' then-broker, London-based Sedgwick Group P.L.C., was bought out by MMC. He didn't stay with Marsh through more than one renewal season, though, citing a constant shuffling of his account through the brokerage's staff.

"I like to have a consistent account, but every other week somebody new was on it," he complained. "With these giant conglomerates, pretty soon the service starts going down." Mr. Jeske said.